



# First Quarter Report 2014

For the three  
month period ended  
March 31, 2014



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements of Harvest Operations Corp. ("Harvest", "we", "us", "our" or the "Company") for the three months ended March 31, 2014 and the audited annual consolidated financial statements for the year ended December 31, 2013 together with the accompanying notes. The information and opinions concerning the future outlook are based on information available at May 13, 2014.

**In this MD&A, all dollar amounts are expressed in Canadian dollars unless otherwise indicated. Tabular amounts are in millions of dollars, except where noted. All financial data has been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board except where otherwise noted.**

Natural gas volumes are converted to barrels of oil equivalent ("boe") using the ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil ("bbl"). Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead. In accordance with Canadian practice, petroleum and natural gas revenues are reported on a gross basis before deduction of Crown and other royalties.

Additional information concerning Harvest, including its audited annual consolidated financial statements and Annual Information Form ("AIF") can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

**ADVISORY**

This MD&A contains non-GAAP measures and forward-looking information about our current expectations, estimates and projections. Readers are cautioned that the MD&A should be read in conjunction with the "Non-GAAP Measures" and "Forward-Looking Information" sections at the end of this MD&A.

**FINANCIAL AND OPERATING HIGHLIGHTS**

	Three Months Ended March 31	
	2014	2013
<b>UPSTREAM OPERATIONS</b>		
Daily sales volumes (boe/d)	<b>48,487</b>	55,571
Average realized price		
Oil and NGLs (\$/bbl) <sup>(2)</sup>	<b>82.30</b>	69.41
Gas (\$/mcf) <sup>(2)</sup>	<b>6.16</b>	3.46
Operating netback prior to hedging (\$/boe) <sup>(1)</sup>	<b>37.27</b>	27.55
Operating income (loss)	<b>21.8</b>	(22.5)
Cash contribution from operations <sup>(1)</sup>	<b>139.8</b>	122.9
Capital asset additions (excluding acquisitions)	<b>134.3</b>	123.2
Property and business acquisitions (dispositions), net	<b>(2.1)</b>	3.2
Net wells drilled	<b>31.9</b>	44.9
Net undeveloped land additions (acres)	<b>6,444</b>	16,213
<b>BLACKGOLD OIL SANDS</b>		
Capital asset additions	<b>42.2</b>	61.0
<b>DOWNSTREAM OPERATIONS</b>		
Average daily throughput (bbl/d)	<b>95,767</b>	100,074
Average refining gross margin (US\$/bbl) <sup>(1)</sup>	<b>9.58</b>	2.51
Operating income (loss)	<b>31.5</b>	(55.0)
Cash contribution (deficiency) from operations <sup>(1)</sup>	<b>33.7</b>	(33.0)
Capital asset additions	<b>3.1</b>	12.5
<b>NET INCOME (LOSS)<sup>(3)</sup></b>	<b>3.0</b>	(95.4)

(1) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(2) Excludes the effect of risk management contracts designated as hedges.

(3) Net income (loss) includes the consolidated operating results of Harvest's operating segments.

**REVIEW OF OVERALL PERFORMANCE**

**Upstream**

- Sales volumes for the first quarter ended March 31, 2014 decreased by 7,084 boe/d as compared to the same quarter in 2013. The decrease was primarily due to natural declines and dispositions of certain non-core producing properties during the year 2013.
- Operating netback prior to hedging for the first quarter of 2014 was \$37.27/boe, an increase of \$9.72/boe from the same quarter in 2013 mainly due to higher average realized prices, partially offset by higher operating expense and royalties per boe.
- Operating income was \$21.8 million for the first quarter of 2014 (2013 – operating loss of \$22.5 million), an increase of \$44.3 million mainly due to the reduction in DD&A expense and the increase in average realized selling price.

- Cash contribution from Harvest's Upstream operations for the first quarter of 2014 increased \$16.9 million mainly driven by the increase in average realized prices, partially offset by lower sales volumes.
- Capital asset additions of \$134.3 million during the first quarter of 2014 mainly related to the drilling, completion and tie-in of wells. Forty-one gross wells (31.9 net) were rig-released during the first quarter.
- On April 23, 2014, Harvest entered into two joint ventures with KERR Canada Co. Ltd. ("KERR"). See the "2014 Outlook" section for further discussion.

**BlackGold**

- Capital asset additions were \$42.2 million for the first quarter of 2014 mainly related to the construction of the central processing facility ("CPF").
- As at March 31, 2014 Phase 1 of the project was approximately 93% complete. Phase 1 completion, commissioning of the CPF and first steam are expected in 2014.

**Downstream**

- Throughput volume averaged 95,767 bbl/d for the first quarter of 2014 (2013 – 100,074 bbl/d). Reduced throughput was due to lower volumes of vacuum gas oil processed because of constrained market economics.
- Refining gross margin per bbl averaged US\$9.58/bbl during the first quarter of 2014 (2013 - US\$2.51/bbl). The increase in gross margin was mainly due to higher realized product margins as a consequence of improved sour crude differentials.
- Cash contribution from Harvest's Downstream operations was \$33.7 million for the first quarter of 2014 (2013 – deficiency of \$33.0 million). The improvement in Downstream's cash contribution was mainly due to higher average refining gross margin per bbl and improved yield mix as compared to the prior year quarter.
- Operating income totaled \$31.5 million for the first quarter of 2014 (2013 – loss of \$55.0 million). The improvement in operating income is mainly due to the increase in gross margin and reduction in depreciation and amortization.

**Corporate**

- Net income was \$3.0 million for the first quarter of 2014 (2013 – net loss of \$95.4 million). Net income increased in the first quarter of 2014 as compared to the same period in the prior year due to the improvements of the operating income in both the Upstream and Downstream segments in the current quarter as described above, partially offset by greater foreign exchange losses and a lower income tax recovery during the first quarter of 2014.
- On February 28, 2014, Harvest borrowed \$80.0 million under the subordinated loan agreement with KNOC.

**UPSTREAM OPERATIONS**

**Summary of Financial and Operating Results**

	Three Months Ended March 31	
	2014	2013
<b>FINANCIAL</b>		
Petroleum and natural gas sales <sup>(1)</sup>	287.7	268.9
Royalties	(36.2)	(32.7)
<b>Revenues</b>	<b>251.5</b>	<b>236.2</b>
<b>Expenses</b>		
Operating	88.5	91.8
Transportation and marketing	6.3	5.1
Realized gains on risk management contracts <sup>(2)</sup>	(0.5)	(1.8)
Operating netback after hedging <sup>(3)</sup>	157.2	141.1
General and administrative	16.8	17.7
Depreciation, depletion and amortization	109.5	145.2
Exploration and evaluation	8.6	8.5
Unrealized gains on risk management contracts <sup>(4)</sup>	(0.2)	(1.2)
Losses (gains) on disposition of assets	0.7	(6.6)
Operating income (loss)	21.8	(22.5)
Capital asset additions (excluding acquisitions)	134.3	123.2
Property and business acquisitions (dispositions), net	(2.1)	3.2
Decommissioning and environmental remediation expenditures	2.9	5.8
<b>OPERATING</b>		
Light to medium oil (bbl/d)	10,989	13,217
Heavy oil (bbl/d)	15,777	17,227
Natural gas liquids (bbl/d)	4,917	5,953
Natural gas (mcf/d)	100,823	115,050
<b>Total (boe/d)</b>	<b>48,487</b>	<b>55,571</b>

(1) Includes the effective portion of Harvest's realized natural gas and crude oil hedges.

(2) Realized gains on risk management contracts include the settlement amounts for power, crude oil and foreign exchange derivative contracts, excluding the effective portion of realized gains from Harvest's designated accounting hedges. See "Risk Management, Financing and Other" section of this MD&A for details.

(3) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(4) Unrealized gains on risk management contracts reflect the change in fair value of derivative contracts that are not designated as accounting hedges and the ineffective portion of changes in fair value of designated hedges. See "Risk Management, Financing and Other" section of this MD&A for details.

**Commodity Price Environment**

	Three Months Ended March 31		
	2014	2013	Change
West Texas Intermediate ("WTI") crude oil (US\$/bbl)	<b>98.68</b>	94.37	5%
West Texas Intermediate crude oil (\$/bbl)	<b>108.95</b>	95.17	14%
Edmonton light sweet crude oil (\$/bbl)	<b>99.83</b>	88.03	13%
Western Canadian Select ("WCS") crude oil (\$/bbl)	<b>83.36</b>	62.97	32%
AECO natural gas daily (\$/mcf)	<b>5.66</b>	3.20	77%
U.S. / Canadian dollar exchange rate	<b>0.906</b>	0.992	(9%)
<b>Differential Benchmarks</b>			
WCS differential to WTI (\$/bbl)	<b>25.59</b>	32.20	(21%)
WCS differential as a % of WTI	<b>23.5%</b>	33.8%	(31%)

The average WTI benchmark price for the first quarter of 2014 increased 5% compared to 2013. The average Edmonton light sweet crude oil price ("Edmonton Light") increased 13% in the first quarter of 2014 as compared to the first quarter of 2013 mainly due to the increase in the WTI price and the strengthening of the U.S. dollar against the Canadian dollar, partially offset by the widening of the Edmonton light differential.

Heavy oil differentials fluctuate based on a combination of factors including the level of heavy oil production and inventories, pipeline and rail capacity to deliver heavy crude to U.S. markets and the seasonal demand for heavy oil. The increase in the WCS price for the first quarter 2014 as compared to the first quarter of 2013 was mainly the result of the narrowing of the WCS differential to WTI, the increase in the WTI price and the strengthening of the US dollar.

**Realized Commodity Prices**

	Three Months Ended March 31		
	2014	2013	Change
Light to medium oil (\$/bbl)	<b>91.35</b>	80.14	14%
Heavy oil (\$/bbl)	<b>80.25</b>	64.38	25%
Natural gas liquids (\$/bbl)	<b>68.67</b>	60.16	14%
Natural gas prior to hedging (\$/mcf)	<b>6.16</b>	3.46	78%
Average realized price prior to hedging (\$/boe) <sup>(1)</sup>	<b>67.29</b>	53.43	26%
Natural gas after hedging (\$/mcf) <sup>(2)</sup>	<b>5.48</b>	3.50	57%
Average realized price after hedging (\$/boe) <sup>(1) (2)</sup>	<b>65.87</b>	53.52	23%

(1) Inclusive of sulphur revenue.

(2) Inclusive of the realized gains (losses) from contracts designated as hedges. Foreign exchange swaps and power contracts are excluded from the realized price.

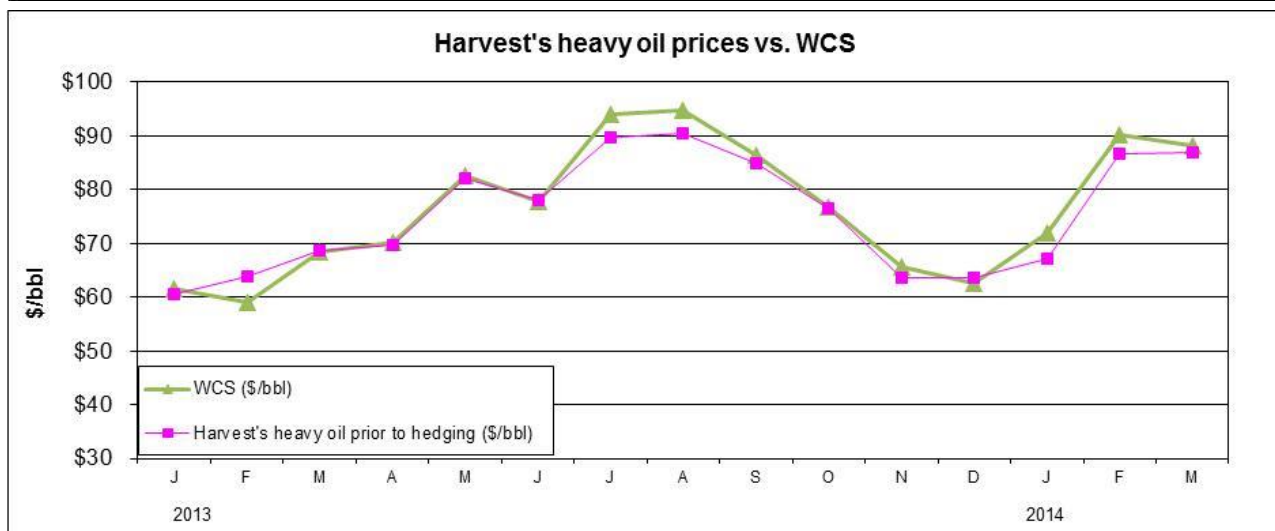
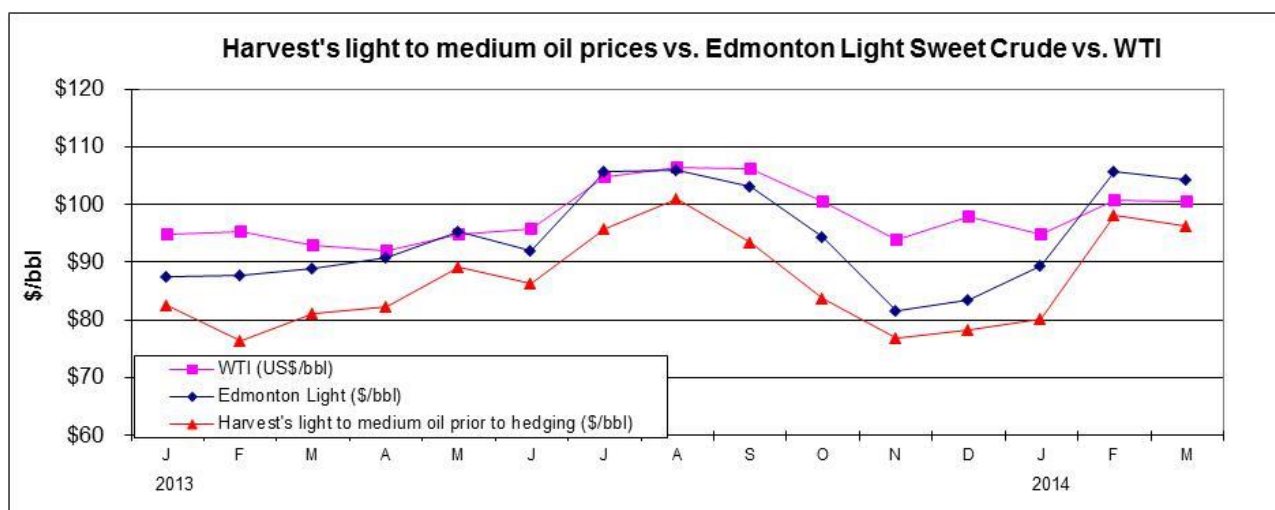
Harvest's realized prices prior to hedging for light to medium oil, heavy oil and natural gas generally trend with the Edmonton Light, WCS and AECO benchmark prices, respectively. For the first quarter of 2014, the period-over-period variances and movements of light to medium oil and natural gas were consistent with the changes in their related benchmarks. Harvest's heavy oil prices for the first quarter of 2014 increased 25% as

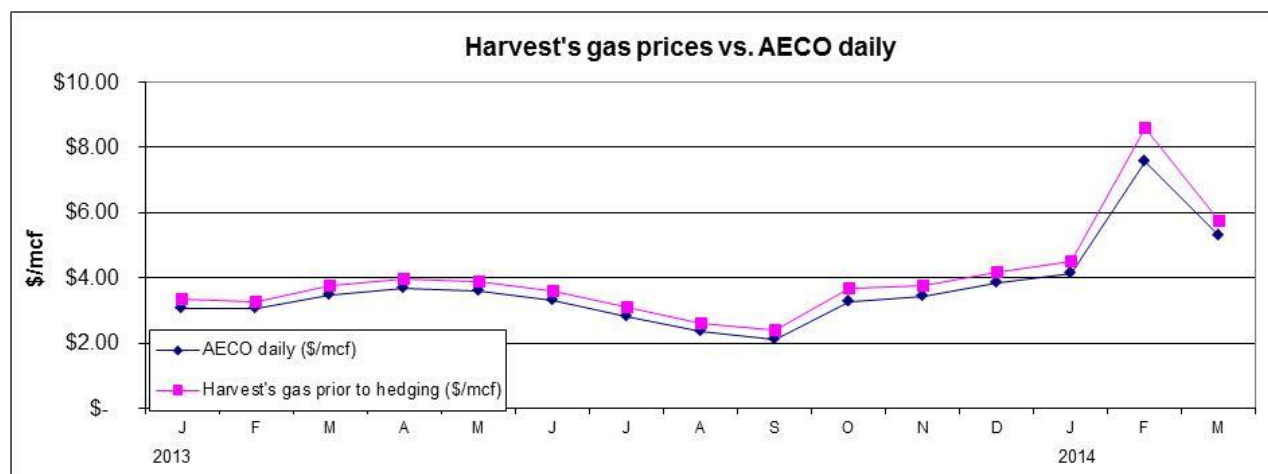
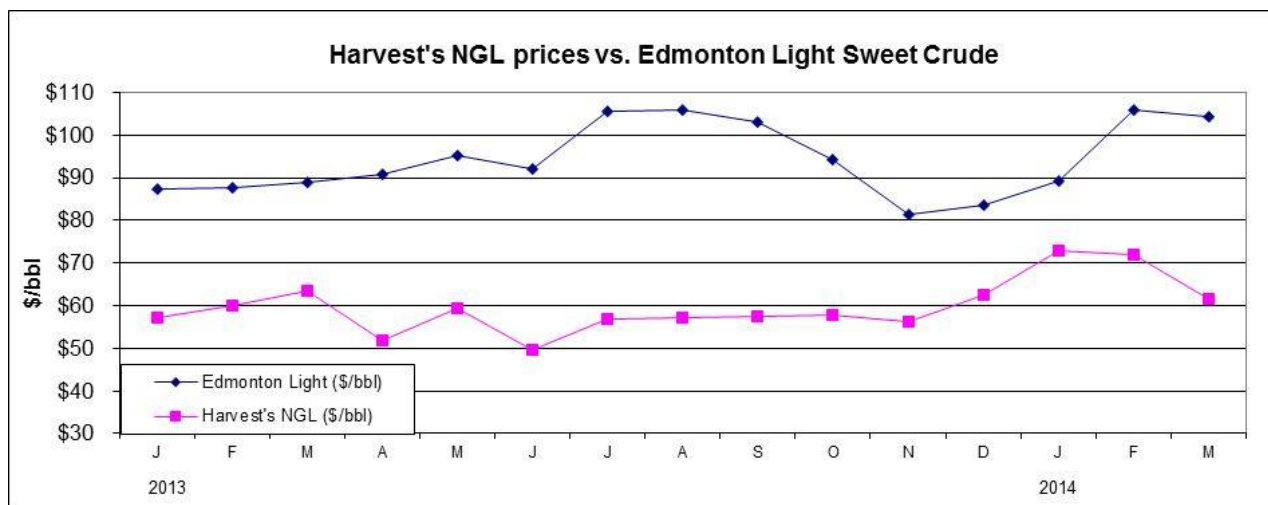


compared to the prior year while the related WCS benchmark increased by 32%. The discrepancy between Harvest's realized price on its heavy oil and the WCS benchmark is due to the fact a portion of our heavy oil volumes are actually sold based on a discounted light to medium price rather than the WCS benchmark. Because light to medium oil prices did not increase by the same percentage as heavy oil prices, a discrepancy between our realized heavy oil price and the WCS benchmark occurred.

Realized natural gas liquids prices increased by 14% for the first quarter 2014 as compared to the same period in the prior year. The increase mainly reflects the increase in the propane price from the first quarter of 2013.

In order to mitigate the risk of fluctuating cash flows due to natural gas volatility, Harvest was party to AECO derivative contracts during the first quarters of 2014 and 2013. Including the impact from the AECO hedges, Harvest's realized natural gas price for the first quarter of 2014 decreased by \$0.68/mcf (2013 – increased by \$0.04/mcf). Please see "Cash Flow Risk Management" section in this MD&A for further discussion with respect to the cash flow risk management program.



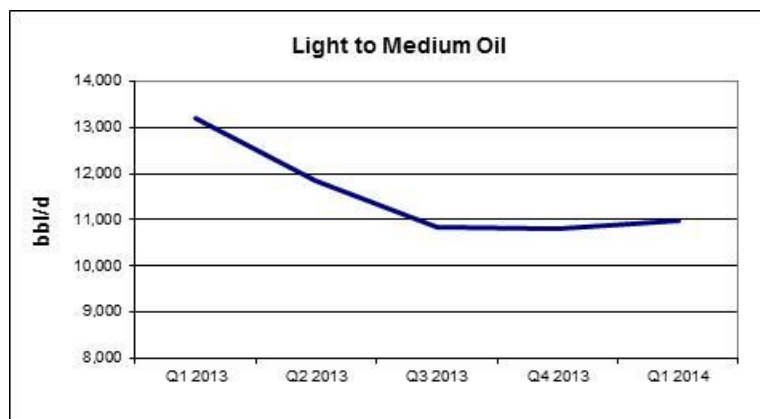


## Sales Volumes

Three Months Ended March 31

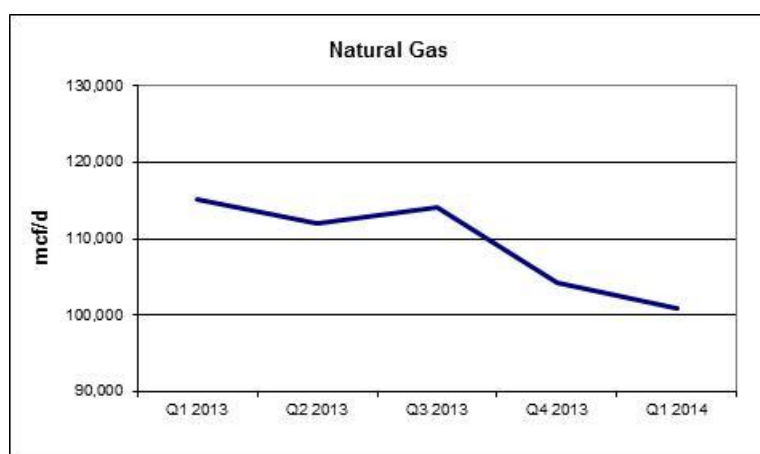
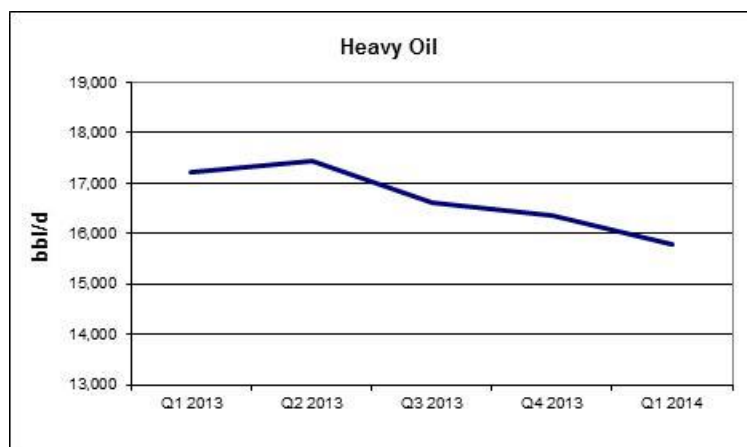
	2014		2013		
	Volume	Weighting	Volume	Weighting	% Volume Change
Light to medium oil (bbl/d)	10,989	23%	13,217	24%	(17%)
Heavy oil (bbl/d)	15,777	33%	17,227	31%	(8%)
Natural gas liquids (bbl/d)	4,917	10%	5,953	11%	(17%)
Total liquids (bbl/d)	31,683	66%	36,397	66%	(13%)
Natural gas (mcf/d)	100,823	34%	115,050	34%	(12%)
Total oil equivalent (boe/d)	48,487	100%	55,571	100%	(13%)





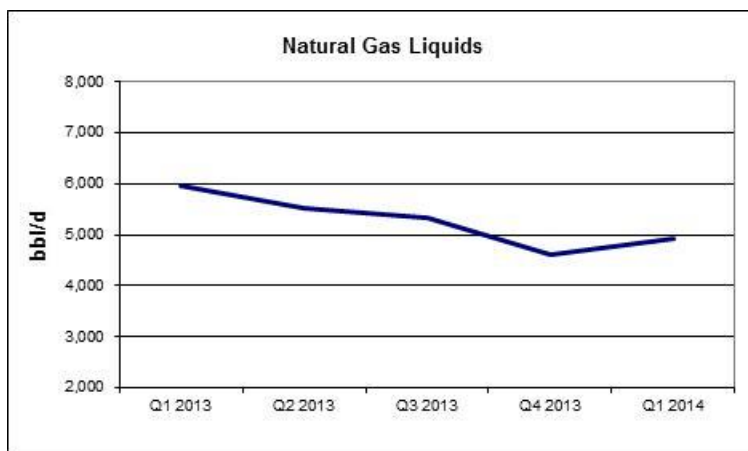
Harvest's average daily sales of light to medium oil decreased 17% for the first quarter of 2014 as compared to the first quarter of 2013. The decrease was due to natural declines and the disposition of non-core properties during 2013, partially offset by the results of Harvest's drilling activity during the first quarter of 2014.

Heavy oil sales for the first quarter of 2014 decreased 8% as compared to the prior year quarter, mainly due to natural declines and the disposition of non-core assets during 2013.



Natural gas sales during the first quarter of 2014 decreased 12% from the first quarter of 2013. The decrease was mainly due to natural declines, third-party facility constraints and the disposition of non-core assets during 2013.

Natural gas liquids sales for the first quarter of 2014 decreased by 17% from the same quarter in 2013. Consistent with natural gas sales volumes the decrease was mainly due to natural declines, third-party facility constraints and the disposition of non-core assets during 2013.



### Revenues

	Three Months Ended March 31		
	2014	2013	Change
Light to medium oil sales	90.4	95.3	(5%)
Heavy oil sales	114.0	99.8	14%
Natural gas sales after hedging <sup>(1)</sup>	49.7	36.3	37%
Natural gas liquids sales	30.4	32.2	(6%)
Other <sup>(2)</sup>	3.2	5.3	(40%)
Petroleum and natural gas sales	287.7	268.9	7%
Royalties	(36.2)	(32.7)	11%
<b>Revenues</b>	<b>251.5</b>	<b>236.2</b>	<b>6%</b>

(1) Inclusive of the effective portion of realized gains (losses) from natural gas contracts designated as hedges.

(2) Inclusive of sulphur revenue and miscellaneous income.

Harvest's revenue is subject to changes in sales volumes, commodity prices, currency exchange rates and hedging activities. In the first quarter of 2014, total petroleum and natural gas sales increased by 7%, mainly due to the 23% increase in realized prices after hedging activities and partially offset by the 13% decrease in sales volumes.

Sulphur revenue represented \$3.0 million of the total in other revenues for the first quarter of 2014 (2013 - \$4.0 million).

### Royalties

Harvest pays Crown, freehold and overriding royalties to the owners of mineral rights from which production is generated. These royalties vary for each property and product and Crown royalties are based on various sliding scales dependent on incentives, production volumes and commodity prices.

For the first quarter of 2014, royalties as a percentage of gross revenue averaged 12.6% (2013 – 12.2%) and were consistent with the same quarter in the prior year.

**Operating and Transportation Expenses**

	Three Months Ended March 31				
	2014	\$/boe	2013	\$/boe	\$/boe Change
Power and purchased energy	21.0	4.82	22.1	4.42	0.40
Well servicing	12.3	2.81	15.9	3.17	(0.36)
Repairs and maintenance	13.3	3.05	14.0	2.80	0.25
Lease rentals and property tax	9.8	2.23	9.4	1.88	0.35
Labor - internal	9.3	2.13	9.7	1.94	0.19
Labor - contract	3.4	0.78	4.2	0.84	(0.06)
Chemicals	5.6	1.29	6.1	1.22	0.07
Trucking	3.4	0.78	3.5	0.69	0.09
Processing and other fees	8.8	2.02	10.4	2.07	(0.05)
Other	1.6	0.38	(3.5)	(0.71)	1.09
Total operating expenses	88.5	20.29	91.8	18.32	1.97
Transportation and marketing	6.3	1.43	5.1	1.02	0.41

Operating expenses for the first quarter of 2014 decreased by \$3.3 million compared to the same period in 2013. The lower operating expenses were mainly attributable to the decrease in well servicing expenses. Operating costs on a per barrel basis increased by 11% to \$20.29/boe for the first quarter of 2014 mainly due to lower sales volumes.

	Three Months Ended March 31		
(\$/boe)	2014	2013	Change
Power and purchased energy costs	4.82	4.42	0.40
Realized gains on electricity risk management contracts	(0.11)	(0.05)	(0.06)
Net power and purchased energy costs	4.71	4.37	0.34
Alberta Power Pool electricity price (\$/MWh)	61.75	64.12	(2.37)

Power and purchased energy costs, comprised primarily of electric power costs, represented approximately 24% of total operating expenses for the first quarter of 2014 (2013 – 24%). Power and purchased energy costs per boe were relatively consistent between the first quarters of 2014 and 2013 due to the comparable levels of operating activity and only a \$2.37/MWh change in the average Alberta electricity price.

Transportation and marketing expenses relate primarily to delivery of natural gas to the Nova Gas Transmission Limited System and the cost of trucking crude oil to pipeline or rail receipt points. As a result, the total dollar amount of costs generally fluctuates in relation to sales volumes. In the first quarter of 2014 higher transportation costs were incurred in the Deep Basin and Hayter areas due to facility restrictions as compared to the same period in the prior year. As such, despite the lower sales volumes for the first quarter of 2014, transportation and marketing expenses increased by \$1.2 million as compared to the same period in 2013.

**Operating Netback<sup>(1)</sup>**

	Three Months Ended March 31		
(\$/boe)	2014	2013	\$/boe Change
Petroleum and natural gas sales prior to hedging <sup>(2)</sup>	<b>67.29</b>	53.43	13.86
Royalties	<b>(8.30)</b>	(6.54)	(1.76)
Operating expenses	<b>(20.29)</b>	(18.32)	(1.97)
Transportation and marketing	<b>(1.43)</b>	(1.02)	(0.41)
Operating netback prior to hedging <sup>(1)</sup>	<b>37.27</b>	27.55	9.72
Hedging (loss) gain <sup>(3)</sup>	<b>(1.30)</b>	0.45	(1.75)
Operating netback after hedging <sup>(1)</sup>	<b>35.97</b>	28.00	7.97

(1) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(2) Excludes miscellaneous income not related to oil and gas production

(3) Hedging (loss) gain include the settlement amounts for natural gas, crude oil and power contracts.

**General and Administrative ("G&A") Expenses**

	Three Months Ended March 31	
	2014	2013
G&A	<b>16.8</b>	17.7
G&A (\$/boe )	<b>3.85</b>	3.54

For the first quarter of 2014, G&A expenses decreased \$0.9 million from same period in the prior year. Harvest does not have a stock option program, however there is a long-term incentive program which is a cash settled plan that has been included in the G&A expense.

**Depletion, Depreciation and Amortization ("DD&A") Expenses**

	Three Months Ended March 31	
	2014	2013
DD&A	<b>109.5</b>	145.2
DD&A (\$/boe)	<b>25.09</b>	29.03

DD&A expenses for the first quarter of 2014 decreased by \$35.7 million as compared to the first quarter of 2013 mainly due to a change in Harvest's DD&A accounting estimate in the fourth quarter of 2013, as well as lower sales volumes in the first quarter of 2014.

**Capital Asset Additions**

	Three Months Ended March 31	
	2014	2013
Drilling and completion	<b>81.8</b>	78.3
Well equipment, pipelines and facilities	<b>43.2</b>	32.2
Geological and geophysical	<b>4.6</b>	7.5
Land and undeveloped lease rentals	<b>0.6</b>	1.1
Corporate	<b>1.5</b>	1.3
Other	<b>2.6</b>	2.8
Total additions excluding acquisitions	<b>134.3</b>	123.2

Total capital additions were greater for the first quarter of 2014 as compared to the same period in the prior year mainly due to the drilling of deeper and more expensive wells, especially in the Red Earth and Deep Basin areas, in the current quarter.

The following table summarizes the wells drilled by Harvest and the related drilling and completion costs incurred in the period. A well is recorded in the table as having being drilled after it has been rig-released, however related drilling costs may be incurred in a period before a well has been spud (including survey, lease acquisition and construction costs) and related completion costs may be incurred in a period afterwards, depending on the timing of the completion work.

Area	Three Months Ended March 31, 2014		
	Gross	Net	Drilling and completion
Red Earth	5.0	4.9	\$ 25.6
Hay River	16.0	16.0	20.4
Deep Basin	7.0	2.8	15.4
Western Alberta	5.0	1.8	6.8
Cecil	2.0	2.0	3.5
Suffield	2.0	2.0	2.9
Heavy Oil	1.0	1.0	2.2
Other areas	3.0	1.4	5.0
<b>Total</b>	<b>41.0</b>	<b>31.9</b>	<b>\$ 81.8</b>

During the first quarter of 2014, Harvest continued to concentrate its drilling activities in certain of its core growth areas: Deep Basin, Hay River and Red Earth; supplemented with drilling in the strategic revenue generating areas in Western Alberta and the Heavy Oil area. The primary areas of focus for Harvest's Upstream drilling program are as follows:

- Deep Basin – participating or drilling deep, horizontal multi-stage fractured wells to develop the liquids-rich Falher and Montney liquids-rich gas formations;
- Hay River – pursuing heavy gravity oil in the Bluesky formation using multi-leg horizontal oil wells;
- Red Earth – activities are spread across the Loon Lake, Gift, Evi and Golden areas targeting light oil formations primarily in the Slave Point and also the Gilwood;
- Western Alberta – activities spread across several fields with recent efforts targeting mainly the Cardium, Glauconite, Ostracod, and Notikewin formations;
- Heavy Oil area – horizontal heavy oil wells in the Lloydminster region of Alberta into the McLaren, Lloydminster, Grand Petroleum and Sparky formations.

### **Decommissioning Liabilities**

Harvest's Upstream decommissioning liabilities at March 31, 2014 were \$714.4 million (December 31, 2013 - \$709.4 million) for future remediation, abandonment, and reclamation of Harvest's oil and gas properties. The total of the decommissioning liabilities are based on management's best estimate of costs to remediate, reclaim, and abandon wells and facilities. The costs will be incurred over the operating lives of the assets with the majority being at or after the end of reserve life. Please refer to the "Contractual Obligations and

Commitments" section of this MD&A for the payments expected for each of the next five years and thereafter in respect of the decommissioning liabilities.

## **BLACKGOLD OIL SANDS**

### **Capital Asset Additions**

	Three Months Ended March 31	
	2014	2013
Drilling and completion	—	3.6
Well equipment, pipelines and facilities	33.0	55.3
Pre-operating costs	0.1	—
Land and undeveloped lease rentals	0.4	0.1
Other	8.7	2.0
Total BlackGold additions	42.2	61.0

During the first quarter of 2014, Harvest invested \$33.0 million on the CPF. As at March 31, 2014, the overall oil sands project was approximately 93% complete.

### **Oil Sands Project Development**

Harvest is developing its BlackGold oil sands CPF under the engineering, procurement and construction ("EPC") contract. Expected total costs under the EPC contract are approximately \$650 million. Under the EPC contract, a maximum of approximately \$101 million of the EPC costs will be paid in equal installments, without interest, over 10 years commencing on the completion of the EPC work in 2014. The liability is considered a financial liability and is initially recorded at fair value, which is estimated as the present value of all future cash payments discounted using the prevailing market rate of interest for similar instruments. As at March 31, 2014, Harvest recognized a liability of \$76.2 million (December 31, 2013 - \$76.2 million) using a discount rate of 4.5% (December 31, 2013 - 4.5%). Non-cash capital additions are recognized in well equipment, pipelines and facilities as the work is performed and the related deferred EPC liability is recognized. For the first quarter of 2014, no non-cash adjustments were recorded relating to the EPC contract (2013 – \$10.3 million non-cash addition).

Initial drilling of 30 steam assisted gravity drainage ("SAGD") wells (15 well pairs) was completed by the end of 2012. More SAGD wells will be drilled in the future to compensate for the natural decline in production of the initial well pairs and maintain the Phase 1 production capacity of 10,000 bbl/d. Preliminary construction has been substantially completed, including the building of the CPF plant site, the placement of site equipment and pipe rack module installation. Piping and cabling of the CPF are now ongoing. Commissioning of the CPF and first steam is anticipated in the fourth quarter of 2014. Phase 2 of the project, which is targeted to increase production capacity to 30,000 bbl/d, received all required regulatory approvals in 2013.

As at March 31, 2014, Harvest has incurred costs of \$580.5 million on the EPC contract. After the accounting impact of the deferred liability described above, Harvest has recorded \$561.6 million of costs for the EPC contract and has recorded \$773.1 million of costs on the entire project since acquiring the BlackGold assets in 2010.



The BlackGold project faces similar cost and schedule pressures as other oil sand projects, including shortage of skilled labor and rising costs.

### **Decommissioning Liabilities**

Harvest's BlackGold decommissioning liabilities at March 31, 2014 were \$34.7 million (December 31, 2013 - \$34.3 million) relating to the future remediation, abandonment, and reclamation of the SAGD wells and CPF. Please see the "Contractual Obligations and Commitments" section of this MD&A for the payments expected for each of the next five years and thereafter in respect of the decommissioning liabilities.

## **DOWNSTREAM OPERATIONS**

### **Summary of Financial and Operating Results**

	Three Months Ended March 31	
	2014	2013
<b>FINANCIAL</b>		
Refined products sales <sup>(1)</sup>	1,113.4	1,122.0
Purchased products for processing and resale <sup>(1)</sup>	1,008.0	1,086.4
Gross margin <sup>(2)</sup>	105.4	35.6
Operating expense	30.7	34.0
Purchased energy expense	37.9	33.1
Marketing expense	1.7	1.5
General and administrative	0.2	0.2
Depreciation and amortization	3.6	21.8
Gains on disposition of assets	(0.2)	—
Operating income (loss)	31.5	(55.0)
Capital expenditures	3.1	12.5
<b>OPERATING</b>		
Feedstock volume (bbl/d) <sup>(3)</sup>	95,767	100,074
Yield (% of throughput volume) <sup>(4)</sup>		
Gasoline and related products	32%	29%
Ultra low sulphur diesel and jet fuel	37%	35%
High sulphur fuel oil and other	28%	34%
Total	97%	98%
Average refining gross margin (US\$/bbl) <sup>(5)</sup>	9.58	2.51

(1) Refined product sales and purchased products for processing and resale are net of intra-segment sales of \$150.1 million for the three months ended March 31, 2014 (2013 - \$133.4 million), reflecting the refined products produced by the refinery and sold by the marketing division.

(2) These are non-GAAP measures; please refer to "Non-GAAP Measures" in this MD&A.

(3) Barrels per day are calculated using total barrels of crude oil feedstock and purchased vacuum gas oil.

(4) Based on production volumes after adjusting for changes in inventory held for resale.

(5) Average refining gross margin is calculated based on per barrel of feedstock throughput.

**Refining Benchmark Prices**

	Three Months Ended March 31		
	2014	2013	Change
WTI crude oil (US\$/bbl)	<b>98.68</b>	94.37	5%
Brent crude oil (US\$/bbl)	<b>107.95</b>	112.62	(4%)
Argus sour crude index ("ASCI") (US\$/bbl)	<b>100.51</b>	108.97	(8%)
Brent – WTI differential (US\$/bbl)	<b>9.27</b>	18.25	(49%)
Brent – ASCI differential (US\$/bbl)	<b>7.44</b>	3.65	104%
Refined product prices			
Platts RBOB (US\$/bbl)	<b>113.61</b>	122.42	(7%)
Platts Ultra Low Sulfur Diesel (US\$/bbl)	<b>128.02</b>	130.63	(2%)
Platts High Sulphur Fuel Oil (US\$/bbl)	<b>91.68</b>	97.52	(6%)
U.S. / Canadian dollar exchange rate	<b>0.906</b>	0.992	(9%)

**Summary of Gross Margins**

	Three Months Ended March 31					
	2014			2013		
	Volumes (million bbls)	(US\$/bbl)		Volumes (million bbls)	(US\$/bbl)	
<b>Refinery</b>						
<b>Sales</b>						
Gasoline products	<b>383.6</b>	<b>3.1</b>	<b>110.24</b>	347.3	2.9	117.00
Distillates	<b>458.4</b>	<b>3.3</b>	<b>125.78</b>	427.7	3.3	128.10
High sulphur fuel oil	<b>209.5</b>	<b>2.2</b>	<b>87.29</b>	224.2	2.4	92.81
Other <sup>(1)</sup>	<b>23.1</b>	<b>0.2</b>	<b>113.70</b>	87.0	0.8	110.20
Total sales	<b>1,074.6</b>	<b>8.8</b>	<b>110.47</b>	1,086.2	9.4	114.19
<b>Feedstock</b> <sup>(2)</sup>						
Crude oil	<b>912.0</b>	<b>8.5</b>	<b>97.51</b>	905.7	8.3	108.62
Vacuum Gas Oil ("VGO")	<b>17.3</b>	<b>0.1</b>	<b>108.26</b>	83.9	0.7	113.26
Total feedstock	<b>929.3</b>	<b>8.6</b>	<b>97.69</b>	989.6	9.0	108.99
Other <sup>(3)</sup>	<b>54.2</b>			73.8		
Total feedstock and other costs	<b>983.5</b>			1,063.4		
<b>Refinery gross margin</b> <sup>(4)</sup>	<b>91.1</b>	<b>9.58</b>		22.8		2.51
<b>Marketing</b>						
Sales	<b>188.9</b>			169.2		
Cost of products sold	<b>174.6</b>			156.4		
<b>Marketing gross margin</b> <sup>(4)</sup>	<b>14.3</b>			12.8		
<b>Total gross margin</b> <sup>(4)</sup>	<b>105.4</b>			35.6		

(1) Includes sales of vacuum gas oil and hydrocracker bottoms.

(2) Cost of feedstock includes all costs of transporting the crude oil to the refinery in Newfoundland.

(3) Includes inventory adjustments, additives and blendstocks and purchased product for resale.

(4) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

Feedstock throughput averaged 95,767 bbl/d in the first quarter of 2014, 4% lower than the 100,074 bbl/d average feedstock in the first quarter of the prior year. The isomax throughput rate in the first quarter of 2014 was limited to process only the internally produced VGO as market economics did not dictate purchasing additional VGO to take advantage of the excess unit capacity. Crude feedstock throughput was higher this year, averaging 94,163 bbl/d compared to 91,904 bbl/d in 2013. The daily average throughput rate for 2013 was affected by an unplanned two-week outage in February due to a power failure during a storm, followed by a partial outage in March for additional repairs. Crude throughput rates in 2014 have been negatively impacted by a weather related power outage in January resulting in an unplanned one week unit outage.

The table below provides a comparison between the product crack spreads realized by Downstream and the benchmark crack spread for the three months ended March 31 2014 and 2013, with both crack spreads referring to the price of Brent crude oil.

Three Months Ended March 31						
	2014			2013		
	Refinery	Benchmark <sup>(1)</sup>	Difference	Refinery	Benchmark <sup>(1)</sup>	Difference
Gasoline products (US\$/bbl)	<b>12.55</b>	<b>5.66</b> <sup>(2)</sup>	<b>6.89</b>	8.01	9.80 <sup>(2)</sup>	(1.79)
Distillates (US\$/bbl)	<b>28.09</b>	<b>20.07</b> <sup>(2)</sup>	<b>8.02</b>	19.11	18.01 <sup>(3)</sup>	1.10
High Sulphur Fuel Oil (US\$/bbl)	<b>(10.40)</b>	<b>(16.27)</b> <sup>(3)</sup>	<b>(5.87)</b>	(16.18)	(15.10) <sup>(4)</sup>	(1.08)

(1) Benchmark product crack is relative to Brent crude oil

(2) RBOB and ultra low sulfur diesel benchmark market prices sourced from Platts.

(3) High Sulphur Fuel Oil benchmark market price sourced from Platts. Our high sulphur fuel oil normally contains higher sulphur content than the 3% content reflected in the benchmark price.

Downstream's product crack spreads are different from the above noted benchmarks due to several factors, including the timing of actual sales and feedstock purchases differing from the calendar month benchmarks, transportation costs, sour crude differentials, quality differentials and variability in the throughput volume over a given period of time. The refinery sales also include products for which market prices are not reflected in the benchmarks. Downstream's crack spreads for gasoline products and distillates in the above tables include the actual cost of renewable identification numbers ("RINS") that are necessary to meet blending requirements for RBOB gasoline and ultra-low sulphur diesel ("ULSD") in the US market as mandated by the US government. Our average RINs cost for the three months ended March 31, 2014 was approximately US\$2.00/bbl each for RBOB gasoline and ULSD products compared to US\$2.00/bbl and US\$1.45/bbl, respectively, for the same period in the prior year. For more detail on RINs, see "Operational and Other Business Risks".

Our refinery sales decreased by \$11.6 million in the first quarter of 2014 from \$1,086.2 million in the same period of 2013 mainly as a result of lower sales volume and lower realized product prices partially offset by a gain on the U.S. exchange rate. The lower realized product prices are consistent with changes in the benchmark market prices.

The refinery gross margin for the three months ended March 31, 2014 was nearly four times more than the \$22.8 million as reported in the same period of the prior year mainly due to higher realized product margins as a consequence of wider sour crude differentials. The cost of our crude feedstock in the first quarter of 2014

was a US\$10.44/bbl discount to the benchmark Brent crude oil as compared to a discount of US\$4.00/bbl in the same period of the prior year.

The overall gross margin for our refinery is also impacted by the purchasing of blendstocks to meet summer gasoline specifications, additives to meet product specifications, the build of unfinished saleable products some of which are recorded at a value lower than cost, and inventory write-downs and reversals. These costs are included in "other costs" in the Summary of Gross Margin Table above. The decrease in other costs of \$19.6 million for the three months ended March 31, 2014 is mainly due to the sale and consumption of products in the first quarter of the prior year that were previously held in inventory.

The gross margin from the marketing operations is comprised of the margin from both the retail and wholesale distribution of gasoline and home heating fuels as well as the revenues from marine services including tugboat revenues and reflects a 12% improvement for the three months ended March 31, 2014 as compared to the same period in 2013.

During the first quarter of this year, the Canadian dollar weakened as compared to the US dollar. As seen in the gross margin table, the weakening of the Canadian dollar has had a positive impact to the contribution from the refinery operations relative to the prior year as substantially all of its gross margin, cost of purchased energy and marketing expense are denominated in U.S. dollars.

### Operating Expenses

	Three Months Ended March 31					
	2014			2013		
	Refining	Marketing	Total	Refining	Marketing	Total
Operating cost	25.7	5.0	30.7	28.7	5.3	34.0
Purchased energy	37.9	-	37.9	33.1	-	33.1
	63.6	5.0	68.6	61.8	5.3	67.1
(\$/bbl of feedstock throughput)						
Operating cost	2.98	-	-	3.19	-	-
Purchased energy	4.39	-	-	3.67	-	-
	7.37	-	-	6.86	-	-

The refining operating cost per barrel of feedstock throughput decreased by 7% in the first quarter of 2014 as compared to the prior year mainly as a result of lower operating costs partially offset by lower throughput rates. Operating costs in 2013 include those associated with the February outage.

Purchased energy, consisting of LSFO and electricity, is required to provide heat and power to refinery operations. The purchased energy cost per barrel of feedstock throughput increased by 20% during the three months ended March 31, 2014 from the same period of 2013 mainly due to a lower consumption of produced fuel gas.

### Capital Assets Additions

Capital asset additions for the three months ended March 31, 2014 totaled \$3.1 million (2013 - \$12.5 million), relating to various maintenance and sustaining projects.

### Depreciation and Amortization Expense

	Three Months Ended March 31	
	2014	2013
Refining	2.8	20.8
Marketing	0.8	1.0
Total depreciation and amortization	3.6	21.8

Depreciation and amortization expense decreased \$18.2 million for the three months ended March 31, 2014 as compared to 2013 because of the \$458.9 million impairment of refinery property, plant and equipment which occurred in the fourth quarter of 2013. The process units are amortized over an average useful life of 20 to 35 years and turnaround costs are amortized to the next scheduled turnaround.

### Decommissioning Liabilities

Harvest's Downstream decommissioning liabilities result from the ownership of the refinery and marketing assets. At March 31, 2014, Downstream's decommissioning liabilities were \$16.8 million (December 31, 2013 – \$16.7 million) relating to the reclamation and abandonment of these assets with an expected abandonment date of 2069. Please see "Contractual Obligations and Commitments" section of this MD&A for the payments expected for each of the next five years and thereafter in respect of the decommissioning liabilities.

## RISK MANAGEMENT, FINANCING AND OTHER

### Cash Flow Risk Management

The Company at times enters into natural gas, crude oil, electricity and foreign exchange contracts to reduce the volatility of cash flows from some of its forecast sales and purchases, and when allowable, will designate these contracts as cash flow hedges. The WCS price swap and foreign exchange swap were entered into concurrently and complement each other. The WCS swap mitigates crude oil price risk by fixing a certain U.S. dollar price per barrel on certain heavy oil volumes. The foreign exchange swap mitigates currency exchange risk by swapping the U.S. dollar notional value of the WCS price swap back to Harvest's functional currency, the Canadian dollar. The following is a summary of Harvest's risk management contracts outstanding at March 31, 2014:

#### Contracts Designated as Hedges

Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
44,600 GJ/day	AECO swap	Apr - Dec 2014	\$3.76/GJ	(8.2)
4,500 bbls/day	WCS price swap	Apr - Dec 2014	US\$76.81/bbl	(1.8)
US\$0.3 million/day	Foreign exchange swap	Apr - Dec 2014	\$1.1123 Cdn/US	–
				(10.0)

**Contracts Not Designated as Hedges**

Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
35 MWh	AESO power swap	Apr - Dec 2014	\$54.74/MWh	(0.2)
5 MWh	AESO power swap	Jan - Dec 2015	\$49.50/MWh	0.1
US\$4.5 million	Foreign exchange swap	Apr-14	\$1.1177 Cdn/US	(0.1)
				(0.2)

The following is a summary of Harvest's realized and unrealized (gains) losses on risk management contracts:

	Three Months Ended March 31, 2014				
	Power	Crude Oil	Currency	Natural Gas	Total
Realized (gains) losses recognized in:					
Revenues	–	–	–	6.2	6.2
Risk management (gains) losses	(0.5)	–	–	–	(0.5)

Unrealized (gains) losses recognized in:					
OCI, before tax	–	1.7	–	14.5	16.2
Risk management (gains) losses	(0.4)	0.2	–	–	(0.2)

	Three Months Ended March 31, 2013				
	Power	Crude Oil	Currency	Natural Gas	Total
Realized (gains) losses recognized in:					
Revenues	–	–	–	(0.4)	(0.4)
Risk management (gains) losses	(0.3)	–	(1.5)	–	(1.8)

Unrealized (gains) losses recognized in:					
OCI, before tax	–	1.6	–	1.5	3.1
Risk management (gains) losses	(0.3)	–	(0.9)	–	(1.2)

**Financing Costs**

	Three Months Ended March 31	
	2014	2013
Credit facility	6.6	4.2
Convertible debentures	–	10.6
6 $\frac{7}{8}$ % senior notes	9.9	9.0
2 $\frac{1}{8}$ % senior notes <sup>(1)</sup>	4.8	–
Related party loans	4.0	2.0
Amortization of deferred finance charges and other	0.6	0.2
Interest and other financing charges	25.9	26.0
Accretion of decommissioning and environmental remediation liabilities	5.8	5.6
Less: capitalized interest	(7.2)	(4.1)
	24.5	27.5

(1) Includes guarantee fee to KNOC.



No interest was paid on convertible debentures in the first quarter of 2014 as all remaining convertible debentures were redeemed in the second quarter 2013.

In May 2013, Harvest issued US\$630 million 2½% senior notes resulting in an interest expense and other financing costs of \$4.8 million for the first quarter of 2014.

**Currency Exchange**

Currency exchange gains and losses are attributed to the changes in the value of the Canadian dollar relative to the U.S. dollar on the U.S. dollar denominated 6⅞% and 2½% senior notes, the ANKOR related party loan and on any U.S. dollar denominated monetary assets or liabilities. As Downstream operations' functional currency is denominated in U.S. dollars, the strengthening (weakening) of the U.S. dollar would result in unrealized currency exchange gains (losses) from its decommissioning liabilities, pension obligations, accounts payable and other balances that are denominated in Canadian dollars, which will partially offset Upstream's unrealized losses (gains) recognized on the 6⅞% and 2½% senior notes, ANKOR loan and any U.S. dollar denominated monetary items. At March 31, 2014, the Canadian dollar had weakened compared to the US dollar as at December 31, 2013 resulting in an unrealized foreign exchange loss of \$30.2 million for the first quarter of 2014 (2013 - \$3.8 million). Harvest recognized a realized foreign exchange loss of \$2.0 million for the first quarter ended March 31, 2014 (2013 - \$2.0 million) as a result of the settlement of U.S. dollar denominated transactions.

The cumulative translation adjustment recognized in other comprehensive loss represents the translation of the Downstream operations' U.S. dollar functional currency financial statements to Canadian dollars. During the first quarter of 2014, Downstream operations incurred a net cumulative translation loss of \$15.4 million (2013 – gain of \$4.3 million) reflecting the changes in the Canadian dollar relative to the U.S. dollar on the negative value of Harvest's net investment in the Downstream segment at March 31, 2014 compared to December 31, 2013.

**Deferred Income Taxes**

For the three months ending March 31, 2014 Harvest recorded a deferred income tax recovery of \$6.4 million (2013 –\$15.4 million). Harvest's deferred income tax asset (liability) will fluctuate during each accounting period to reflect changes in the temporary differences between the book value and tax basis of assets as well as legislative tax rate changes. Currently, the principal sources of temporary differences relate to the Company's property, plant and equipment, decommissioning liabilities and the unclaimed tax pools.

**Related Party Transactions**

The following provides a summary of the related party transactions between Harvest and KNOC for the three months ended March 31, 2014:

*Related Party Loans*

- On December 30, 2013, Harvest entered into a subordinated loan agreement with KNOC to borrow up to \$200 million at a fixed interest rate of 5.3% per annum. The full principal and accrued interest is payable on December 30, 2018. At March 31, 2014, Harvest has drawn \$160 million from the \$200 million available under the loan agreement (December 31, 2013 - \$80 million). The loan amount was

recorded at fair value on initial recognition by discounting the future cash payments at the rate of 7% which is considered the market rate applicable to the liability. The difference between the fair value and the loan amount was recognized in contributed surplus. As at March 31, 2014, \$8.4 million (December 31, 2013 - \$4.3 million) have been recognized in contributed surplus related to the KNOC loan. For the three months ended March 31, 2014, interest expense of \$1.8 million was recorded (2013 - \$nil), of which \$1.6 million remains outstanding as at March 31, 2014. The availability of any undrawn amounts under the facility will expire on December 31, 2014.

- On August 16, 2012, Harvest entered into a subordinated loan agreement with ANKOR to borrow US\$170 million at a fixed interest rate of 4.62% per annum. The principal balance and accrued interest is payable on October 2, 2017. At March 31, 2014, Harvest's related party loan from ANKOR included \$187.9 million (December 31, 2013 - \$180.8 million) of principal and \$0.8 million (December 31, 2013 - \$3.0 million) of accrued interest. Interest expense was \$2.2 million for the three months ended March 31, 2014 (2013 - \$2.0 million).

*Other Related Party Transactions*

	<b>Transactions</b>		<b>Balance Outstanding</b>			
	Three Months Ended March 31		Accounts Receivable as at		Accounts Payable as at	
	2014	2013	March 31, 2014	December 31, 2013	March 31, 2013	December 31, 2012
<b>Revenues</b>						
Other KNOC Subsidiaries <sup>(1)</sup>	0.1	0.2	–	–	–	–
<b>Operating Expenses</b>						
Other KNOC Subsidiaries <sup>(2)</sup>	–	0.1	–	–	–	–
<b>G&amp;A Expenses</b>						
KNOC <sup>(3)</sup>	(1.1)	(0.4)	0.6	–	2.0	0.5
<b>Finance Costs</b>						
KNOC <sup>(4)</sup>	1.0	–	–	–	1.5	0.5

<sup>(1)</sup> On February 28, 2014 KNOC purchased 100% of the shares of KNOC Trading Corporation for US\$0.4 million. Prior to the sale of KNOC Trading Corporation ("KNOC Trading"), KNOC Trading was a wholly owned subsidiary of North Atlantic. KNOC Trading bills Ankor E&P Holdings Corp. ("ANKOR") and Dana Petroleum plc ("Dana") for oil marketing services, such as the sale of products, performed on behalf of ANKOR and Dana. Both ANKOR and Dana are wholly owned subsidiaries of KNOC.

<sup>(2)</sup> Billing from Ankor for office rent and salaries and benefits related to KNOC Trading.

<sup>(3)</sup> Global Technology and Research Centre ("GTRC") is used as a training and research facility for KNOC. Amounts relate to the reimbursement from KNOC for general and administrative expenses incurred by the GTRC. Also included is Harvest's reimbursement to KNOC for secondees salaries paid by KNOC on behalf of Harvest.

<sup>(4)</sup> Charges from KNOC for the irrevocable and unconditional guarantee they provided on Harvest's 2½% senior notes and the senior unsecured credit facility. A guarantee fee of 52 basis points per annum is charged by KNOC.

The Company identifies its related party transactions by: making inquiries of management and the Board of Directors, reviewing KNOC's subsidiaries and associates, and performing a comprehensive search of transactions recorded in the accounting system. Material related party transactions require the Board of Directors' approval.

**CAPITAL RESOURCES**

The following table summarizes Harvest's capital structure and provides the key financial ratios defined in the credit facility agreement.

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Debt</b>		
Credit facility <sup>(1)</sup>	<b>695.1</b>	788.5
6 $\frac{7}{8}$ % senior notes (US\$500 million) <sup>(2)</sup>	<b>552.8</b>	531.8
2 $\frac{1}{8}$ % senior notes (US\$630 million) <sup>(2)</sup>	<b>696.5</b>	670.1
Related party loans (US\$170 million and CAD\$160 million) <sup>(2)</sup>	<b>347.9</b>	260.8
	<b>2,292.3</b>	2,251.2
<b>Shareholder's Equity</b>		
386,078,649 common shares issued <sup>(3)</sup>	<b>1,922.5</b>	1,939.2
	<b>4,214.8</b>	4,190.4
<b>Financial Ratios</b> <sup>(4) (5)</sup>		
Senior debt to annualized EBITDA	<b>1.77</b>	2.41
Annualized EBITDA to annualized interest expense	<b>4.56</b>	3.62
Senior debt to total capitalization	<b>18%</b>	22%
Total debt to total capitalization	<b>45%</b>	54%

(1) The credit facility net of deferred financing costs is \$692.0 million (December 31, 2013 - \$785.2 million).

(2) Face value converted at the period end exchange rate.

(3) As at May 13, 2014, the number of common shares issued is 386,078,649.

(4) Calculated based on Harvest's credit facility covenant requirements.

(5) The financial ratios and their components are non-GAAP measures; please refer to the "Non-GAAP Measures" section of this MD&A.

On April 15, 2014, Harvest amended its credit facility to accommodate the progression of non-wholly owned partnership and joint venture arrangements for the development of Company lands. The amendments included provisions that allow the formation, operation and funding of partnerships that Harvest does not fully own, within specific parameters regarding the amount of assets and production contributed to such non-wholly owned partnership and joint venture arrangements. Limitation on distributions has been amended to allow distributions to Harvest or third parties by a joint venture partnership under specific provisions. The definitions for financial measures that are used in covenant ratios, including annualized EBITDA, total debt and senior debt have also been amended to accommodate the partnership and joint venture arrangements. In addition, the amendment removed Harvest's option to cause the BlackGold assets to be removed from the security package of the credit facility, effectively enabling the Company to recognize equity related to BlackGold of \$457.5 million as at March 31, 2014 for purposes of total capitalization, and specified an incremental amount of \$229.5 million to be added to total capitalization for purposes of the total debt to total capitalization covenant, representing partial relief of the Downstream impairment charge incurred in 2013, effective March 31, 2014.

**LIQUIDITY**

The Company's liquidity needs are met through the following sources: cash generated from operations, proceeds from asset dispositions, joint ventures, borrowings under the credit facility, related party loans, long-term debt issuances and capital injections by KNOC. Harvest's primary uses of funds are operating expenses, capital expenditures, and interest and principal repayments on debt instruments.

Cash flow from operating activities for the three months ended March 31, 2014 was \$195.6 million (2013 – \$66.6 million), an increase of \$129.0 million as compared to the same period in 2013. The increase is mainly a result of the increase in cash contribution of both the Downstream and Upstream segments.

Cash contribution from Harvest's Downstream operations was \$33.7 million for the first quarter of 2014 (2013 – deficiency of \$33.0 million), a \$66.7 million improvement from the same quarter in the prior year. The increase in Downstream's cash contribution was mainly due to higher average refining gross margins per bbl and improved yield mix, partially offset by a decrease in throughput volumes as compared to the same quarter in the prior year. Cash contribution from Harvest's Upstream operations was \$139.8 million for the first quarter of 2014, a \$16.9 million increase from the same period in 2013 mainly due to higher operating netback per boe, partially offset by lower sale volumes. See the "Cash Contribution (Deficiency) from Operations" section of this MD&A for further detail.

Harvest funded \$179.6 million of capital expenditures for the three months ending March 31, 2014 (2013 – \$186.4 million) with cash generated from operating activities, property dispositions and borrowings under the credit facility.

Harvest had a working capital deficiency of \$123.7 million as at March 31, 2014, as compared to a \$75.4 million deficiency at December 31, 2013. The change in the working capital position was primarily related to the increase of accounts payable and accrued liabilities. Harvest's working capital is expected to fluctuate from time to time, and will be funded from cash flows from operations and borrowings from the credit facility, as required.

On February 28, 2014, Harvest borrowed \$80.0 million under the subordinated loan agreement with KNOC (see the "Related Party Loans" section). These funds were used to repay a portion of the credit facility.

Harvest's net repayment to the credit facility was \$93.4 million during the first quarter of 2014 (2013 - \$98.9 million net borrowing).

Harvest ensures its liquidity through the management of its capital structure, seeking to balance the amount of debt and equity used to fund investment in each of our operating segments. Harvest evaluates its capital structure using the same financial covenant ratios as the ones externally imposed under the Company's credit facility. The Company continually monitors its credit facility covenants and actively takes steps, such as reducing borrowings, increasing capitalization, amending or renegotiating covenants as and when required, to ensure compliance. Harvest was in compliance with all debt covenants at March 31, 2014. Harvest expects to meet its future cash requirements and financial obligations with cash from operations, joint ventures and the undrawn borrowing room under the credit facility and KNOC subordinated loan agreement.

### Contractual Obligations and Commitments

Harvest has recurring and ongoing contractual obligations and estimated commitments entered into in the normal course of operations. As at the end of March 31, 2014, Harvest has the following significant contractual obligations and estimated commitments:

	Payments Due by Period				Total
	1 year	2-3 years	4-5 years	After 5 years	
Debt repayments <sup>(1)</sup>	9.2	–	2,282.8	–	2,292.0
Debt interest payments <sup>(1) (2)</sup>	77.8	155.3	140.2	–	373.3
Purchase commitments <sup>(3)</sup>	75.0	21.0	80.0	–	176.0
Operating leases	10.3	8.2	6.5	2.7	27.7
Firm processing commitments	15.1	40.5	33.0	94.3	182.9
Firm transportation agreements	12.8	38.5	46.3	90.2	187.8
Employee benefits <sup>(4)</sup>	2.5	3.2	1.2	3.8	10.7
Decommissioning and environmental liabilities <sup>(5)</sup>	40.1	58.9	42.3	1,490.9	1,632.2
<b>Total</b>	<b>242.8</b>	<b>325.6</b>	<b>2,632.3</b>	<b>1,681.9</b>	<b>4,882.6</b>

(1) Assumes constant foreign exchange rate.

(2) Assumes interest rates as at March 31, 2014 will be applicable to future interest payments.

(3) Relates to drilling commitments, BlackGold oil sands project commitment and Downstream capital commitments.(4)

(4) Relates to the expected contributions to employee benefit plans and long-term incentive plan payments.

(5) Represents the undiscounted obligation by period.

Harvest also has commitments to purchase refinery crude stock and sell refined products under a supply and offtake agreement with Macquarie Energy Canada Ltd. ("Macquarie"). These purchase commitments will be net settled against any refined product sales to Macquarie.

### Off Balance Sheet Arrangements

As at March 31, 2014, Harvest has no off balance sheet arrangements in place.

**SUMMARY OF QUARTERLY RESULTS**

The following table and discussion highlights the first quarter of 2014 results relative to the preceding 7 quarters:

	2014	2013				2012		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
<b>FINANCIAL</b>								
Revenues	<b>1,364.9</b>	1,307.3	1,299.9	1,399.3	1,358.2	1,546.0	1,275.1	1,533.8
Net income (loss)	<b>3.0</b>	(517.8)	(79.5)	(89.2)	(95.4)	(536.7)	(38.5)	(73.5)
Cash from operating activities	<b>195.6</b>	6.1	50.6	77.3	66.6	133.0	153.9	70.8
Total financial debt <sup>(1)</sup> , non-current	<b>2,269.7</b>	2,232.6	1,989.0	1,920.6	1,511.2	1,450.0	1,519.4	1,770.7
Total assets	<b>5,378.3</b>	5,289.9	5,626.1	5,606.6	5,672.1	5,654.6	6,162.9	6,277.5
<b>OPERATIONS</b>								
<b>Upstream</b>								
Daily sales volumes (boe/d)	<b>48,487</b>	49,154	51,783	53,461	55,571	58,228	57,686	60,874
Realized price prior to hedges (\$/boe)	<b>67.29</b>	54.01	60.62	58.22	53.43	52.82	51.86	51.42
<b>Downstream</b>								
Average daily throughput (bbl/d)	<b>95,767</b>	92,339	93,798	106,245	100,074	114,065	84,889	114,552
Average refining gross margin (loss) (US\$/bbl)	<b>9.58</b>	2.50	(1.43)	0.74	2.51	6.43	6.03	2.71

(1) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

The quarterly revenues and cash from operating activities are mainly impacted by the Upstream sales volumes, realized prices and operating expenses and Downstream throughput volumes, cost of feedstock and refined product prices. Significant items that impacted Harvest's quarterly revenues include:

- Revenues were highest in the fourth and second quarters of 2012, as a result of the refinery operating at near capacity during those periods.
- The decline in Upstream's sales volumes since 2012 were mainly due to natural declines, asset dispositions and a reduced capital program since 2012.
- Downstream's average daily throughput was lower in the third quarter of 2012 as compared to the other reported quarters due to a two-week partial outage of some process units and a three-week unplanned shutdown of all process units while repairs were completed to the SRU. The average daily throughput was lower in the third quarter of 2013 due to repairs on the SRU reactor and lower in the fourth quarter of 2013 due to repairs and maintenance of the isomax and crude units.
- Downstream's refining gross margin/bbl was highest in the first quarter of 2014 mainly due to improved sour crude differentials. The weaker margins during 2013 reflected poorer yield and the decrease in the sour-crude differential from the Brent benchmark price for crude oil. The refining gross margin was negatively impacted by increased RINs costs since the second quarter of 2013.



Net income (loss) reflects both cash and non-cash items. Changes in non-cash items including deferred income tax, DD&A expense, accretion of decommissioning and environmental remediation liabilities, impairment of long-lived assets, unrealized foreign exchange gains and losses, and unrealized gains and losses on risk management contracts impact net loss from period to period. For these reasons, the net loss may not necessarily reflect the same trends as revenues or cash from operating activities, nor is it expected to. Net losses in the fourth quarters of 2013 and 2012 were mainly due to the \$458.9 million and \$535.5 million impairments, respectively, of Downstream PP&E. Total assets also decreased significantly in the fourth quarters of 2013 and 2012 as a result.

Cash from operating activities was highest for the first quarter of 2014 mainly as a result of the significant improvement of cash contribution from Downstream as compared to previous quarters and a positive change in non-cash working capital. Cash from operating activities was lowest in the fourth quarter of 2013, mainly due to poor cash contribution from operations from the Upstream and Downstream segments and a negative \$55 million change in non-cash working capital.

The increase in long-term financial debt in the second quarter of 2013 was a result of the issuance of the US\$630 million 2½% senior notes due 2018 which were used to early redeem Harvest's convertible debentures, a portion of which had been classified as short-term debt. The \$243.6 million increase in long-term financial debt in fourth quarter of 2013 as compared to the third quarter of 2013 was mainly a result of \$125 million of further draws on our credit facility, receiving \$80 million under the KNOC subordinated loan agreement and the \$44 million impact of the weakening Canadian dollar on our U.S. dollar denominated debt.

## **2014 OUTLOOK**

The following guidance is provided as general information for stakeholders regarding management's expectations for 2014 for the Upstream, BlackGold and Downstream business segments. The guidance information provided is consistent with Harvest's most recent budget information. Readers are cautioned that the guidance information provided within this Outlook may not be appropriate for other purposes and the actual results may differ materially from those anticipated.

### *Upstream*

Production volume for the year 2014 is targeted at approximately 48,800 boe/d reflecting natural declines and assets dispositions during 2013 and our 2014 operating costs are expected to average \$17.80/boe. During the first quarter of 2014 production averaged 48,487 boe/d and operating expense was \$20.29/boe due to higher than expected power costs as well as repairs and maintenance charges.

The 2014 annual capital budget for the Upstream business is \$350 million and during the first quarter of 2014 Harvest spent \$134.3 million on capital expenditures.

Harvest has not budgeted for asset acquisitions or dispositions. The Company has identified non-core properties for disposition representing approximately 2,400 boe/d of production. Proceeds from dispositions would be used to manage Harvest's liquidity, fund development of core assets and for the acquisition of strategic assets.

*BlackGold*

Due to extreme winter conditions the project scaled back construction activities during the first quarter of 2014. Harvest anticipates resuming full construction activities in the second quarter of 2014 and has revised the project schedule accordingly.

BlackGold currently has a capital spending budget of \$131 million of which \$42.2 million was spent in the first quarter of 2014.

Harvest anticipates construction completion of the 10,000 bbl/d Phase 1 CPF in the second half of 2014 with first steam expected in the fourth quarter of 2014.

*Downstream*

The 2014 capital budget for the Downstream operations has been revised to \$38 million from \$139 million due to the rescheduling of a refinery turnaround that was planned for the second half of 2014. The turnaround postponement is a result of running cleaner produced vacuum gas oils in the Isomax unit resulting in an extension of the catalyst life. The remaining capital spending in 2014 is allocated to sustaining and reliability improvement projects. As at the end of the first quarter of 2014 the Downstream Operations had utilized \$3.1 million of the capital budget.

For the full year 2014 throughput is anticipated to average approximately 92,500 bbl/d, with operating costs and purchased energy costs aggregating to approximately \$8.00/bbl. In the first quarter of 2014 throughput averaged 95,767 bbl/d with operating and purchased energy costs of \$7.37/bbl.

Harvest continues to evaluate various business opportunities pertaining to the Downstream business including, but not limited to, introduction of joint venture partners, disposition, in whole or in part, as well as multiple other economic scenarios for future operations. An outcome or recommendation arising out of this review has not been determined to date.

Harvest's revised capital expenditure budget for 2014 is \$519 million, comprised of \$350 million for Upstream oil & gas operations, \$131 million for the BlackGold oil sands project and \$38 million for the Downstream refining and marketing business.

**Joint Ventures with KERR**

On April 23, 2014, Harvest entered into two joint ventures with KERR Canada Co. Ltd. ("KERR"): Deep Basin Partnership and HK MS Partnership. Deep Basin Partnership was established for the purposes of exploring, developing and producing from certain oil and gas properties in the Deep Basin area in Northwest Alberta. Harvest contributed certain producing and non-producing properties to Deep Basin Partnership in exchange for 467,386,000 of common partnership units, while KERR contributed \$100.4 million for 100,368,000 preferred partnership units. Amounts contributed by KERR will be spent by the Deep Basin Partnership to drill and develop partnership properties in the Deep Basin area. If funding from KERR is insufficient to fund the entire agreed initial multi-year development program, Harvest will fund the balance of the program from its share of partnership distributions. The preferred partnership units provide KERR certain preference rights, including a put option right exercisable after 10.5 years, whereby KERR could cause Deep Basin Partnership

to redeem all its preferred partnership units for consideration equal to its initial contribution plus an after-tax internal rate of return of two percent. If Deep Basin Partnership does not have sufficient funds to complete the redemption obligation and after making efforts to secure funding, whether via issuing new equity, entering into a financing arrangement or selling assets, the partnership can cash-call Harvest to meet such obligation.

HK MS Partnership was formed for the purposes of constructing and operating a gas processing facility, which will be primarily used to process the gas produced from the properties owned by the Deep Basin Partnership. A gas processing agreement was entered by the two partnerships. For the HK MS Partnership, KERR contributed \$22.6 million for partnership units, which represent 34.82% of the outstanding partnership units. The remaining 65.18% will be contributed by Harvest as cash is required for the construction of the gas processing facility. On the earlier of 10.5 years after the formation of the HK MS Partnership or when KERR achieves certain internal rate of return, Harvest will have the right but not the obligation to purchase all of KERR's interest for nominal consideration.

### **CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Further information on the basis of preparation and significant accounting policies and estimates can be found in the notes to the audited consolidated financial statements for the year ended December 31, 2013. There have been no changes to the accounting policies and estimates in the first quarter of 2014, except for the following as a result of new and amended IFRS accounting standards:

- IAS 32 "Financial instruments: Presentation" has been amended to clarify that the right to offset financial assets and liabilities must be available on the current date and cannot be contingent on a future event. The adoption of this standard did not have any impact on the Company's financial statements.
- IFRS Interpretations Committee ("IFRIC") 21 "Levies", clarifies the recognition requirements concerning a liability to pay a levy imposed by a government other than income tax. IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment occurs. The adoption of this standard did not have any impact on Harvest's financial statements.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

A description of additional accounting pronouncements that will be adopted by Harvest in future periods can be found in note 3 of the Audited Consolidated Financial Statements for the year ended December 31, 2013.

**OPERATIONAL AND OTHER BUSINESS RISKS**

Harvest's operational and other business risks remain unchanged from those discussed in the annual MD&A and AIF for the year ended December 31, 2013 as filed on SEDAR at [www.sedar.com](http://www.sedar.com).

**CHANGES IN REGULATORY ENVIRONMENT**

Harvest's regulatory environment remains unchanged from that discussed in the annual MD&A and AIF for the year ended December 31, 2013 as filed on SEDAR at [www.sedar.com](http://www.sedar.com).

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

There were no significant changes in the internal controls over financial reporting or disclosure controls and procedures described in the annual MD&A for the year ended December 31, 2013 as filed on SEDAR at [www.sedar.com](http://www.sedar.com) that have materially affected, or are reasonably likely to affect, internal controls over financial reporting.

**ADDITIONAL GAAP MEASURE**

Harvest uses "operating income (loss)", an additional GAAP measure that is not defined under IFRS hereinafter also referred to as "GAAP". The measure is commonly used for comparative purposes in the petroleum and natural gas and refining industries to reflect operating results before items not directly related to operations. Harvest uses this measure to assess and compare the performance of its operating segments.

**NON-GAAP MEASURES**

Throughout this MD&A, the Company has referred to certain measures of financial performance that are not specifically defined under GAAP such as "operating netback", "operating netback prior to/after hedging", "gross margin (loss)", "refining margin", "average refining gross margin", "cash contribution (deficiency) from operations", "total debt", "total financial debt", "total capitalization", "Annualized EBITDA", "senior debt to Annualized EBITDA", "total debt to Annualized EBITDA", "senior debt to total capitalization", and "total debt to total capitalization".

"Operating netbacks" are reported on a per boe basis and used extensively in the Canadian energy sector for comparative purposes. "Operating netbacks" include revenues, operating expenses, transportation and marketing expenses, and realized gains or losses on risk management contracts. "Gross margin (loss)", "refining margin" or "average refining gross margin" are commonly used in the refining industry to reflect the net funds received from the sale of refined products after considering the cost to purchase the feedstock and is calculated by deducting purchased products for resale and processing from total revenue. "Cash contribution (deficiency) from operations" is calculated as operating income (loss) adjusted for non-cash items. The measure demonstrates the ability of the each segment of Harvest to generate the cash from operations necessary to repay debt, make capital investments, and fund the settlement of decommissioning and environmental remediation liabilities. "Total debt", "total financial debt", "total capitalization", and "Annualized EBITDA" are used to assist management in assessing liquidity and the Company's ability to meet financial obligations. "Senior debt to Annualized EBITDA", "total debt to Annualized EBITDA", "senior debt to total capitalization" and "total debt to total capitalization" are terms defined in Harvest's credit facility agreement for the purpose of calculation of financial covenants. The non-GAAP measures do not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures used by other

issuers. The determination of the non-GAAP measures have been illustrated throughout this MD&A, with reconciliations to IFRS measures and/or account balances, except for Annualized EBITDA and cash contribution (deficiency) which are shown below.

### **Annualized EBITDA**

The measure of Consolidated EBITDA (herein referred to as "Annualized EBITDA") used in Harvest's credit facility agreement is defined as earnings before finance costs, income tax expense or recovery, DD&A, exploration and evaluation costs, impairment of assets, unrealized gains or losses on risk management contracts, unrealized gains or losses on foreign exchange, gains or losses on disposition of assets and other non-cash items. The following is a reconciliation of Annualized EBITDA to the nearest GAAP measure net loss:

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Net loss	<b>(683.5)</b>	(781.9)
DD&A	<b>558.9</b>	612.8
Finance costs	<b>91.2</b>	94.2
Income tax recovery	<b>(55.3)</b>	(64.2)
EBITDA	<b>(88.7)</b>	(139.1)
Unrealized losses on risk management contracts	<b>1.6</b>	0.5
Unrealized losses on foreign exchange	<b>67.2</b>	40.8
Unsuccessful exploration and evaluation costs	<b>11.8</b>	11.5
Impairment of PP&E	<b>483.0</b>	483.0
Gains on disposition of assets	<b>(27.1)</b>	(34.1)
Other non-cash items	<b>(3.7)</b>	(1.7)
Adjustments on acquisitions and dispositions and other <sup>(1)</sup>	<b>(8.9)</b>	(15.4)
Annualized EBITDA <sup>(1)</sup>	<b>435.2</b>	345.5

(1) Annualized EBITDA is on a consolidated basis for any period, the aggregate of the last four quarters of the earnings (calculated in accordance with GAAP) and accordingly is a twelve month rolling measure which, as well, is required to be adjusted to the net income impact from acquisitions or dispositions (with net proceeds over \$20 million) as if the transaction had been effected at the beginning of the period.

### **Cash Contribution (Deficiency) from Operations**

Cash contribution (deficiency) from operations represents operating income (loss) adjusted for non-cash expense items within: general and administrative, exploration and evaluation, depletion, depreciation and amortization, gains on disposition of PP&E, risk management contracts gains or losses, impairment on PP&E, and the inclusion of cash interest, realized foreign exchange gains or losses and other cash items not included in operating income (loss). The measure demonstrates the ability of the Upstream and Downstream segments of Harvest to generate cash from their operations and is calculated before changes in non-cash working capital. There are no operating activities to report for the BlackGold segment as it is under development. The most directly comparable additional GAAP measure is operating income (loss). Operating income (loss) as presented in the notes to Harvest's consolidated financial statements is reconciled to cash contribution (deficiency) from operations below:

	Three Months Ended March 31					
	Upstream		Downstream		Total	
	2014	2013	2014	2013	2014	2013
Operating income (loss)	21.8	(22.5)	31.5	(55.0)	53.3	(77.5)
Adjustments:						
Operating	1.5	0.1	(1.2)	0.2	0.3	0.3
General and administrative	(1.8)	(0.1)	–	–	(1.8)	(0.1)
Exploration and evaluation	8.3	8.0	–	–	8.3	8.0
Depletion, depreciation and amortization	109.5	145.2	3.6	21.8	113.1	167.0
(Gains) losses on disposition of assets	0.7	(6.6)	(0.2)	–	0.5	(6.6)
Unrealized gains on risk management contracts	(0.2)	(1.2)	–	–	(0.2)	(1.2)
<b>Cash contribution (deficiency) from operations</b>	<b>139.8</b>	<b>122.9</b>	<b>33.7</b>	<b>(33.0)</b>	<b>173.5</b>	<b>89.9</b>
Inclusion of items not attributable to segments:						
Net cash interest paid					17.9	24.0
Realized foreign exchange losses					2.0	2.0
<b>Consolidated cash contribution from operations</b>					<b>153.6</b>	<b>63.9</b>

#### FORWARD-LOOKING INFORMATION

This MD&A highlights significant business results and statistics from the consolidated financial statements for the three months ended March 31, 2014 and the accompanying notes thereto. In the interest of providing Harvest's lenders and potential lenders with information regarding Harvest, including the Company's assessment of future plans and operations, this MD&A contains forward-looking statements that involve risks and uncertainties.

Such risks and uncertainties include, but are not limited to: risks associated with conventional petroleum and natural gas operations; risks associated with refining and marketing operations; risks associated with the construction of the oil sands project; the volatility in commodity prices, interest rates and currency exchange rates; risks associated with realizing the value of acquisitions; general economic, market and business conditions; changes in environmental legislation and regulations; the availability of sufficient capital from internal and external sources; and, such other risks and uncertainties described from time to time in regulatory reports and filings made with securities regulators. The impact of any one risk, uncertainty or factor on a particular forward-looking statement is not determinable with certainty as these factors are interdependent, and management's future course of action would depend on the assessment of all information at that time. Please also refer to "Operational and Other Business Risks" in this MD&A and "Risk Factors" in the Annual Information Form for detailed discussion on these risks.

Forward-looking statements in this MD&A include, but are not limited to, the forward looking statements made in the "Outlook" section as well as statements made throughout with reference to the following items to future periods: production volumes, refinery throughput volumes, royalty rates, operating costs, commodity prices, general and administrative costs, price risk management activities, acquisitions and dispositions, capital spending and allocation of such to various projects, reserve estimates and ultimate recovery of reserves, potential timing and commerciality of Harvest's capital projects, the extent and success rate of Upstream and



BlackGold drilling programs, the ability to achieve the maximum capacity from the BlackGold central processing facilities, refinery utilization and reliability rates, availability of the credit facility, access and ability to raise capital, ability to maintain debt covenants, debt levels, recovery of long-lived assets, the timing and amount of decommission and environmental related costs, income taxes, cash from operating activities, regulatory approval of development projects and regulatory changes. For this purpose, any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements often contain terms such as "may", "will", "should", "anticipate", "expect", "target", "plan", "potential", "intend", and similar expressions.

All of the forward-looking statements in this MD&A are qualified by the assumptions that are stated or inherent in such forward-looking statements. Although Harvest believes that these assumptions are reasonable based on the information available to us on the date such assumptions were made, this list is not exhaustive of the factors that may affect any of the forward-looking statements and the reader should not place an undue reliance on these assumptions and such forward-looking statements. The key assumptions that have been made in connection with the forward-looking statements include the following: that the Company will conduct its operations and achieve results of operations as anticipated; that its development plans and sustaining maintenance programs will achieve the expected results; the general continuance of current or, where applicable, assumed industry conditions; the continuation of assumed tax, royalty and regulatory regimes; the accuracy of the estimates of the Company's reserve volumes; commodity price, operation level, and cost assumptions; the continued availability of adequate cash flow and debt and/or equity financing to fund the Company's capital and operating requirements as needed; and the extent of Harvest's liabilities. Harvest believes the material factors, expectations and assumptions reflected in the forward-looking statements are reasonable, but no assurance can be given that these factors, expectations and assumptions will prove to be correct.

Although management believes that the forward-looking information is reasonable based on information available on the date such forward-looking statements were made, no assurances can be given as to future results, levels of activity and achievements. Therefore, readers are cautioned not to place undue reliance on forward-looking statements as the plans, intentions or expectations upon which the forward-looking information is based might not occur. Forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

**ADDITIONAL INFORMATION**

Further information about us can be accessed under our public filings found on SEDAR at [www.sedar.com](http://www.sedar.com) or at [www.harvestenergy.ca](http://www.harvestenergy.ca). Information can also be found by contacting our Investor Relations department at (403) 265-1178 or at 1-866-666-1178.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

As at (millions of Canadian dollars)	Notes	March 31, 2014	December 31, 2013
<b>Assets</b>			
Current assets			
Accounts receivable	9	\$ 187.0	\$ 168.9
Inventories	11	47.8	51.6
Prepaid expenses		18.7	14.1
Risk management contracts	9	0.4	0.3
		253.9	234.9
Non-current assets			
Long-term deposit and other		0.6	5.6
Deferred income tax asset		158.4	148.8
Exploration and evaluation assets	6	55.7	59.4
Property, plant and equipment	5	4,529.9	4,461.4
Goodwill		379.8	379.8
		5,124.4	5,055.0
<b>Total assets</b>		<b>\$ 5,378.3</b>	<b>\$ 5,289.9</b>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities	9	\$ 314.2	\$ 258.3
Current portion of long-term debt	7, 9	9.2	12.3
Current portion of provisions	10	43.6	39.1
Risk management contracts	9	10.6	0.6
		377.6	310.3
Non-current liabilities			
Long-term debt	7, 9	1,927.5	1,973.0
Related party loans	9, 19	342.2	259.6
Long-term liability	9, 12	67.7	69.5
Non-current provisions	10	734.1	731.5
Post-employment benefit obligations		6.7	6.8
		3,078.2	3,040.4
<b>Total liabilities</b>		<b>\$ 3,455.8</b>	<b>\$ 3,350.7</b>
<b>Shareholders' equity</b>			
Shareholder's capital		3,860.8	3,860.8
Contributed surplus	19	8.4	4.3
Deficit		(1,890.2)	(1,893.2)
Accumulated other comprehensive loss	17	(56.5)	(32.7)
<b>Total shareholder's equity</b>		<b>1,922.5</b>	<b>1,939.2</b>
<b>Total liabilities and shareholder's equity</b>		<b>\$ 5,378.3</b>	<b>\$ 5,289.9</b>

Commitments [Note 18]

Subsequent events [Note 20]

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

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)**

Three months ended March 31,

<i>(millions of Canadian dollars)</i>	Notes	2014	2013
Petroleum, natural gas, and refined product sales		\$ 1,401.1	\$ 1,390.9
Royalties		(36.2)	(32.7)
<b>Revenues</b>	13	<b>1,364.9</b>	<b>1,358.2</b>
<b>Expenses</b>			
Purchased products for processing and resale		1,008.0	1,086.4
Operating		157.1	158.9
Transportation and marketing		8.0	6.6
General and administrative		17.0	17.9
Depletion, depreciation and amortization	5	113.1	167.0
Exploration and evaluation	6	8.6	8.5
Losses (gains) on disposition of assets		0.5	(6.6)
Finance costs	14	24.5	27.5
Risk management contracts gains	9	(0.7)	(3.0)
Foreign exchange losses	15	32.2	5.8
<b>Loss before income tax</b>		<b>(3.4)</b>	<b>(110.8)</b>
Income tax recovery		(6.4)	(15.4)
<b>Net income (loss)</b>		<b>\$ 3.0</b>	<b>\$ (95.4)</b>
<b>Other comprehensive loss ("OCL")</b>			
<i>Items that may be reclassified to net income</i>			
Losses on designated cash flow hedges, net of tax	9, 17	(7.3)	(2.6)
Gains (losses) on foreign currency translation	17	(15.4)	4.3
<i>Items that will not be reclassified to net income</i>			
Actuarial gains (losses), net of tax	17	(1.1)	5.0
<b>Comprehensive loss</b>		<b>\$ (20.8)</b>	<b>\$ (88.7)</b>

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

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY  
(UNAUDITED)**

<i>(millions of Canadian dollars)</i>	Notes	Shareholder's Capital	Contributed Surplus	Deficit	Accumulated Other Comprehensive Loss ("AOCL")	Total Shareholder's Equity
Balance at December 31, 2013		\$ 3,860.8	\$ 4.3	\$ (1,893.2)	\$ (32.7)	\$ 1,939.2
Losses on derivatives designated as cash flow hedges, net of tax	17	-	-	-	(7.3)	(7.3)
Losses on foreign currency translation	17	-	-	-	(15.4)	(15.4)
Actuarial losses, net of tax	17	-	-	-	(1.1)	(1.1)
Shareholder loan (see note 19)		-	4.1	-	-	4.1
Net income		-	-	3.0	-	3.0
<b>Balance at March 31, 2014</b>		<b>\$ 3,860.8</b>	<b>\$ 8.4</b>	<b>\$ (1,890.2)</b>	<b>\$ (56.5)</b>	<b>\$ 1,922.5</b>
Balance at December 31, 2012		\$ 3,860.8	\$ -	\$ (1,111.3)	\$ (57.6)	\$ 2,691.9
Losses on derivatives designated as cash flow hedges, net of tax		-	-	-	(2.6)	(2.6)
Gains on foreign currency translation		-	-	-	4.3	4.3
Actuarial gains, net of tax		-	-	-	5.0	5.0
Net loss		-	-	(95.4)	-	(95.4)
<b>Balance at March 31, 2013</b>		<b>\$ 3,860.8</b>	<b>\$ -</b>	<b>\$ (1,206.7)</b>	<b>\$ (50.9)</b>	<b>\$ 2,603.2</b>

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

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

Three months ended March 31,

<i>(millions of Canadian dollars)</i>	Notes	2014	2013
<b>Cash provided by (used in)</b>			
<b>Operating Activities</b>			
Net income (loss)		\$ 3.0	\$ (95.4)
Items not requiring cash			
Depletion, depreciation and amortization		113.1	167.0
Accretion of decommissioning and environmental remediation liabilities	10, 14	5.8	5.6
Unrealized gains on risk management contracts	9	(0.2)	(1.2)
Unrealized losses on foreign exchange	15	30.2	3.8
Unsuccessful exploration and evaluation cost	6	8.3	8.0
Losses (gains) on disposition of assets		0.5	(6.6)
Deferred income tax recovery		(6.4)	(15.4)
Other non-cash items		(0.9)	(1.9)
Settlement of decommissioning and environmental remediation liabilities	10	(2.9)	(5.8)
Change in non-cash working capital	16	45.1	8.5
		\$ 195.6	\$ 66.6
<b>Financing Activities</b>			
Credit facility (repayment) borrowings, net	7	(93.4)	98.9
Borrowings from related party loans	19	80.0	-
Repayment of promissory note	7	(3.1)	(2.9)
		\$ (16.5)	\$ 96.0
<b>Investing Activities</b>			
Additions to property, plant and equipment	5	(173.2)	(173.1)
Additions to exploration and evaluation assets	6	(6.4)	(13.3)
Property dispositions, net		2.3	8.6
Change in non-cash working capital	16	(1.8)	16.4
		\$ (179.1)	\$ (161.4)
Change in cash		-	1.2
Cash, beginning of period		-	7.6
Cash, end of period		\$ -	\$ 8.8
Interest paid		\$ 8.2	\$ 11.8

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

## **NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

For the three months ended March 31, 2014 and 2013

*(Tabular amounts in millions of Canadian dollars unless otherwise indicated)*

### **1. Nature of Operations and Structure of the Company**

Harvest Operations Corp. ("Harvest" or the "Company") is an energy company in the business of the exploration, development, and production of crude oil, bitumen, natural gas and natural gas liquids in western Canada with a petroleum refining and marketing business located in the Province of Newfoundland and Labrador. Harvest has three reportable segments: Upstream, BlackGold oil sands ("BlackGold") and Downstream. For further information regarding these reportable segments, see note 4.

Harvest is a wholly owned subsidiary of Korea National Oil Corporation ("KNOC"). The Company is incorporated and domiciled in Canada. Harvest's principal place of business is located at 2100, 330 – 5<sup>th</sup> Avenue SW, Calgary, Alberta, Canada T2P 0L4.

### **2. Basis of Presentation**

These condensed interim consolidated financial statements have been prepared in accordance with the International Accounting Standards ("IAS") 34 – "Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The interim consolidated financial statements do not include all of the information required for annual financial statements and should be read in conjunction with the Audited Consolidated Financial Statements as at and for the year ended December 31, 2013, which were prepared in accordance with IFRS.

These consolidated financial statements were approved and authorized for issue by the Board of Directors on May 13, 2014.

#### **Basis of Measurement**

The consolidated financial statements have been prepared on the historical cost basis except for held-for-trading financial assets and derivative financial instruments, which are measured at fair value.

#### **Functional and Presentation Currency**

In these consolidated financial statements, unless otherwise indicated, all dollar amounts are expressed in Canadian dollars, which is the Company's functional currency. All references to US\$ are to United States dollars.

### **3. Significant Accounting Policies**

These condensed interim consolidated financial statements follow the same accounting principles and methods of application as those disclosed in note 4 of the Company's Audited Consolidated Financial Statements as at and for the year ended December 31, 2013, except as described below.

#### **Change in Accounting Policies**

Effective January 1, 2014, the Company has adopted the following new IFRS standards and amendments:

- IAS 32 "Financial instruments: Presentation" has been amended to clarify that the right to offset financial assets and liabilities must be available on the current date and cannot be contingent on a future event. The adoption of this standard did not have a material impact on the Company's financial statements.
- IFRS Interpretations Committee ("IFRIC") 21 "Levies", clarifies the recognition requirements concerning a liability to pay a levy imposed by a government other than income tax. IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment occurs. The adoption of this standard did not have a material impact on Harvest's financial statements.

### Accounting Pronouncements

There were no new or amended standards issued during the three months ended March 31, 2014 that are applicable to Harvest in future periods. A description of additional accounting pronouncements that will be adopted by Harvest in future periods can be found in note 3 of the Audited Consolidated Financial Statements for the year ended December 31, 2013.

### 4. Segment Information

Harvest's operating segments are determined based on the nature of the products and services. The following summary describes the operations in each of the segments:

- Upstream operations consist of exploration, development, production and subsequent sale of petroleum, natural gas and natural gas liquids in western Canada.
- The BlackGold oil sands project is located near Conklin, Alberta. Phase 1 of the project that is designed to produce 10,000 barrels of bitumen per day is currently under construction and development. BlackGold will use steam assisted gravity drainage technology to recover bitumen.
- Downstream operations include the purchase and refining of crude oil at a medium gravity sour crude oil hydrocracking refinery, and the sale of the refined products to commercial, wholesale and retail customers. Downstream is located in the Province of Newfoundland and Labrador.

	Three months ended March 31 <sup>(3)</sup>					
	Upstream <sup>(2)</sup>		Downstream <sup>(2)</sup>		Total	
	2014	2013	2014	2013	2014	2013
Petroleum, natural gas and refined products sales <sup>(1)</sup>	\$ 287.7	\$ 268.9	\$ 1,113.4	\$ 1,122.0	\$ 1,401.1	\$ 1,390.9
Royalties	(36.2)	(32.7)	-	-	(36.2)	(32.7)
<b>Revenues</b>	<b>251.5</b>	<b>236.2</b>	<b>1,113.4</b>	<b>1,122.0</b>	<b>1,364.9</b>	<b>1,358.2</b>
<b>Expenses</b>						
Purchased products for resale and processing	-	-	1,008.0	1,086.4	1,008.0	1,086.4
Operating	88.5	91.8	68.6	67.1	157.1	158.9
Transportation and marketing	6.3	5.1	1.7	1.5	8.0	6.6
General and administrative	16.8	17.7	0.2	0.2	17.0	17.9
Depletion, depreciation and amortization	109.5	145.2	3.6	21.8	113.1	167.0
Exploration and evaluation	8.6	8.5	-	-	8.6	8.5
Losses (gains) on disposition of assets	0.7	(6.6)	(0.2)	-	0.5	(6.6)
Risk management contracts gains	(0.7)	(3.0)	-	-	(0.7)	(3.0)
Operating income (loss)	\$ 21.8	\$ (22.5)	\$ 31.5	\$ (55.0)	\$ 53.3	\$ (77.5)
Finance costs					24.5	27.5
Foreign exchange losses					32.2	5.8
Loss before income tax					(3.4)	(110.8)
Income tax recovery					(6.4)	(15.4)
<b>Net income (loss)</b>					<b>\$ 3.0</b>	<b>\$ (95.4)</b>

(1) Of the total Downstream revenue, one customer represents sales of \$924.8 million for the three months ended March 31, 2014 (2013 – one customer with sales of \$953.0 million). No other single customer within either segment represents greater than 10% of Harvest's total revenue.





## CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(2) There is no intersegment activity.

(3) The BlackGold segment is under development, as such, there are no operating activities to report.

<b>Capital Additions</b>	Three months ended March 31, 2014			
	Upstream	BlackGold	Downstream	Total
Additions to PPE	\$ 127.9	\$ 42.2	\$ 3.1	\$ 173.2
Additions to E&E	6.4	-	-	6.4
Property acquisitions (dispositions), net	(2.1)	-	(0.2)	(2.3)
<b>Total capital additions</b>	<b>\$ 132.2</b>	<b>\$ 42.2</b>	<b>\$ 2.9</b>	<b>\$ 177.3</b>

<b>Capital Additions</b>	Three months ended March 31, 2013			
	Upstream	BlackGold	Downstream	Total
Additions to PPE	\$ 109.9	\$ 61.0	\$ 12.5	\$ 183.4
Additions to E&E	13.3	-	-	13.3
Property acquisitions (dispositions), net	3.2	-	-	3.2
<b>Total capital additions</b>	<b>\$ 126.4</b>	<b>\$ 61.0</b>	<b>\$ 12.5</b>	<b>\$ 199.9</b>

	<b>Total Assets</b>	<b>PP&amp;E</b>	<b>E&amp;E</b>	<b>Goodwill</b>
<b>March 31, 2014</b>				
Upstream	\$ 3,841.9	\$ 3,186.9	\$ 55.7	\$ 379.8
BlackGold	1,181.3	1,181.1	-	-
Downstream	355.1	161.9	-	-
<b>Total</b>	<b>\$ 5,378.3</b>	<b>\$ 4,529.9</b>	<b>\$ 55.7</b>	<b>\$ 379.8</b>

<b>December 31, 2013</b>				
Upstream	\$ 3,794.0	\$ 3,166.2	\$ 59.4	\$ 379.8
BlackGold	1,144.0	1,138.8	-	-
Downstream	351.9	156.4	-	-
<b>Total</b>	<b>\$ 5,289.9</b>	<b>\$ 4,461.4</b>	<b>\$ 59.4</b>	<b>\$ 379.8</b>

**5. Property, Plant and Equipment (“PP&E”)**

	Upstream	BlackGold	Downstream	Total
Cost:				
As at December 31, 2012	\$ 5,085.5	\$ 679.8	\$ 1,390.3	\$ 7,155.6
Additions	305.6	444.5	53.2	803.3
Acquisitions	16.3	0.7	-	17.0
Disposals	(177.9)	-	(4.9)	(182.8)
Transfer from E&E	11.3	-	-	11.3
Change in decommissioning liabilities	31.5	13.8	-	45.3
Exchange adjustment	-	-	99.4	99.4
As at December 31, 2013	\$ 5,272.3	\$ 1,138.8	\$ 1,538.0	\$ 7,949.1
Additions	127.9	42.2	3.1	173.2
Acquisitions	0.5	-	-	0.5
Disposals	(0.8)	-	(0.2)	(1.0)
Change in decommissioning liabilities	2.6	0.1	-	2.7
Exchange adjustment	-	-	60.6	60.6
<b>As at March 31, 2014</b>	<b>\$ 5,402.5</b>	<b>\$ 1,181.1</b>	<b>\$ 1,601.5</b>	<b>\$ 8,185.1</b>

Accumulated depletion, depreciation, amortization and impairment losses:

As at December 31, 2012	\$ 1,577.9	\$ -	\$ 785.8	\$ 2,363.7
Depreciation, depletion and amortization	530.0	-	82.8	612.8
Disposals	(25.9)	-	(4.7)	(30.6)
Impairment	24.1	-	458.9	483.0
Exchange adjustments	-	-	58.8	58.8
As at December 31, 2013	\$ 2,106.1	\$ -	\$ 1,381.6	\$ 3,487.7
Depreciation, depletion and amortization	109.5	-	3.6	113.1
Exchange adjustments	-	-	54.4	54.4
<b>As at March 31, 2014</b>	<b>\$ 2,215.6</b>	<b>\$ -</b>	<b>\$ 1,439.6</b>	<b>\$ 3,655.2</b>

Net Book Value:

<b>As at March 31, 2014</b>	<b>\$ 3,186.9</b>	<b>\$ 1,181.1</b>	<b>\$ 161.9</b>	<b>\$ 4,529.9</b>
As at December 31, 2013	\$ 3,166.2	\$ 1,138.8	\$ 156.4	\$ 4,461.4

General and administrative costs directly attributable to PP&E addition activities of \$5.0 million have been capitalized during the three months ended March 31, 2014 (2013 – \$4.3 million). Borrowing costs relating to the development of BlackGold assets have been capitalized within PP&E during the three months ended March 31, 2014 in the amount of \$7.2 million (2013 – \$4.1 million), at a weighted average interest rate of 4.6% (2013 – 5.7%). PP&E additions also include non-cash additions relating to the BlackGold deferred payment of \$nil (December 31, 2013 – \$71.5 million) (see note 12).

At March 31, 2014, the following costs were excluded from the asset base subject to depreciation, depletion and amortization: BlackGold oil sands assets of \$1.2 billion (December 31, 2013 – \$1.1 billion), Downstream assets under construction of \$39.9 million (December 31, 2013 – \$37.0 million) and Downstream major parts inventory of \$8.6 million (December 31, 2013 – \$8.3 million).

**6. Exploration and Evaluation Assets ("E&E")**

As at December 31, 2012	\$	73.4
Additions		16.7
Disposition		(7.9)
Unsuccessful E&E costs		(11.5)
Transfer to property, plant and equipment		(11.3)
As at December 31, 2013	\$	59.4
Additions		6.4
Acquisition		0.1
Disposition		(1.9)
Unsuccessful E&E costs		(8.3)
<b>As at March 31, 2014</b>	<b>\$</b>	<b>55.7</b>

The Company determined certain E&E costs to be unsuccessful and not recoverable, which were expensed as follows, together with pre-licensing expenses.

	Three months ended March 31,	
	2014	2013
Pre-licensing costs	\$ 0.3	\$ 0.5
Unsuccessful E&E costs	8.3	8.0
E&E expense	\$ 8.6	\$ 8.5

**7. Long-Term Debt**

	March 31, 2014	December 31, 2013
Credit facility (note 7a)	\$ 692.0	\$ 785.2
6% senior notes due 2017 (US\$500 million)	543.2	522.1
2% senior notes due 2018 (US\$630 million)	692.3	665.7
Promissory note (note 7b)	9.2	12.3
Long-term debt outstanding	1,936.7	1,985.3
Less current portion	(9.2)	(12.3)
<b>Long-term debt</b>	<b>\$ 1,927.5</b>	<b>\$ 1,973.0</b>

**a) Credit facility**

At March 31, 2014, Harvest had \$695.1 million drawn from the \$1.0 billion available under the credit facility (December 31, 2013 - \$788.5 million), of which US\$40.0 million were LIBOR based loans (December 31, 2013 - US\$40.0 million). The carrying value of the credit facility includes \$3.1 million of deferred financial fees at March 31, 2014 (December 31, 2013 - \$3.3 million). For the three months ended March 31, 2014, interest charges on the credit facility borrowings aggregated to \$6.5 million (2013 - \$4.3 million), reflecting an effective interest rate of 3.5% (2013 - 3.0%). Also see note 20 – Subsequent Events.

**b) Promissory note**

During the first quarter of 2013, Downstream entered in to an agreement with a third party to convert \$24.2 million of a trade payable to a two-year promissory note. The promissory note bears interest of 3%. The principal and interest are to be repaid in 24 equal installments, which started in January 2013. For the three months ended

March 31, 2014, interest charges of \$0.1 million (2013 - \$0.2 million) relating to this promissory note were recorded. At March 31, 2014, the current portion of the promissory note was \$9.2 million (December 31, 2013 - \$12.3 million).

## 8. Capital Structure

Harvest considers its capital structure to be its long term debt, related party loans, and shareholder's equity.

		<b>March 31, 2014</b>	<b>December 31, 2013</b>
Credit facility <sup>(1)</sup>	\$	<b>695.1</b>	\$ 788.5
6% senior notes (US\$500 million) <sup>(1)(2)</sup>		<b>552.8</b>	531.8
2 1/8% senior notes (US\$630 million) <sup>(1)(2)</sup>		<b>696.5</b>	670.1
Related party loans (US\$170 million and CAD\$160 million) <sup>(2)(3)</sup> (note 19)		<b>347.9</b>	260.8
	\$	<b>2,292.3</b>	\$ 2,251.2
Shareholder's equity		<b>1,922.5</b>	1,939.2
	\$	<b>4,214.8</b>	\$ 4,190.4

(1) Excludes capitalized financing fees

(2) Face value converted at the period end exchange rate

(3) As at December 31, 2013, related party loans comprised of US\$170 million from ANKOR and CAD\$80 million from KNOC.

Harvest's primary objective in its management of capital resources is to have access to capital to fund its financial obligations as well as future operating and capital activities. Harvest monitors its capital structure and makes adjustments according to market conditions to remain flexible while meeting these objectives. Accordingly, Harvest may adjust its capital spending programs, issue equity, issue new debt or repay existing debt.

Harvest evaluates its capital structure using the same financial covenant ratios as the ones externally imposed under the Company's credit facility. Harvest was in compliance with all debt covenants at March 31, 2014.

	<b>Covenant</b>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Senior debt <sup>(1)</sup> to annualized EBITDA <sup>(2)</sup>	3.00 to 1.0 or less	<b>1.77</b>	2.41
Annualized EBITDA <sup>(2)</sup> to annualized interest expense <sup>(3)</sup>	2.50 to 1.0 or higher	<b>4.56</b>	3.62
Senior debt <sup>(1)</sup> to total capitalization <sup>(4)</sup>	50% or less	<b>18%</b>	22%
Total debt <sup>(5)</sup> to total capitalization <sup>(6)</sup>	55% or less	<b>45%</b>	54%

(1) Senior debt consists of letters of credit of \$14.8 million (December 31, 2013 - \$13.3 million), credit facility of \$692.0 million (December 31, 2013 - \$785.2 million), guarantees of \$50.9 million (December 31, 2013 - \$32.8 million) and risk management contracts liabilities of \$10.6 million (December 31, 2013 - \$0.6 million) at March 31, 2014.

(2) The measure of Consolidated EBITDA (herein referred to as "annualized EBITDA") used in Harvest's credit facility agreement is defined as earnings before finance costs, income tax expense or recovery, DD&A, exploration and evaluation costs, impairment of assets, unrealized gains or losses on risk management contracts, unrealized gains or losses on foreign exchange, gains or losses on disposition of assets and other non-cash items during the last four quarters.

(3) Annualized interest expense is a reference to Consolidated Interest Expense as defined in Harvest's credit facility agreement and includes all interest expenses and finance charges incurred during the last four quarters.

(4) Senior debt to total capitalization was amended on April 15, 2014 (see note 20). For the purposes of calculating the senior debt to total capitalization ratio, total capitalization will include total debt, related party loans, and shareholder's equity of \$1,922.5 as at March 31, 2014. Prior to the amendment, Harvest excluded equity related to BlackGold of \$457.7 million as at December 31, 2013 in total capitalization.

(5) Total debt consists of senior debt and senior notes.

(6) Total debt to total capitalization was amended on April 15, 2014 (see note 20). Effective March 31, 2014, for the purposes of calculating the total debt to total capitalization ratio, total capitalization will include total debt, related party loans, shareholder's equity, plus an incremental amount of \$229.5 million representing partial relief of the Downstream impairment charge incurred in 2013.

## 9. Financial Instruments

### (a) Fair Values

Financial instruments of Harvest consist of cash, accounts receivable, accounts payable and accrued liabilities, borrowings under the credit facility, risk management contracts, promissory note, senior notes, related party loans and long term liability. Cash and risk management contracts are the only financial instruments that are measured in fair value on a recurring basis. Harvest classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
- Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

	March 31, 2014		Fair Value Measurements	
	Carrying Value	Fair Value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)
<b>Financial Assets</b>				
<u>Loans and Receivables</u>				
Accounts receivable	\$ 187.0	\$ 187.0	\$ -	\$ 187.0
<u>Held for Trading</u>				
Fair value of risk management contracts	0.4	0.4	-	0.4
<b>Total Financial Assets</b>	<b>\$ 187.4</b>	<b>\$ 187.4</b>	<b>\$ -</b>	<b>\$ 187.4</b>
<b>Financial Liabilities</b>				
<u>Held for Trading</u>				
Fair value of risk management contracts	\$ 10.6	\$ 10.6	\$ -	\$ 10.6
<u>Measured at Amortized Cost</u>				
Accounts payable and accrued liabilities	314.2	314.2	-	314.2
Credit Facility	692.0	695.1	-	695.1
6 $\frac{7}{8}$ % senior notes	543.2	598.4	-	598.4
2 $\frac{1}{8}$ % senior notes	692.3	690.5	690.5	-
Promissory note	9.2	9.2	-	9.2
Related party loans	342.2	328.3	-	328.3
Long-term liability	67.4	59.3	-	59.3
<b>Total Financial Liabilities</b>	<b>\$ 2,671.1</b>	<b>\$ 2,705.6</b>	<b>\$ 690.5</b>	<b>\$ 2,015.1</b>

	December 31, 2013		Fair Value Measurements	
	Carrying Value	Fair Value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)
<b>Financial Assets</b>				
<u>Loans and Receivables</u>				
Accounts receivable	\$ 168.9	\$ 168.9	\$ -	\$ 168.9
<u>Held for Trading</u>				
Fair value of risk management contracts	0.3	0.3	-	0.3
<b>Total Financial Assets</b>	\$ 169.2	\$ 169.2	\$ -	\$ 169.2
<b>Financial Liabilities</b>				
<u>Held for Trading</u>				
Fair value of risk management contracts	\$ 0.6	\$ 0.6	\$ -	\$ 0.6
<u>Measured at Amortized Cost</u>				
Accounts payable and accrued liabilities	258.3	258.3	-	258.3
Credit facility	785.2	788.5	-	788.5
6%% senior notes	522.1	577.7	-	577.7
2%% senior notes	665.7	653.2	653.2	-
Promissory note	12.3	12.3	-	12.3
Related party loans	259.6	242.1	-	242.1
Long-term liability	69.2	60.7	-	60.7
<b>Total Financial Liabilities</b>	\$ 2,573.0	\$ 2,593.4	\$ 653.2	\$ 1,940.2

**b) Risk Management Contracts**

The Company at times enters into natural gas, crude oil, electricity and foreign exchange contracts to reduce the volatility of cash flows from some of its forecast sales and purchases, and when allowable, will designate these contracts as cash flow hedges. These derivative contracts are entered for periods consistent with the underlying hedged transactions. Under hedge accounting, the effective portion of the unrealized gains and losses is included in OCL. The effective portion of the realized gains and losses is removed from AOCL and included in petroleum, natural gas, and refined product sales (see note 13 and 17). The ineffective portion of the unrealized and realized gains and losses are recognized in the consolidated statement of comprehensive loss.

Risk management contracts (gains) losses recorded to income include the ineffective portion of the gains or losses on the derivative contracts designated as cash flow hedges, the gains or losses on the derivatives that were not designated as hedges and the gains or losses subsequent to the discontinuation of hedge accounting on the previously designated derivatives:

Three months ended March 31								
	2014				2013			
	Realized gains	Unrealized (gains) losses	Total		Realized gains	Unrealized gains	Total	
Power	\$ (0.5)	\$ (0.4)	\$ (0.9)	\$ (0.3)	\$ (0.3)	\$ (0.3)	\$ (0.6)	
Crude Oil	-	0.2	0.2	-	-	-	-	
Currency	-	-	-	(1.5)	(0.9)	(2.4)		
	\$ (0.5)	\$ (0.2)	\$ (0.7)	\$ (1.8)	\$ (1.2)	\$ (3.0)		

The following is a summary of Harvest's risk management contracts outstanding at March 31, 2014:

**Contracts Designated as Hedges**

Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
44,600 GJ/day	AECO swap	Apr – Dec 2014	\$3.76/GJ	\$ (8.2)
4,500 bbls/day	WCS price swap	Apr – Dec 2014	US\$76.81/bbl	(1.8)
US\$0.3 million/day	Foreign exchange swap	Apr – Dec 2014	\$1.1123 Cdn/US	–
				\$ (10.0)

**Contracts Not Designated as Hedges**

Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
35 MWh	AESO power swap	Apr – Dec 2014	\$54.74/MWh	\$ (0.2)
5 MWh	AESO power swap	Jan – Dec 2015	\$49.50/MWh	0.1
US\$4.5 million	Foreign exchange swap	April 2014	\$1.1177 Cdn/US	(0.1)
				\$ (0.2)

**(c) Risk Exposure**

A description of the nature and extent of these risks can be found under note 16 of the Audited Consolidated Financial Statements for the year ended December 31, 2013. Risks associated with financial assets and liabilities have not changed significantly since December 31, 2013.

**10. Provisions**

	Upstream	BlackGold	Downstream	Total
<b>Decommissioning liabilities at December 31, 2012</b>	\$ 709.3	\$ 19.8	\$ 16.2	\$ 745.3
Liabilities incurred	8.6	14.9	-	23.5
Settled during the period	(18.6)	(0.1)	-	(18.7)
Revisions (change in estimated timing and costs)	22.9	(1.1)	-	21.8
Disposals	(33.6)	-	-	(33.6)
Accretion	20.8	0.8	0.5	22.1
Decommissioning liabilities at December 31, 2013	\$ 709.4	\$ 34.3	\$ 16.7	\$ 760.4
Environmental remediation at December 31, 2013	6.7	-	-	6.7
Other provisions at December 31, 2013	3.5	-	-	3.5
Less current portion	(39.1)	-	-	(39.1)
Balance at December 31, 2013	\$ 680.5	\$ 34.3	\$ 16.7	\$ 731.5
<b>Decommissioning liabilities at December 31, 2013</b>	\$ 709.4	\$ 34.3	\$ 16.7	\$ 760.4
Liabilities incurred	2.4	0.1	-	2.5
Settled during the period	(2.9)	-	-	(2.9)
Revisions (change in estimated timing and costs)	0.2	-	-	0.2
Disposals	-	-	-	-
Accretion	5.3	0.3	0.1	5.7
Decommissioning liabilities at March 31, 2014	\$ 714.4	\$ 34.7	\$ 16.8	\$ 765.9
Environmental remediation at March 31, 2014	8.3	-	-	8.3
Other at March 31, 2014	3.5	-	-	3.5
Less current portion	(43.6)	-	-	(43.6)
<b>Balance at March 31, 2014</b>	<b>\$ 682.6</b>	<b>\$ 34.7</b>	<b>\$ 16.8</b>	<b>\$ 734.1</b>



Harvest estimates the total undiscounted amount of cash flows required to settle its decommissioning and environmental remediation liabilities to be approximately \$1.6 billion at March 31, 2014 (December 31, 2013 - \$1.6 billion), which will be incurred between 2014 and 2074. A risk-free discount rate of 3.0% (December 31, 2013 - 3.0%) and inflation rate of 1.7% (December 31, 2013 - 1.7%) were used to calculate the fair value of the decommissioning and environmental remediation liabilities.

## 11. Inventories

	March 31, 2014		December 31, 2013	
Petroleum products				
Upstream – pipeline fill	\$	2.2	\$	3.0
Downstream		40.7		43.8
Total petroleum product inventory		42.9		46.8
Parts and supplies		4.9		4.8
	\$	47.8	\$	51.6

For the three months ended March 31, 2014, Downstream recognized inventory impairments of \$0.6 million (2013 - \$1.7 million) and impairment reversals of \$0.2 million (2013 - \$0.2 million). Such write-down and recovery amounts are included as costs in “purchased products for processing and resale” in the consolidated statements of comprehensive loss. The amount of petroleum products inventory recognized as an expense during the three month period is included in “purchased products for processing and resale expense” in the consolidated statements of comprehensive loss.

## 12. Long-Term Liability

Under the BlackGold oil sands engineering, procurement and construction (“EPC”) contract, a maximum of approximately \$101 million of the EPC costs will be paid in equal installments, without interest, over 10 years commencing on the completion of the EPC work in 2014. The liability is considered a financial liability and is initially recorded at fair value, which is estimated as the present value of all future cash payments discounted using the prevailing market rate of interest for similar instruments. As at March 31, 2014, Harvest recognized a total liability of \$76.2 million (December 31, 2013 – \$76.2 million) using a discount rate of 4.5% (December 31, 2013 – 4.5%) of which \$9.6 million (December 31, 2013 - \$9.6 million) is payable within a year and has been included with accounts payable and accrued liabilities.

Also included in long-term liability and other is an accrual related to Harvest’s long term incentive program of \$0.8 million (December 31, 2013 – \$2.6 million) as well as deferred credits of \$0.3 million (December 31, 2013 – \$0.3 million).

## 13. Revenues

	Three months ended March 31			
	2014		2013	
Crude oil and natural gas sales, net of royalties	\$	257.7	\$	235.8
Refinery products sales		1,113.4		1,122.0
Effective portion of realized cash flow hedges		(6.2)		0.4
	\$	1,364.9	\$	1,358.2

## 14. Finance Costs

	Three months ended March 31			
	2014		2013	
Interest and other financing charges	\$	25.9	\$	26.0
Accretion of decommissioning and environmental remediation liabilities		5.8		5.6

Less: capitalized interest		(7.2)		(4.1)
	\$	24.5	\$	27.5

### 15. Foreign Exchange

	Three months ended March 31			
	2014		2013	
Realized losses on foreign exchange	\$	2.0	\$	2.0
Unrealized losses on foreign exchange		30.2		3.8
	\$	32.2	\$	5.8

### 16. Supplemental Cash Flow Information

	Three months ended March 31			
	2014		2013	
Source (use) of cash:				
Accounts receivable	\$	(18.1)	\$	(5.9)
Prepaid expenses and long-term deposit		0.4		0.9
Inventories		3.8		28.7
Accounts payable and accrued liabilities		55.9		(23.7)
Net changes in non-cash working capital		42.0		-
Changes relating to operating activities		45.1		8.5
Changes relating to investing activities		(1.8)		16.4
Promissory note (note 7b)		-		(24.1)
Add: Other non-cash changes		(1.3)		(0.8)
	\$	42.0	\$	-

### 17. Accumulated Other Comprehensive Loss ("AOCL")

	Foreign Currency Translation Adjustment	Designated Cash Flow Hedges, Net of Tax	Actuarial Loss, Net of Tax	Total
Balance at December 31, 2012	\$ (42.1)	\$ 1.2	\$ (16.7)	\$ (57.6)
Reclassification to net income of gains on cash flow hedges	-	(2.8)	-	(2.8)
Gains on derivatives designated as cash flow hedges, net of tax	-	1.7	-	1.7
Actuarial loss, net of tax	-	-	18.1	18.1
Gains on foreign currency translation	7.9	-	-	7.9
Balance at December 31, 2013	\$ (34.2)	\$ 0.1	\$ 1.4	\$ (32.7)
Reclassification to net income of losses on cash flow hedges	-	4.5	-	4.5
Losses on derivatives designated as cash flow hedges, net of tax	-	(11.8)	-	(11.8)
Actuarial loss, net of tax	-	-	(1.1)	(1.1)
Losses on foreign currency translation	(15.4)	-	-	(15.4)
<b>Balance at March 31, 2014</b>	<b>\$ (49.6)</b>	<b>\$ (7.2)</b>	<b>\$ 0.3</b>	<b>\$ (56.5)</b>

The following table summarizes the impacts of the cash flow hedges on the OCL:

Three months ended March 31					
After-tax			Pre-tax		
	2014	2013	2014	2013	
(Gains) losses reclassified from OCL to revenues	\$ 4.5	\$ (0.3)	\$ 6.2	\$ (0.4)	
Losses recognized in OCL	(11.8)	(2.3)	(16.2)	(3.1)	
Total	\$ (7.3)	\$ (2.6)	\$ (10.0)	\$ (3.5)	

The Company expects the \$7.2 million after-tax accumulated loss reported in AOCL (\$9.9 million pre-tax) related to the natural gas and crude oil cash flow hedges to be released to net income within the next nine months.

## 18. Commitments

The following is a summary of Harvest's contractual obligations and estimated commitments as at March 31, 2014:

	Payments Due by Period				
	1 year	2-3 years	4-5 years	After 5 years	Total
Debt repayments <sup>(1)</sup>	\$ 9.2	\$ –	\$ 2,282.8	\$ –	\$ 2,292.0
Debt interest payments <sup>(1) (2)</sup>	77.8	155.3	140.2	–	373.3
Purchase commitments <sup>(3)</sup>	75.0	21.0	80.0	–	176.0
Operating leases	10.3	8.2	6.5	2.7	27.7
Firm processing commitments	15.1	40.5	33.0	94.3	182.9
Firm transportation agreements	12.8	38.5	46.3	90.2	187.8
Employee benefits <sup>(4)</sup>	2.5	3.2	1.2	3.8	10.7
Decommissioning and environmental liabilities <sup>(5)</sup>	40.1	58.9	42.3	1,490.9	1,632.2
Total	\$ 242.8	\$ 325.6	\$ 2,632.3	\$ 1,681.9	\$ 4,882.6

(1) Assumes constant foreign exchange rate.

(2) Assumes interest rates as at March 31, 2014 will be applicable to future interest payments.

(3) Relates to drilling commitments, BlackGold oil sands project commitment and Downstream capital commitments.

(4) Relates to the expected contributions to employee benefit plans and long-term incentive plan payments.

(5) Represents the undiscounted obligation by period.

Harvest also has commitments to purchase refinery crude stock and sell refined products under a supply and offtake agreement with Macquarie Energy Canada Ltd. ("Macquarie"). These purchase commitments will be net settled against any refined product sales to Macquarie.

## 19. Related Party Transactions

### a) Related party loans

On December 30, 2013, Harvest entered into a subordinated loan agreement with KNOC to borrow up to \$200 million at a fixed interest rate of 5.3% per annum. The full principal and accrued interest is payable on December 30, 2018. At March 31, 2014, Harvest has drawn \$160 million from the \$200 million available under the loan agreement (December 31, 2013 - \$80 million). The loan amount was recorded at fair value on initial recognition by discounting the future cash payments at the rate of 7% which is considered the market rate applicable to the liability. The difference between the fair value and the loan amount was recognized in contributed surplus. As at March 31, 2014, \$8.4 million (December 31, 2013 - \$4.3 million) have been recognized in contributed surplus related to the KNOC loan. For the three months ended March 31, 2014, interest expense of \$1.8 million was

recorded (2013 - \$nil), of which \$1.6 million remains outstanding as at March 31, 2014. The availability of any undrawn amounts under the facility will expire on December 31, 2014.

On August 16, 2012, Harvest entered into a subordinated loan agreement with ANKOR to borrow US\$170 million at a fixed interest rate of 4.62% per annum. The principal balance and accrued interest is payable on October 2, 2017. At March 31, 2014, Harvest's related party loan from ANKOR included \$187.9 million (December 31, 2013 - \$180.8 million) of principal and \$0.8 million (December 31, 2013 - \$3.0 million) of accrued interest. Interest expense was \$2.2 million for the three months ended March 31, 2014 (2013 - \$2.0 million).

The related party loans are unsecured and the loan agreements contain no restrictive covenants. For purposes of Harvest's credit facility covenant requirements, the related party loans are excluded from the 'total debt' amount but included in the 'total capitalization' amount.

**b) Other related party transactions**

	Transactions		Balance Outstanding			
	Three months ended		Accounts receivable as at		Accounts payable as at	
	2014	2013	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
<b>Revenues</b>						
Other KNOC subsidiaries <sup>(1)</sup>	\$ 0.1	\$ 0.2	\$ -	\$ -	\$ -	\$ -
<b>Operating Expenses</b>						
Other KNOC subsidiaries <sup>(2)</sup>	\$ -	\$ 0.1	\$ -	\$ -	\$ -	\$ -
<b>G&amp;A Expenses</b>						
KNOC <sup>(3)</sup>	\$ (1.1)	\$ (0.4)	\$ 0.6	\$ -	\$ 2.0	\$ 0.5
<b>Finance costs</b>						
KNOC <sup>(4)</sup>	\$ 1.0	\$ -	\$ -	\$ -	\$ 1.5	\$ 0.5

<sup>(1)</sup> On February 28, 2014 KNOC purchased 100% of the shares of KNOC Trading Corporation for US\$0.4 million. Prior to the sale of KNOC Trading Corporation ("KNOC Trading"), KNOC Trading was a wholly owned subsidiary of North Atlantic. KNOC Trading bills Ankor E&P Holdings Corp. ("ANKOR") and Dana Petroleum plc ("Dana") for oil marketing services, such as the sale of products, performed on behalf of ANKOR and Dana. Both ANKOR and Dana are wholly owned subsidiaries of KNOC.

<sup>(2)</sup> Billing from Ankor for office rent and salaries and benefits related to KNOC Trading.

<sup>(3)</sup> Global Technology and Research Centre ("GTRC") is used as a training and research facility for KNOC. Amounts relate to the reimbursement from KNOC for general and administrative expenses incurred by the GTRC. Also included is Harvest's reimbursement to KNOC for secondees salaries paid by KNOC on behalf of Harvest.

<sup>(4)</sup> Charges from KNOC for the irrevocable and unconditional guarantee they provided on Harvest's 2 1/2% senior notes and the senior unsecured credit facility. A guarantee fee of 52 basis points per annum is charged by KNOC.

**20. Subsequent Events**

On April 15, 2014, Harvest amended its credit facility to accommodate the progression of non-wholly owned partnership and joint venture arrangements for the development of Company lands. The amendments included provisions that allow the formation, operation and funding of partnerships that Harvest does not fully own, within specific parameters regarding the amount of assets and production contributed to such non-wholly owned partnership and joint venture arrangements. Limitation on distributions has been amended to allow distributions to Harvest or third parties by a joint venture partnership under specific provisions. The definitions for financial measures that are used in covenant ratios, including annualized EBITDA, total debt and senior debt have also been amended to accommodate the partnership and joint venture arrangements. In addition, the amendment removed Harvest's option to cause the BlackGold assets to be removed from the security package of the credit facility, effectively enabling the Company to recognize equity related to BlackGold of \$457.5 million as at March 31, 2014 for purposes of total capitalization, and specified an incremental amount of \$229.5 million to be added to total capitalization for purposes of the total debt to total capitalization covenant, representing partial relief of the Downstream impairment charge incurred in 2013, effective March 31, 2014.

On April 23, 2014, Harvest entered into two joint ventures with KERR Canada Co. Ltd. ("KERR"): Deep Basin Partnership and HK MS Partnership. Deep Basin Partnership was established for the purposes of exploring, developing and producing from certain oil and gas properties in the Deep Basin area in Northwest Alberta. Harvest contributed certain producing and non-producing properties to Deep Basin Partnership in exchange for 467,386,000 of common partnership units, while KERR contributed \$100.4 million for 100,368,000 preferred partnership units. Amounts contributed by KERR will be spent by the Deep Basin Partnership to drill and develop partnership properties in the Deep Basin area. If funding from KERR is insufficient to fund the entire agreed initial multi-year development program, Harvest will fund the balance of the program from its share of partnership distributions. The preferred partnership units provide KERR certain preference rights, including a put option right exercisable after 10.5 years, whereby KERR could cause Deep Basin Partnership to redeem all its preferred partnership units for consideration equal to its initial contribution plus an after-tax internal rate of return of two percent. If Deep Basin Partnership does not have sufficient funds to complete the redemption obligation and after making efforts to secure funding, whether via issuing new equity, entering into a financing arrangement or selling assets, the partnership can cash-call Harvest to meet such obligation.

HK MS Partnership was formed for the purposes of constructing and operating a gas processing facility, which will be primarily used to process the gas produced from the properties owned by the Deep Basin Partnership. A gas processing agreement was entered by the two partnerships. For the HK MS Partnership, KERR contributed \$22.6 million for partnership units, which represent 34.82% of the outstanding partnership units. The remaining 65.18% will be contributed by Harvest as cash is required for the construction of the gas processing facility. On the earlier of 10.5 years after the formation of the HK MS Partnership or when KERR achieves certain internal rate of return, Harvest will have the right but not the obligation to purchase all of KERR's interest for nominal consideration.