

Petrocapita Income Trust
Condensed Interim Consolidated Financial Statements
For the three and six months ended
June 30, 2017 and 2016
(in Canadian dollars)
(unaudited)

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements; they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying unaudited condensed interim consolidated financial statements of the Trust have been prepared by management and the Audit Committee and Board of Directors have approved them for issuance to the Trustee. The Trust's independent auditors have not performed a review of these unaudited condensed interim consolidated financial statements in accordance with the standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

Petrocapita Income Trust
Condensed Interim Consolidated Balance Sheets
(in Canadian dollars)
(unaudited)

	Note	June 30 2017	December 31 2016
Assets			
Current assets			
Cash		\$ 2,001,279	\$ 2,532,582
Accounts receivable	20(b)	1,361,503	1,907,822
Crude oil inventory	5	681,809	836,831
Prepaid expenses and deposits		661,607	546,845
Total current assets		4,706,198	5,824,080
Non-current assets			
Property and equipment	6	53,087,120	50,430,656
Exploration and evaluation assets	7	2,799,997	2,789,952
Total assets		\$ 60,593,315	\$ 59,044,688
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	20(c)	\$ 7,295,394	\$ 6,188,075
Bank debt	8	175,000	95,000
Loans payable	9	211,442	211,442
Current portion of obligation under finance leases	10	86,616	79,214
Current portion of convertible debentures	12	965,284	160,204
Total current liabilities		8,733,736	6,733,935
Non-current liabilities			
Decommissioning provisions	13	24,760,679	23,129,666
Obligation under finance leases	10	113,055	158,296
Debenture	11	4,615,707	4,565,987
Convertible debentures	12	6,561,130	5,510,911
Conversion feature of convertible debentures	12	4,020,060	2,679,931
Preferred units	14(b)	1,581,613	-
Deferred tax liability		116,000	116,000
Total liabilities		50,501,980	42,894,726
Unitholders' Equity			
Common units	14(a)	37,368,608	37,368,608
Equity component of preferred units	14(b)	217,000	-
Warrants	15	324,436	309,461
Deficit		(27,818,709)	(21,528,107)
Total unitholders' equity		10,091,335	16,149,962
Total liabilities and unitholders' equity		\$ 60,593,315	\$ 59,044,688

Going concern (note 1)
 Commitments (notes 11, 21)
 Subsequent events (note 23)

See accompanying notes to the condensed interim consolidated financial statements.

Approved by the Trustees:

(signed) "Alex Lemmens" Trustee

(signed) "Richard Mellis" Trustee

Petrocapita Income Trust

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

(in Canadian dollars)

(unaudited)

	Note	Three months ended		Six months ended	
		June 30	June 30	June 30	June 30
		2017	2016	2017	2016
Revenue					
Revenue	17	\$ 2,054,013	\$ 684,771	\$ 5,135,444	\$ 1,058,666
Royalties expense		(241,218)	(51,075)	(583,055)	(71,099)
Revenue, net of royalties		1,812,795	633,696	4,552,389	987,567
Expenses					
Operating	17	1,833,374	610,311	5,305,419	1,184,732
General and administrative	22(b)	839,113	352,774	2,227,499	771,499
Depletion and depreciation	6	604,243	194,314	1,469,550	423,898
Total expenses		3,276,730	1,157,399	9,002,468	2,380,129
Operating loss		(1,463,935)	(523,703)	(4,450,079)	(1,392,562)
Finance expenses	18	(772,606)	(221,248)	(1,458,266)	(320,565)
Loss on asset acquisition		-	(354,733)	-	(354,733)
Unrealized loss on conversion feature of convertible debentures	12	(222,467)	(73,103)	(324,606)	(45,511)
Loss and comprehensive loss		(2,459,008)	(1,172,787)	(6,232,951)	(2,113,371)
Current tax		(22,248)	-	(57,651)	-
Loss and comprehensive loss		\$ (2,481,256)	\$ (1,172,787)	\$ (6,290,602)	\$ (2,113,371)
Loss per common unit, basic and diluted	16	\$ (0.002)	\$ (0.002)	\$ (0.006)	\$ (0.002)

See accompanying notes to the condensed interim consolidated financial statements.

Petrocapita Income Trust

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity (Deficiency)

(in Canadian dollars)

(unaudited)

	Note	Common Units	Equity Component Series 1 Preferred Units	Warrants	Deficit	Total Unitholders' Equity (Deficiency)
Balance at December 31, 2015		\$ 37,368,608	\$ -	\$ 4,929	\$ (16,523,518)	\$ 20,850,019
Issuance of warrants	12,15	-	-	60,800	-	60,800
Loss and comprehensive loss for the period		-	-	-	(2,113,371)	(2,113,371)
Balance at June 30, 2016		\$ 37,368,608	\$ -	\$ 65,729	\$ (18,636,889)	\$ 18,797,448
Balance at December 31, 2016		\$ 37,368,608	\$ -	\$ 309,461	\$ (21,528,107)	\$ 16,149,962
Issuance of warrants	12,15	-	-	14,975	-	14,975
Issuance of preferred units	14(b)	-	217,000	-	-	217,000
Loss and comprehensive loss for the period		-	-	-	(6,290,602)	(6,290,602)
Balance at June 30, 2017		\$ 37,368,608	\$ 217,000	\$ 324,436	\$ (27,818,709)	\$ 10,091,335

See accompanying notes to the condensed interim consolidated financial statements.

Petrocapita Income Trust

Condensed Interim Consolidated Statements of Cash Flows

(in Canadian dollars)

(unaudited)

	Note	Six Months Ended	
		June 30 2017	June 30 2016
Cash provided by (used in):			
Cash flows provided by (used in) operating activities			
Loss for the period		\$ (6,290,602)	\$ (2,113,371)
Adjustments for:			
Depletion and depreciation	6	1,469,550	423,898
Accretion of decommissioning provision	13	310,045	78,711
Accretion of convertible debenture	12,18	205,228	24,730
Convertible debentures issued under DRIP		33,736	-
Preferred units issued under DRIP		15,180	-
Amortization of financing costs	18	175,496	107,141
Loss on asset acquisition			354,733
Unrealized loss on conversion feature of convertible debentures	12	324,606	45,511
Changes in non-cash working capital	19(b)	1,193,119	(343,421)
Net cash used in operating activities		(2,563,642)	(1,422,068)
Cash flows provided by (used in) investing activities			
Additions to property and equipment	6	(1,008,221)	(278,444)
Additions to exploration and evaluation assets	7	(10,045)	(3,740)
Cash acquired (paid) on acquisitions	4(b)	(21,825)	2,001
Changes in non-cash working capital	19(b)	259,914	(201,203)
Net cash used in investing activities		(780,177)	(481,386)
Cash flows provided by (used in) financing activities			
Proceeds from issue of convertible debentures	12(a)	1,023,000	1,753,000
Costs related to issue of convertible debentures	12(a)	(88,100)	(196,564)
Repayment of principal on convertible debentures	12(b)	(188,847)	(3,014)
Proceeds from issue of debentures		-	5,000,000
Costs related to issuance of debentures		-	(501,587)
Proceeds from issue of preferred units	14(b)	2,170,000	-
Preferred units issue costs	14(b)	(386,567)	-
Proceeds from (repayment of) bank debt	8	80,000	(15,000)
Repayment of finance leases	10	(37,839)	-
Changes in non-cash working capital	19(b)	240,868	170,301
Net cash provided by financing activities		2,812,515	6,207,136
Change in cash		(531,303)	4,303,682
Cash, beginning of period		2,532,582	763,065
Cash, end of period		\$ 2,001,279	\$ 5,066,747

See accompanying notes to the condensed interim consolidated financial statements.

Petrocapita Income Trust
Notes to the Condensed Interim Consolidated Financial Statements (*unaudited*)
For the three and six months ended June 30, 2017 and 2016
(in Canadian dollars)

1. General business description and going concern

Petrocapita Income Trust (the "Trust") was formed pursuant to a Declaration of Trust dated January 22, 2010. The Declaration of Trust was amended and restated on October 1, 2010, October 26, 2015 and October 18, 2016. The beneficiaries of the unincorporated Trust are the unitholders.

Following the internal reorganization described in note 2(c), the Trust has the objective of investing directly in the Petrocapita Energy Corp., who, through its ownership in Petrocapita Processing L.P. and Petrocapita Oil & Gas L.P., will carry on the business of investing in, conducting, engaging in, or otherwise being involved in one or more of the acquisition, exploration, exploitation, development, optimization, enhancement, production and processing of oil and natural gas and related products, and such other business activities as are in any way related, ancillary or incidental thereto.

The Trust became a public entity on November 19, 2015 and accordingly, the Trust became a "specified investment flow-through" (SIFT) trust for purposes of the *Income Tax Act (Canada)*. As a result, under the SIFT rules, certain distributions from a SIFT are not deductible in computing taxable income and the Trust is subject to tax on such distributions at a rate that is substantially equivalent to the general income tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital are not subject to the SIFT tax. Based on the current organization of the Trust and its subsidiaries, the Trust expects that its income distributed to unitholders will not be subject to SIFT tax.

The address and principal place of business of the Trust is Suite 1400, 717 – 7th Avenue SW, Calgary, Alberta, T2P 0Z3. The Trust's units are listed on the Canadian Securities Exchange ("CSE") and trade under the symbol "CSE.PCE.UN".

These condensed interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of obligations in the normal course of business. Continuing weak commodity prices experienced over the past two years and reactivation costs expensed have negatively impacted operating income and cash flow for the first two quarters and prior year. Net loss for the six months ended June 30, 2017 was \$6,290,602 (year ended December 31, 2016 - \$5,004,589). Cash flows from operating activities prior to changes in non-cash working capital for the six months was negative \$2,563,642 (year ended December 31, 2016 – negative \$4,015,380). As at June 30, 2017, the Trust had a working capital deficiency (note 20(f)) of \$4,027,538 (December 31, 2016 - \$909,855).

The above-noted factors describe matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt as to the Trust's ability to continue as a going concern.

The Trust will require additional funding to reduce its exposure to liquidity risk. The Trust has been actively seeking private equity, facility financings and reviewing potential mergers and acquisitions to strengthen cash flows from operating activities. The Trust cannot provide any assurance that sufficient cash flows will be generated from operating activities or proceeds from other activities noted above will be able to reduce its working capital deficiency.

The Trust continues to raise funds related to private placements of convertible debentures (note 12(a)) as well as through the issuance of series 1 preferred units of the Trust (note 14 (b)). A total of \$3,193,000 was raised during the first six months of the year related to these financings.

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The Trust is currently offering up to \$20,000,000 of the series 1 preferred trust units of the Trust by way of an exempt market offering which consists of a tied offering of preferred units of the Trust and Class A Shares of Petrocapita Energy Corp., a wholly-owned subsidiary of the Trust as described in more detail in note 14(b).

After giving consideration to the recent and ongoing financings and the offering of series 1 preferred trust units noted above, management believes that it will be able to raise additional necessary funds in the future. Accordingly, the use of the going concern assumption is considered appropriate and the Trust's condensed interim consolidated financial statements have been prepared on a going concern basis.

2. Basis of preparation

(a) Statement of compliance

The condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and interpretations of the International Financial Reporting Interpretations Committee (IFRIC), and International Accounting Standard (IAS) 34, *Interim Financial Reporting*, and should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2016. Certain information and disclosure included in the notes to the annual consolidated financial statements is condensed in the interim financial statements or disclosed only on an annual basis.

On August 28, 2017, the Board of Trustees authorized these condensed interim consolidated financial statements for issue.

(b) Reporting entity

The condensed interim consolidated financial statements of the Trust, comprise the Trust and its wholly-owned subsidiaries: Petrocapita Energy Corp. ("Petrocapita Energy"), Petrocapita GP I Ltd., Petrocapita GP II Ltd., Hytop Well Servicing Inc., PCap Trucking Inc. and Smartworks Oilfield Maintenance Ltd.

Petrocapita Energy was incorporated under the *Business Corporations Act (Alberta)* on September 26, 2016 for the purpose of completing a reorganization of the entity structures of the Trust, in conjunction with the Offering Memorandum described in note 14 (b).

(c) Internal reorganization

Effective January 1, 2017, the Trust completed a reorganization of the entity structures whereby:

- Petrocapita Energy purchased all of the outstanding units of the following wholly-owned entity of the Trust:
 - Petrocapita Oil & Gas LP ("Oil & Gas LP"), for total consideration of \$39,711,655 through the assumption of a secured note payable with interest payable at 0% per annum.
 - Following the purchase by Petrocapita Energy of the Oil & Gas LP, Petrocapita Energy issued 39,711,655 Class B common shares to the Trust for consideration by way of cancelling the \$39,711,655 secured note payable.

Petrocapita Income Trust
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- Petrocapita Energy purchased all of the assets (“Palliser assets”) of the following wholly-owned subsidiary of the Trust:
 - GP I Ltd, total consideration of \$5,000,000 paid through the assumption of a secured note payable with interest payable at 12.5% per annum.
- Subsequent to the purchase of the Palliser assets, Petrocapita Energy disposed of its interest in these assets whereby:
 - certain tangible assets were sold to Petrocapita Processing L.P. (“Processing LP”) for total consideration of \$1,000,000 through the issuance of 1,000,000 partnership units of the Processing LP
 - certain intangible assets were sold to Oil & Gas LP for total consideration of \$4,000,000 through the issuance of 4,000,000 partnership units of the Oil & Gas LP
 - in addition, as part of the corporate reorganization, the Oil & Gas LP disposed of all its tangible assets to Processing LP for total consideration of \$3,474,558 through the issuance of a secured note payable with interest payable at 6% per annum.

As a result of the internal reorganization described above the Petrocapita Energy now has the following subsidiaries:

- Petrocapita Oil & Gas L.P., limited partnership interest of 99.9999% (9,833,382 partnership units held) of the total partnership units outstanding (9,833,392 partnership units)
- Petrocapita Processing L.P., limited partnership interest of 99.9999% (1,000,001 partnership units held) of the total partnership units outstanding (1,000,002 partnership units)
- The General Partners of the Oil & Gas L.P. and Processing L.P., being, Petrocapita GP I Ltd. and Petrocapita GP II Ltd., respectively, continue to be wholly-owned subsidiaries of the Trust.

Following the internal reorganization, the Trust has the objective of investing directly in the Petrocapita Energy, who, through its ownership in the Processing LP and Oil & Gas LP, will carry on the business of investing in, conducting, engaging in, or otherwise being involved in one or more of the acquisition, exploration, exploitation, development, optimization, enhancement, production and processing of oil and natural gas and related products, and such other business activities as are in any way related, ancillary or incidental thereto.

The primary business carried on by the Oil & Gas LP will consist of drilling and development of its heavy oil assets and production thereof in the Lloydminster area of Alberta and Saskatchewan.

The primary business carried on by the Processing LP will consist of oil and gas transport, disposal and processing activities and conduct of well servicing and waste disposal activities.

(d) Use of estimates and judgments

The preparation of financial statements requires management to make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the condensed interim consolidated financial statements and the reported amounts of revenues and expenses during the period. By their nature, estimates are subject to estimation uncertainty.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results.

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Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In preparing these condensed interim consolidated financial statements, the significant estimates and judgements made by management in applying the Trust's accounting policies and the key sources of estimation uncertainty were the same as those applicable to the consolidated financial statements for the year ended December 31, 2016.

3. Significant accounting policies

The condensed interim consolidated financial statements have been prepared using the same accounting policies and methods of computation of the Trust's audited financial statements for the year ended December 31, 2016.

4. Asset acquisitions

(a) Maha Energy Inc.

During the six months ended June 30, 2017, the Trust acquired all of the Canadian oil and gas properties and assets of Maha Energy Inc. ("Maha") including a produced water disposal facility and connecting water disposal flowlines for \$1,650,000 to create additional operating efficiencies. The acquisition was accounted for as a business combination as the acquired assets and liabilities assumed constituted a business. The values attributed to property and equipment were determined with reference to an internal reserve report prepared by management using proved developed producing reserves discounted at approximately 15% - 20%.

Consideration was given by issuance of a convertible debenture in the amount of \$1,650,000. The convertible debenture is secured by the acquired assets. The convertible debenture is for a term of seven years, carries an interest rate of 6% per annum, payable monthly, and principal repayments were due beginning on March 15, 2017, being \$50,000 on each of March 15, 2017, April 15, 2017 and May 15, 2017, \$200,000 on each of September 15, 2017, October 15, 2017 and November 15, 2017. The remaining principal balance of \$900,000 will be repaid in equal monthly payments of approximately \$12,000 beginning December 15, 2017 through February 9, 2024. The convertible debenture has the same convertible option as the convertible debentures issued for corporate acquisitions (note 12(c)) and are described in more detail in note 12(b).

Recognized amounts of identifiable assets acquired and liabilities assumed:

Property and equipment (note 6)	\$ 2,047,409
Decommissioning provisions (note 13)	<u>(397,409)</u>
Net assets acquired	1,650,000
<hr/>	
Purchase consideration transferred	<u>\$ 1,650,000</u>

Petrocapita Income Trust
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Consideration:

Convertible debentures (note 12(b))	\$ 1,650,000
Total non-cash consideration	\$ 1,650,000

These consolidated financial statements reflect the results of operations of the property acquisition as of the closing date. The acquired assets' revenues and net income since the acquisition dates and pro forma revenues and net income giving effect to the transaction noted above, as if they occurred on January 1, 2017 are not significant to determine.

(b) Asset acquisitions

During the first six months of the year, the Trust acquired ten wells and associated production equipment for cash consideration of \$21,825. Future abandonment and reclamation obligations associated with these assets are estimated at approximately \$555,110.

Recognized amounts of identifiable assets acquired and liabilities assumed:

Property and equipment (note 6)	\$ 576,935
Decommissioning provisions (note 13)	(555,110)
Net assets acquired, being the cash consideration	\$ 21,825

In a separate transaction, the Trust acquired three oil transport vehicles for total consideration of \$125,000. Consideration was given by issuance of a convertible debenture secured by the acquired assets, for a term of seven years and an interest rate of 6% per annum, payable monthly (note 12 (b)).

5. Crude oil inventory

	June 30 2017	December 31 2016
Crude oil inventories	\$ 681,809	\$ 836,831

Crude oil inventory has been recorded at lower of cost or net realizable value at June 30, 2017 and December 31, 2016.

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Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
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(in Canadian dollars)

6. Property and equipment

	Heavy Oil Property Interests	Transport and Disposal Assets	Oilfield Service Assets	Total
Cost				
Balance at December 31, 2015	\$ 31,738,691	\$ 4,359,830	\$ -	\$ 36,098,521
Capital expenditures	1,610,605	75,625	80,479	1,766,709
Asset acquisitions	28,000,000	-	-	28,000,000
Corporate acquisitions	-	293,500	674,856	968,356
GORR disposition (note 11)	(3,804,000)	-	-	(3,804,000)
Change in decommissioning costs (note 13)	(3,076,286)	(187,000)	-	(3,263,286)
Balance at December 31, 2016	54,469,010	4,541,955	755,335	59,766,300
Capital expenditures	990,136	18,085	5,000	1,013,221
Transfers	-	(5,000)	-	(5,000)
Asset acquisitions (note 4)	2,294,344	330,000	125,000	2,749,344
Change in decommissioning costs (note 13)	368,449	-	-	368,449
Balance at June 30, 2017	\$ 58,121,939	\$ 4,885,040	\$ 885,335	\$ 63,892,314
Accumulated depletion and depreciation				
Balance at December 31, 2015	\$ 6,637,272	\$ 692,106	\$ -	\$ 7,329,378
Depletion and depreciation for the period	1,601,053	291,581	39,899	1,932,533
Impairment loss	-	73,733	-	73,733
Balance at December 31, 2016	8,238,325	1,057,420	39,899	9,335,644
Depletion and depreciation for the period	1,303,000	126,750	39,800	1,469,550
Balance at June 30, 2017	\$ 9,541,325	\$ 1,184,170	\$ 79,699	\$ 10,805,194
Net book value				
Balance at December 31, 2016	\$ 46,230,685	\$ 3,484,535	\$ 715,436	\$ 50,430,656
Balance at June 30, 2017	\$ 48,580,614	\$ 3,700,870	\$ 805,636	\$ 53,087,120

(a) Depletion and depreciation

The calculation of depletion and depreciation expense for the six months ended June 30, 2017 included future development costs of \$35,392,000 (December 31, 2016 - \$8,487,000) associated with the development of the Trust's proved and probable reserves.

(b) Capitalized general and administrative and borrowing costs

The Trust has not capitalized any general and administrative expenses or interest in the six months ended June 30, 2017 or 2016.

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(c) Secured assets

The net book value of all assets included in property and equipment have been pledged by the Trust as security of the debenture and convertible debentures.

7. Exploration and evaluation assets

Balance at December 31, 2015	\$ 1,007,141
Asset acquisitions	1,650,000
Corporate acquisitions	508,044
Impairment loss	(375,233)
Balance at December 31, 2016	2,789,952
Additions	10,045
Balance at June 30, 2017	\$ 2,799,997

Exploration and evaluation assets consist of the Trust's exploration projects for which proved and/or probable reserves have not yet been determined, equipment not in use and seismic assets.

8. Bank Debt

In conjunction with the corporate acquisitions made in the prior year, the Trust acquired a revolving demand facility (the "facility") in the amount of \$175,000 with an interest rate of prime plus 2.25% per annum paid monthly. The facility is secured by a General Security Agreement over the acquired assets and was drawn by \$175,000 at June 30, 2017 (\$95,000 at December 31, 2016). The facility is guaranteed in the amount of \$700,000 by the former shareholders of the company acquired and any amounts outstanding under the facility take priority claim over the loans payable amounts to the same shareholders (note 9). Under the terms of the facility, the Trust is subject to certain financial and reporting covenants. As at June 30, 2017, the Trust was in compliance with all covenants under this facility.

9. Loans payable

In conjunction with corporate acquisitions made in the prior year, the Trust acquired various loans payable to the previous shareholders of the companies acquired. The loans have no fixed terms of repayment, are unsecured and are non-interest bearing. The balances at June 30, 2017 and December 31, 2016 are as follows:

	June 30 2017	December 31 2016
Loans payable	\$ 211,442	\$ 211,442

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10. Obligation under finance leases

In conjunction with corporate acquisitions made in the prior year, the Trust acquired finance leases on certain transport and disposal assets that it will continue to use in operations. The leases contain a notional annual interest rate of 18%, and are for terms that encompass substantially all the assets' useful lives. The obligations are secured by the underlying assets. The future minimum lease payments under finance leases at the inception of the leases were \$462,567 and are now as follows:

	June 30 2017	December 31 2016
Total future minimum lease payments	\$ 240,920	\$ 298,741
Interest included in installments	41,249	61,231
Obligation under finance leases	199,671	237,510
Current portion	86,616	79,214
Long-term portion	\$ 113,055	\$ 158,296

The Trust is required to make payments under the lease agreements of approximately \$9,600 per month. Future minimum lease payments under the finance leases, on a calendar year basis, are as follows:

2017	\$ 41,371
2018	94,710
2019	63,590
Total obligations under finance leases	\$ 199,671

11. Debenture

On April 29, 2016, the Trust completed through private placement the issuance of a secured debenture in the amount of \$5,000,000 with a maturity date of April 29, 2021. The debenture bears interest at 12.5% per annum, payable quarterly. A total of \$501,587 in administration and due diligence fees were paid to secure the debenture. The debenture has been recorded net of the related financing costs which will be amortized over the term of the debenture.

The debenture holder was granted a first security interest in all of the oil and gas properties of Petrocapita Oil and Gas L.P., including the oil and gas properties associated with the asset acquisition. The debenture will rank "*pari-passu*" with the private placements of the secured convertible debentures described in note 12(a). As part of the agreement, the debenture holder shall be paid a gross overriding royalty ("GORR") of 3% for 12 production months after the closing of the acquisition, increasing to 5% thereafter on all oil and gas properties acquired in the Palliser acquisition and a 3% royalty ("SWD Royalty") on all produced water disposed at any salt water disposal facility or well acquired in the acquisition. The Trust has the option to purchase the GORR and the SWD Royalty at any time for \$5,000,000. On issuance of the debenture, no value was assigned to the GORR or the option to purchase by the Trust as management determined that the likelihood of the amounts being payable or the option being exercised to be nil. A value of \$3,804,000 was assigned to the GORR on closing of the acquisition on July 11, 2016 and was recorded as a disposition of property and equipment (note 6).

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During the six months ended June 30, 2017, \$309,932 (2016-\$43,493) of interest expense and \$49,720 (2016 - \$17,031) of amortization of debt issue costs were included in finance expenses (note 18).

12. Convertible debentures

The following tables summarize changes in the convertible debentures:

Six months ended June 30, 2017	Debt Component	Conversion Feature Component	Warrants	Total
Balance at December 31, 2016	\$ 5,671,115	\$ 2,679,931	\$ 309,461	\$ 8,660,507
Debt issued for cash	731,028	291,972	-	1,023,000
Debt issued for acquisitions (note 4(a))	1,051,449	723,551	-	1,775,000
Debt issue costs	(103,075)	-	14,975	(88,100)
Debt issued under DRIP	33,736	-	-	33,736
Accretion of discount (note 18)	205,230	-	-	205,230
Amortization of financing costs (note 18)	125,778	-	-	125,778
Principal repayments	(188,847)	-	-	(188,847)
Change in fair value of conversion feature	-	324,606	-	324,606
Balance at June 30, 2017	\$ 7,526,414	\$ 4,020,060	\$ 324,436	\$ 11,870,910
Less current portion	965,284			
Long-term portion	\$ 6,561,130			

Year ended December 31, 2016	Debt Component	Conversion Feature Component	Warrants	Total
Balance at December 31, 2015	\$ 308,540	\$ 37,932	\$ 4,929	\$ 351,401
Debt issued for cash	4,905,005	1,351,408	46,587	6,303,000
Debt issued for acquisitions	1,038,078	595,873	-	1,633,951
Debt issue costs	(796,506)	-	257,945	(538,561)
Debt issued under DRIP	15,886	-	-	15,886
Accretion of discount (note 18)	152,489	-	-	152,489
Amortization of financing costs (note 18)	68,720	-	-	68,720
Principal repayments	(21,097)	-	-	(21,097)
Change in fair value of conversion feature	-	694,718	-	694,718
Balance at December 31, 2016	\$ 5,671,115	\$ 2,679,931	\$ 309,461	\$ 8,660,507
Less current portion	160,204			
Long-term portion	\$ 5,510,911			

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(a) Convertible debentures issued for cash

During the first six months of the year, the Trust completed three additional tranches of the issuance of convertible secured subordinated debentures for aggregate proceeds of \$1,023,000. In addition, a total of 59,100,000 warrants (note 15) were issued in conjunction with the issuance. The convertible debentures have the same terms and conditions as those described below.

During the prior year, the Trust completed eight separate tranches of the issuance of convertible secured subordinated debentures for aggregate proceeds of \$6,303,000. In addition, a total of 375,430,000 warrants (note 15) were issued in conjunction with the eight issuances.

The convertible debentures have the following terms and conditions:

Total face value	\$1,023,000 (2016 - \$6,303,000)
Interest rate	8% per annum, payable quarterly
Maturity date	December 31, 2020
Conversion option	At the option of the holder, conversion into common units of the Trust on or after December 31, 2017, at an amount equal to the average market trading price of such units for each of the last 20 trading days at any time after the second anniversary from the date of issue
Warrants	Each debenture holder is entitled to 50,000 warrants for every \$1,000 principal amount of convertible debentures subscribed for. Each warrant is exercisable at a price of \$0.06 per warrant for a term of three years.
Security	Secured subordinated note issued by the Partnership

During the six months ended June 30, 2017, \$278,347 (2016 - \$37,548) of interest expense was included in finance expenses (note 18) relating to these convertible debentures.

(b) Convertible debentures issued for asset acquisition

During the first six months of the year, the Trust completed an asset acquisition (note 4(a)) to acquire certain properties and assets. The assets were acquired by issuance of convertible debentures to the entity as follows:

Total face value	\$1,500,000 (2016 - \$nil)
Interest rate	6% per annum, payable quarterly
Principal repayments	Principal repayments of \$50,000 on each of March 15, 2017, April 15, 2017 and May 15, 2017, \$200,000 on each of September 15, 2017, October 15, 2017 and November 15, 2017. The remaining principal balance of \$900,000 will be repaid in equal monthly payments of approximately \$12,000 beginning December 15, 2017 through February 9, 2024.
Maturity date	February 9, 2024
Conversion option	At the option of the holder, conversion into common units of the Trust on or after December 31, 2017, at an amount equal to the average market trading price of such units for each of the last 20 trading days at any time after the second anniversary from the date of issue
Security	Acquired assets

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During the six months ended June 30, 2017, \$150,000 (2016-\$nil) in principal repayments were made and \$36,362 (2016-\$nil) of interest expense was included in finance expenses (note 18) relating to this convertible debenture.

The Trust also completed an asset acquisition (note 4(b)) to acquire certain oil transport assets. The assets were acquired by issuance of convertible debentures to the entity as follows:

Total face value	\$125,000 (2016 - \$nil)
Interest rate	6% per annum, payable monthly
Principal repayments	Monthly payments of \$2,155 commencing on the first anniversary date from issuance
Maturity dates	March 1, 2023
Conversion option	At the option of the holder, conversion into common units of the Trust on or after December 31, 2017, at an amount equal to the average market trading price of such units for each of the last 20 trading days at any time after the second anniversary from the date of issue
Security	Acquired assets

During the six months ended June 30, 2017, \$1,253 (2016-\$nil) of interest expense was included in finance expenses (note 18) relating to this convertible debenture.

(c) Convertible debentures issued for corporate acquisitions

During the prior year, the Trust completed several corporate acquisitions to acquire all of the issued and outstanding common shares of each entity. The shares were acquired by issuance of convertible debentures to the existing shareholders of each entity as follows:

Total face value	(2016 - \$1,633,951)
Interest rate	6% per annum, payable quarterly
Principal repayments	Monthly payments between \$1,368 to \$7,639, commencing on the first anniversary date from issuance
Maturity dates	May 15, 2023 to December 31, 2023
Conversion option	At the option of the holder, conversion into common units of the Trust on or after December 31, 2017, at an amount equal to the average market trading price of such units for each of the last 20 trading days at any time after the second anniversary from the date of issue
Security	Acquired assets of each entity

During the three months ended June 30, 2017, \$48,583 (2016-\$6,192) of interest expense was included in finance expenses (note 18) and \$20,763 (2016-\$nil) in principal was repaid relating to these convertible debentures.

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(d) Hybrid financial instrument

The convertible debentures have been classified as a compound financial instrument and presented in the condensed interim consolidated financial statements in their component parts.

- (i) The conversion feature has been determined to be an embedded derivative and accordingly, the fair value of the conversion feature was calculated on the date of issue using the Black Scholes option pricing model. The conversion feature is carried at fair value through profit or loss and re-measured at each reporting date using the Black Scholes option pricing model.

At June 30, 2017, the fair value of the embedded derivative liability was \$4,020,060 (December 31, 2016 – \$2,679,931) and a fair value adjustment of \$324,606 (2016 – \$45,511) was recognized in profit or loss for the six months ended June 30, 2017.

- (ii) The debt component was calculated at the present value of the required interest and principal payments discounted at a rate approximating the interest rate that would have been applicable to non-convertible debt at the time the debenture was issued. The effective interest rate of the convertible debentures ranged from 15% to 24%. The debt portion will accrete up to the original face value of the debentures at maturity. The accretion and the interest paid are expensed in finance expenses.

- (iii) The residual amount, after considering the conversion feature and the debt component compared to the total fair value of the compound financial instrument, was allocated to equity related to the warrants issued to the debenture holders, if that debenture included an issuance of warrants.

The fair value of the conversion feature and warrants was estimated using the Black-Scholes option pricing model with the following assumptions:

	Conversion feature (date of issue)	Conversion feature (June 30, 2017)	Warrants
Fair value per unit range	\$0.005-\$0.01	\$0.01	\$0.005-\$0.01
Exercise price range	\$0.005-\$0.02	\$0.015	\$0.06
Unit price on grant/value date	\$0.005-\$0.03	\$0.015	\$0.005-\$0.03
Risk-free rate	0.73%	0.73%	0.73%
Expected volatility	75%	75%	75%
Dividend yield	0%	0%	0%
Expected forfeiture rate	0%	0%	0%
Expected life	4.0-6.3 yrs	3.5-6.3 yrs	1.5-2.4 yrs

Expected volatility was determined based on a comparison to other companies in the business of exploration, development and production of oil and natural gas. A forfeiture rate of 0% was used as it is expected that holders will exist until maturity.

Option pricing models require the input of subjective assumptions regarding the expected volatility. Changes in assumptions can materially affect the estimate of fair value, and therefore, use of Black-Scholes option pricing model, may not provide a realistic measure of the fair value of the Trust's convertible debentures at the date of issue or the conversion feature at each reporting date.

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(e) Debt issue costs

During the first six months of the year, the Trust paid cash debt issue costs of \$88,100 (2016 - \$196,564) and issued 7,950,000 (2016 - 16,330,000) broker warrants (note 15) that have been included as debt issue costs with a fair value determined using the Black-Scholes option pricing model of \$14,975 (2016 - \$40,999) for total debt issue costs incurred of \$103,075 (2016 - \$237,563).

The debt issue costs have been allocated to their related component on a pro-rated basis in relation to the face value of the convertible debenture. The debt issue costs allocated to the convertible debenture component have been netted against the gross proceeds and will be amortized to finance expense over the anticipated life of the convertible debentures using the effective interest rate method. During the six months ended June 30, 2017, \$125,778 (2016-\$13,004) in debt issue costs were amortized. The debt issue costs allocated to the conversion feature component have been recorded as a finance expense as the conversion feature is accounted for at fair value. During the six months ended June 30, 2017, \$25,095 (2016-\$77,106) in debt issue costs were expensed as finance costs related to the conversion feature.

(f) Distribution reinvestment plan ("DRIP")

During the six months ended June 30, 2017, the Trust adopted a reinvestment plan whereby eligible holders of convertible debentures can elect to have their quarterly interest payments reinvested in additional convertible debentures. During the six months ended June 30, 2017, the Trust issued \$33,736 (2016-\$nil) of additional debentures under the DRIP plan.

(g) Principal repayments

In accordance with the convertible debenture agreements issued for corporate acquisitions and property and equipment noted above, the Trust must make the following principal repayments:

Within 1 year	2 to 5 years	After 5 years	Total
\$965,284	\$9,753,935	\$288,370	\$11,007,589

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13. Decommissioning provisions

The Trust's decommissioning provisions are an estimate of the future reclamation and abandonment costs arising from the Trust's ownership interest in heavy oil properties and water disposal wells and facilities.

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of the decommissioning provisions associated with the retirement of heavy oil property interests and transport and disposal assets:

	June 30	December 31
	2017	2016
Balance, beginning of period	\$ 23,129,666	\$ 7,806,230
Liabilities acquired on acquisitions (note 4)	952,519	18,934,000
Change in estimated cash flows (note 6)	631,461	-
Change in discount rate (note 6)	(263,012)	(3,804,286)
Actual costs incurred on abandonment	-	(63,278)
Accretion (note 18)	310,045	257,000
Balance, end of period	\$ 24,760,679	\$ 23,129,666

The total undiscounted amount of estimated cash flows required to settle the obligation as at June 30, 2017 was approximately \$35,020,000 (December 31, 2016 - \$34,157,000) which has been discounted using a risk-free rate of 2.13% at June 30, 2017 (December 31, 2016 - 2.31%). An inflation rate of approximately 1.57% was used at June 30, 2017 (December 31, 2016 - 2%). All of these obligations are estimated to be incurred in approximately 2026 and 2033 and will be funded from general Trust resources at the time of the retirement.

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14. Trust capital

(a) Common units

Authorized - Unlimited number of Common units

Each holder of common units of the Trust is entitled to one vote per unit and shall be entitled to receive non-cumulative distributions if, and when, declared by the trustees. All units are redeemable on demand by the unitholder. The redemption price is determined by the Administrator of the Trust. The Administrator shall determine the redemption price as the lesser of: (i) 90% of the market price for the last ten trading days before the unit is tendered for redemption as determined using a volume weighted trading average; or (ii) 100% of the closing market price on the day the unit is tendered for redemption. Redemptions are limited to \$7,500 per month, and any redemptions requested in excess of that amount will be repaid through the issuance of a note payable or distribution of the property of the Trust.

Issued and outstanding	Number of Common Units	Total Stated Amount
Balance at June 30, 2017 and December 31, 2016	1,109,731,962	\$ 37,368,608

(b) Preferred units

Authorized - Unlimited number of Preferred units, issuable in series, redeemable and retractable

During the prior year, the Trust created a new series of Preferred Units, Series 1 ("preferred units"). Each holder of preferred units of the Trust will not be entitled to vote, however will have the right to receive a fixed, preferential cumulative distribution of \$0.09 per preferred unit per annum, payable quarterly in arrears to the extent of distributable cash is available. Prior to the redemption date (fourth anniversary of the date of issuance), preferred units are redeemable on demand by the holders thereof, at a redemption price based on 90% of their market price or 100% of their closing market price, subject to certain limitations on payment of the redemption price and the consideration thereof. Following the redemption date, each preferred unit will be redeemed for \$1.00 per unit plus all accrued and unpaid cumulative distributions. In addition, the Trust may redeem at any time the preferred units for \$1.00 per unit plus all accrued and unpaid cumulative distributions.

The Trust is currently offering up to \$20,000,000 of these series 1 preferred trust units of the Trust by way of an exempt market offering. The offering consists of a tied offering of preferred units of the Trust and Class A Shares of Petrocapita Energy Corp. ("Petrocapita Energy"), a wholly-owned subsidiary of the Trust.

Each preferred unit is priced at \$1.00 and each share is priced at \$0.001. Each share shall be exchangeable for 32 of the publicly traded common units of the Trust at any time on or after 18 months from the date of issuance of the shares, subject to certain restrictions, conditions and adjustments in certain circumstances.

The minimum subscription of the preferred units of the Trust shall be 1,000 preferred units which will entitle the subscriber to subscribe for up to 230 Shares. Accordingly, the minimum subscription of the shares shall be \$0.23. The shares must be purchased as part of a tied unit. A tied unit means a combination of 0.23 Shares and one series 1 preferred unit.

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The agent will be paid a cash commission and administrative fee (equal in aggregate to 10% of the gross proceeds raised by the agent) and will be entitled to subscribe for 20 shares of the 230 shares subscribed for in the minimum subscription of the 1,000 tied units sold through the agent.

In the first six months of the year, the Trust closed the first two tranches of these series 1 preferred units for aggregate principal amounts of approximately \$2,170,000 and \$499.10 for Class A shares of Petrocapita Energy. A total of 2,170,000 units and 499,100 Class A shares were issued in conjunction with the closings.

Transaction costs amounted to \$386,567 and included total cash commissions paid to the agents of \$217,000 in addition to 43,400 Class A shares being issued.

During the six months ended June 30, 2017 a total of \$46,063 (2016-\$nil) in distributions was included in finance expenses (note 18) relating to these units including \$15,180 issued under the Trust's DRIP plan.

The preferred units are considered to be a hybrid instrument with an embedded derivative due to their redemption features. Upon initial issuance, the units are presented in their component parts of debt and equity. The embedded derivative is the holder's option to redeem the units based on fair value at the time of redemption. A summary of the breakdown of the series 1 preferred units at June 30, 2017 is as follows:

	Number of Series 1 Preferred Units	Total Amount	Equity Component	Liability Component
Balance at December 31, 2016	-	\$ -	\$ -	\$ -
Preferred units issued for cash	2,170,000	2,170,000	217,000	1,953,000
Preferred unit issue costs	-	(386,567)	-	(386,567)
Preferred units issued under DRIP	15,180	15,180	-	15,180
Balance at June 30, 2017	2,185,180	\$ 1,798,613	\$ 217,000	\$ 1,581,613

(c) Share-based payment plan

On May 26, 2016, the Board of Trustees approved a stock option plan that provides for the issuance of stock options to employees, directors and officers of the Trust. The plan allows the Trustees at their sole discretion to grant options and determine the vesting provisions of those options subject to applicable regulatory approvals. Since the inception of the plan, there have been no options granted by the Trust.

15. Warrants

During the six months ended June 30, 2017, the Trust issued 51,150,000 (year ended December 31, 2016 - 315,150,000) warrants with the offering of the secured subordinated convertible debentures (note 12). In addition, 7,950,000 (year ended December 31, 2016 - 60,280,000) warrants were issued to the agent as part of debt issue costs related to the secured subordinated convertible debentures (note 12). Each warrant is exercisable on the date of issuance at a price of \$0.06 per warrant and expires on December 31, 2018.

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There have been no warrants exercised during the six months ended June 30, 2017.

A summary of warrants outstanding and exercisable is as follows:

	June 30 2017		December 31 2016	
	Number	Stated value	Number	Stated value
Balance, beginning of period	386,730,000	\$ 309,461	11,300,000	\$ 4,929
Issued to debenture holders	51,150,000	-	315,150,000	46,587
Issued to agents	7,950,000	14,975	60,280,000	257,945
Balance, end of period	445,830,000	\$ 324,436	386,730,000	\$ 309,461

16. Loss per common unit

The following reflects the loss and common unit data used in the basic and diluted income (loss) per common unit computations for the three months ended June 30:

	2017	2016
Numerator:		
Net loss for the period	\$ (2,481,256)	\$ (1,172,787)
Denominator:		
Weighted average number of common units – basic	1,109,731,962	1,109,731,962
Weighted average number of common units - diluted	1,109,731,962	1,109,731,962

The following reflects the loss and common unit data used in the basic and diluted income (loss) per common unit computations for the six months ended June 30:

	2017	2016
Numerator:		
Net loss for the period	\$ (6,290,602)	\$ (2,113,371)
Denominator:		
Weighted average number of common units – basic	1,109,731,962	1,109,731,962
Weighted average number of common units - diluted	1,109,731,962	1,109,731,962

For the three and six months ended June 30, 2017 and 2016 the potential conversion of the convertible debentures and warrants has not been included as the effect on loss per common unit would be anti-dilutive.

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17. Revenue and operating expenses

The following summarizes the breakdown of revenues and operating expenses:

Revenue	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Heavy oil	\$ 1,997,050	\$ 591,995	\$ 4,946,209	\$ 955,932
Transport and disposal	38,373	14,388	72,183	24,346
Oilfield service	18,590	78,388	117,052	78,388
Total revenue	\$ 2,054,013	\$ 684,771	\$ 5,135,444	\$ 1,058,666

Operating expenses	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Production and transportation	\$ 1,648,051	\$ 582,803	\$ 4,918,048	\$ 1,126,212
Transport and disposal	127,577	27,508	288,219	58,520
Oilfield service	57,746	-	99,152	-
Total operating expenses	\$ 1,833,374	\$ 610,311	\$ 5,305,419	\$ 1,184,732

18. Finance expenses

Finance expenses	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Accretion of decommissioning provisions (note 13)	150,630	40,341	310,045	78,711
Accretion of convertible debentures	109,928	19,088	205,230	24,730
Financing costs (notes 11 and 12)	92,008	70,914	175,496	107,141
Interest on finance leases (note 10)	9,569	-	19,982	-
Interest on secured debentures (note 11)	155,822	43,493	309,932	43,493
Interest on convertible debentures (note 12)	196,571	44,846	370,149	63,947
Distributions on preferred units (note 14(b))	42,938	-	46,063	-
Interest on bank debt	4,144	2,601	5,470	2,601
Other	10,996	(35)	15,899	(58)
Finance expense	\$ 772,606	\$ 221,248	\$ 1,458,266	\$ 320,565

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19. Supplemental cash flow information

(a) Components of cash and cash equivalents

	June 30 2017	December 31 2016
Deposits in banks	\$ 1,996,279	\$ 2,377,582
Guaranteed investment certificates (1-year term)	5,000	155,000
	\$ 2,001,279	\$ 2,532,582

(b) Changes in non-cash working capital are comprised of:

	Six months ended June 30, 2017	Six months ended June 30, 2016
Accounts receivable	\$ 546,319	\$ 4,833
Prepaid expenses and deposits	(114,761)	(270,523)
Crude oil inventory	155,022	-
Accounts payable and accrued liabilities	1,107,321	(108,633)
	\$ 1,693,901	\$ (374,323)
Related to:		
Operating activities	\$ 1,193,119	\$ (343,421)
Investing activities	259,914	(201,203)
Financing activities	240,868	170,301
Changes in non-cash working capital	\$ 1,693,901	\$ (374,323)

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(c) Non-cash transactions:

The following non-cash transactions were excluded from the condensed interim consolidated statements of cash flows:

- Corporate and asset acquisitions in exchange for convertible debentures in the amounts of \$1,650,000 (note 4(a)) and \$125,000 (note 4(b));
- Re-invested distributions of \$33,736 during the six months ended June 30, 2017 (2016-\$nil) from the Trust's DRIP into convertible debentures (note 12); and
- Re-invested distributions of \$15,180 during the six months ended June 30, 2017 (2016-\$nil) from the Trust's DRIP into preferred units (note 14(b)).

(d) Interest paid in cash for the three and six months ended June 30, 2017 and 2016:

	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Interest paid	\$ 219,734	\$ 90,940	\$ 548,785	\$ 110,041

20. Financial risk management, fair values and capital management

(a) Overview

The Trust's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

The Trust employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Trust's business objectives and risk tolerance levels. While the Board of Trustees has the overall responsibility for the establishment and oversight of the Trust's risk management framework, management has the responsibility to administer and monitor these risks.

This note presents information about the Trust's exposure to each of the above risks, the Trust's objectives, policies and processes for measuring and managing risk, and the Trust's management of capital. Further quantitative disclosures are included throughout these condensed interim consolidated financial statements. In addition, this note presents information regarding the fair value of financial instruments. There have been no changes to these policies during the three and six months ended June 30, 2017.

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(b) Credit risk

Credit risk is the risk of financial loss to the Trust if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The following table outlines the maximum credit risk exposure, however management believes all amounts will be collected.

Credit risk exposure	June 30 2017	December 31 2016
Cash	\$ 2,001,279	\$ 2,532,582
Accounts receivable	1,361,503	1,907,822
Maximum exposure to credit risk	\$ 3,362,782	\$ 4,440,404

Cash

The Trust manages the credit exposure related to cash by selecting financial institutions with high credit ratings. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

Accounts receivable

All of the Trust's operations are conducted in Canada. The Trust's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The Trust's accounts receivable are from companies in the oil and natural gas industry and are subject to normal industry credit risks. Significant changes in industry conditions and risks that negatively impact customers' ability to generate cash flow will increase the risk of not collecting receivables. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. Management monitors the credit ratings of its customers to ensure no collection issues arise.

The Trust's accounts receivable was comprised of the following amounts:

	June 30 2017	December 31 2016
Heavy oil marketers	\$ 718,284	\$ 1,139,796
Service rig customers	237,231	237,231
Joint interest partners	249,295	311,805
Transport and disposal customers	99,270	56,653
Other	53,725	78,280
Goods and services tax	3,698	84,057
Total accounts receivable	\$ 1,361,503	\$ 1,907,822

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The Trust markets its heavy oil primarily to two marketers which comprise 53% (December 31, 2016 – 60%) of accounts receivable at June 30, 2017. Receivables from heavy oil marketers and water disposal customers are normally collected on the 25th day of the month following production. During the first six months of 2017 and 2016, the Trust has not experienced any collection issues with its heavy oil marketers or transport and disposal customers.

The receivables from joint interest partners are generally with heavy oil producers and arise with the Trust conducts joint operations on behalf of its partners and invoices for their share of costs. Joint interest receivables are generally collected within one to three months of the joint interest bill being issued to the partners. The Trust attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to expenditure and in certain circumstances may elect to cash call a joint interest partner in advance of the work. The Trust does not typically obtain collateral from joint interest partners, however, the Trust does have the ability to withhold production from joint interest partners in the event of non-payment. During the first six months of 2017 and in 2016, the Trust has not experienced any collection issues with its joint interest partners.

Receivables from service rig customers are generally collected 30 days following performance of the service. During the first six months of 2017 and in 2016, the Trust has not experienced any collection issues with its service rig customers.

The accounts receivable is aged as follows:

	June 30 2017	December 31 2016
Current (not past due)	\$ 791,105	\$ 1,497,352
Greater than 90 days (past due)	570,398	410,470
	\$ 1,361,503	\$ 1,907,822

The Trust considers all accounts receivable to be fully collectible and no allowance is required. When determining whether past due accounts are collectible, the Trust factors in the past credit history of the counterparties. The Trust considers all amounts greater than 90 days as past due. Management follows up and takes necessary steps to ensure collection of all accounts receivable which are past due. The Trust has no allowance for doubtful accounts as at June 30, 2017 and December 31, 2016. During the six months ended June 30, 2017, the Trust expensed \$10,035 (2016 - \$nil) of accounts receivable deemed uncollectible.

(c) Liquidity risk

Liquidity risk is the risk that the Trust will not be able to meet its financial obligations as they are due. The Trust's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its liabilities when due. The Trust's ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations. Commodity prices experienced during 2016 and the first two quarters of 2017 have negatively impacted earnings and cashflows.

Net loss for the six months ended June 30, 2017 was \$6,290,602 (2016 – \$2,113,371). Cash flows used in operating activities for the six months ended June 30, 2017 was \$2,563,642 (2016 - \$1,422,068). At June 30, 2017, the Trust has a negative working capital position (excluding derivative financial instruments) of \$4,027,538 (December 31, 2016 - \$909,855). The Trust is required to meet certain financial commitments as described in notes 10 and 11.

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The Trust's accounts payable and accrued liabilities were comprised of the following amounts:

	June 30 2017	December 31 2016
Operating	\$ 5,029,042	\$ 4,711,429
Capital	853,302	746,574
Accruals	1,413,050	730,072
Total accounts payable and accrued liabilities	\$ 7,295,394	\$ 6,188,075

Accounts payable consist of invoices payable to trade suppliers for operating (e.g., general, administrative, royalty, production and transportation), capital (e.g., drilling, completion and equipping oil wells) financing (interest on debt, commissions and other costs for the issue of preferred units) expenditures and capital taxes and are due within one year.

The Trust's financial liabilities under obligations that have contractual maturities are summarized below:

	Less than year	2-5 years	After 5 years	Total
Accounts payable and accrued liabilities	\$ 7,295,394	\$ -	\$ -	\$ 7,295,394
Bank debt	175,000	-	-	175,000
Loans payable	211,442	-	-	211,442
Obligations under finance leases	86,616	113,055	-	199,671
Debentures	-	5,000,000	-	5,000,000
Convertible debentures	965,284	9,753,935	288,370	11,007,589
Preferred units	-	1,798,613	-	1,798,613
	\$ 8,733,736	\$ 16,665,603	\$ 288,370	\$ 25,687,709

The Trust will require additional funding to reduce its exposure to liquidity risk. The Trust has been actively seeking private equity, debentures and facility financings and is reviewing potential mergers and acquisitions to strengthen cash flows from operating activities. The Trust continually monitors its actual and forecast cash flows to review whether there are adequate reserves available to meet its obligations as well as continues to focus on operating and general and administrative cost structures and enhancing operational efficiencies to preserve the Trust's financial health and sustainability in the current commodity price environment. The Trust cannot provide any assurance that sufficient cash flows will be generated from operating activities or proceeds from other activities noted above will improve its working capital.

(d) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Trust's net earnings or the value of financial instruments. The Trust manages and mitigates market risk exposures within acceptable limits, while maximizing returns. There have been no changes to the Trust's policies or processes for managing market risk during the six months ended June 30, 2017 and 2016.

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(e) Fair value of financial instruments

The fair values of accounts receivable and accounts payable and accrued liabilities approximate their carrying values due to the relatively short-term nature of these instruments.

The fair value of bank debt approximates its carrying value as it bears a floating rate of interest.

The fair value of loans payable approximates its carrying value as there is not set terms of repayment.

The fair value of obligations under finance leases approximates its carrying value as the implicit interest rate charged by the lessor is indicative of current credit spreads.

The debentures and convertible debentures bear interest at fixed rates of 6%, 8% or 12.5%, however the carrying values have been determined using an interest rate of 15% which approximates a market rate for similar financing transactions. The face amount of debentures and convertible debentures at June 30, 2017 and December 31, 2016 can be summarized as follows:

	Face value	Carrying value
8% convertible debentures, maturing Dec 30, 2020	\$ 7,597,622	\$ 5,359,785
6% convertible debentures, maturing May 15, 2023	459,362	337,939
6% convertible debentures, maturing June 1, 2023	542,362	354,800
6% convertible debentures, maturing October 1, 2023	176,500	115,641
6% convertible debentures, maturing Nov 30 & Dec 21 2023	428,924	283,047
6% secured debenture, maturing June 1, 2022	177,819	159,594
6% secured debenture, maturing March 1, 2022	125,000	75,715
6% secured debenture, maturing February 9, 2024	1,500,000	839,893
12.5% secured debenture, maturing April 29, 2021	5,000,000	4,615,707
	\$16,007,589	\$12,142,121

Cash is measured at fair value using level 1 fair value measurements.

The Trust's debentures and convertible debentures are not actively traded; therefore, management estimated the fair value using valuation techniques that require inputs that are unobservable (level 3 fair value measurements).

The fair value of the liability component of the conversion feature of the convertible debentures is measured based on level 2 fair value measurements.

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(f) Capital management

The Trust's capital includes unitholders' equity and other debt. The Trust's objective in managing capital is to ensure that it has sufficient working capital and access to sources of capital to finance its operations and to make planned capital expenditures or capital acquisitions as opportunities present themselves. The Trust monitors the level of risk associated for each capital project to balance the proportion of debt and equity in its capital structure. The Trust monitors capital based on its current working capital, projected cash flow from operating activities and anticipated capital expenditures. The Trust's officers are responsible for managing the Trust's capital and do so through weekly meetings and regular reviews of financial information, including budgets and forecasts. The Trust's directors are responsible for overseeing this process. The Trust manages its capital structure and makes changes to it in light of changes in economic conditions, anticipated or planned capital expenditures, opportunities for acquisitions and the risk characteristics of the underlying investments. The Trust's capital management objectives have not changed during the six months ended June 30, 2017 since December 31, 2016.

Total capital managed is determined as follows:

	June 30 2017	December 31 2016
Bank debt	\$ 175,000	\$ 95,000
Loans payable	211,442	211,442
Obligations under finance leases	199,671	237,510
Debenture	4,615,707	4,565,987
Convertible debentures	7,526,414	5,671,115
Preferred units	1,581,613	-
Unitholders' equity	10,091,335	16,149,962
	\$ 24,401,182	\$ 26,931,016

Total capital has decreased from the prior year end due to the net loss for the six months ended June 30, 2017 offset by the convertible debentures and preferred units issued during the period.

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The Trust monitors its working capital closely, which is determined on the following basis:

	June 30 2017	December 31 2016
Cash	\$ 2,001,279	\$ 2,532,582
Accounts receivable	1,361,503	1,907,822
Crude oil inventory	681,809	836,831
Prepaid expenses and deposits	661,607	546,845
Accounts payable and accrued liabilities	(7,295,394)	(6,188,075)
Bank debt	(175,000)	(95,000)
Loans payable	(211,442)	(211,442)
Current portion of obligation under finance lease	(86,616)	(79,214)
Current portion of convertible debenture	(965,284)	(160,204)
Working capital deficiency	\$ (4,027,538)	\$ (909,855)

Working capital deficiency has increased from the prior year end due to assumed liabilities as part of the corporate acquisitions completed in the prior year as well as the reactivation program over year-end.

The Trust is not subject to any externally imposed capital requirements other than certain financial and reporting covenants as a result of bank facility described in note 8 and the conversion features of the debentures (note 12).

21. Commitments

The Trust has entered into lease agreements for office space and equipment which expire in July 2017, May 2019 and March 2022. The required lease payments, exclusive of operating costs, over the remaining term of the leases are as follows:

2017	\$ 103,000
2018	195,000
2019	190,000
2020	179,000
2021	182,000
Thereafter	<u>45,000</u>
	<u>\$ 894,000</u>

22. Related parties

(a) Transactions

During the six months ended June 30, 2017, the Trust issued convertible secured subordinated debentures as described in note 12(a) to certain officers and directors for aggregate principal amounts of \$130,000 (2016 - \$75,000). Total convertible secured subordinated debentures outstanding to certain officers and directors at June 30, 2017 is \$555,000 (December 31, 2016 - \$425,000).

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(b) Compensation of key management personnel

Key management includes the Trust's directors and officers. Total remuneration for key management included in general and administrative expenses during the six months ended June 30, 2017 was approximately \$529,000 (2016 - \$253,000).

As at June 30, 2017 \$125,528 (December 31, 2016 - \$218,613) remains outstanding to key management and is included in accounts payable and accrued liabilities.

23. Subsequent events

(a) Consolidation of common trust units and changes to warrant terms

Subsequent to the quarter end, the Trust announced that it has approved the consolidation of the common trust units (note 14(a)) on the basis of one whole new common trust unit for every existing one hundred Common trust units, effective August 18, 2017. In connection with the consolidation, the Trust has also approved the extension of the expiry date of certain warrants and the re-pricing of these warrants, which were issued in connection with the Trust's 8% convertible debentures (note 12(a)). These transactions remain subject to warrant holder and applicable regulatory approvals.

(b) Offering Memorandum

Subsequent to the quarter end, the Trust closed the third tranche of preferred units (note 14(b)) for aggregate principal amounts of approximately \$221,000 and \$50.83 for Class A shares of Petrocapita Energy. A total of 221,000 preferred units of the Trust and 50,830 Class A shares of Petrocapita Energy were issued in conjunction with the closing. Total cash commissions paid to the agents were \$22,100 in addition to 4,420 Class A shares issued.