PetroShale

Calgary • Denver

Consolidated Financial Statements

For the year ended December 31, 2014, the six months ended December 31, 2013
and the year ended June 30, 2013

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PetroShale Inc.

We have audited the accompanying consolidated financial statements of PetroShale Inc., which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the year ended December 31, 2014, the six-months ended December 31, 2013, the year ended June 30, 2013, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of PetroShale Inc. as at December 31, 2014 and December 31, 2013, and its consolidated financial performance and its consolidated cash flows for the for the year ended December 31, 2014, the six-months ended December 31, 2013, and the year ended June 30, 2013 in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

March 27, 2015
Calgary, Canada

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying audited consolidated financial statements of PetroShale Inc. ("PSH" or the "Company") were prepared by management in accordance with International Financial Reporting Standards ("IFRS"), include Management's best judgments and estimates and reflect the choice of accounting principles and methods that are appropriate to the Company's circumstances. The financial information contained elsewhere in Management's Discussion and Analysis has been reviewed to ensure consistency with the consolidated financial statements.

Management has established processes and procedures designed to provide reasonable assurance that the audited consolidated financial statements fairly present in all material respects the financial condition, results of operations, and cash flows of the Company, as of the date of and for the periods presented.

The Board of Directors is responsible for reviewing and approving the audited consolidated financial statements together with other financial information of the Company and for ensuring that management fulfills its financial reporting responsibilities. An Audit Committee assists the Board of Directors in fulfilling this responsibility. The Audit Committee meets with management and KPMG LLP, an independent firm of public accountants, to review the financial reporting process and the audited consolidated financial statements together with other financial information of the Company. On the recommendation of the Audit Committee, these audited consolidated financial statements have been approved by the Board of Directors.

(signed) "*M. Bruce Chernoff*"
M. Bruce Chernoff
Chief Executive Officer and Chairman

(signed) "*David Rain*"
David Rain, C.A.
Chief Financial Officer

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at (thousands of Canadian dollars)	NOTE	December 31, 2014	December 31, 2013
ASSETS			
Current assets			
Cash and cash equivalents		$ 339	$ 1,312
Accounts receivable	17	2,743	622
Financial derivative asset	5,11	-	17
Prepaid expenses		160	52
		3,242	2,003
Non-current assets			
Restricted cash	15	157	70
Exploration and evaluation	7	-	527
Property, plant and equipment	8	75,036	10,331
		75,193	10,928
		$ 78,435	$ 12,931
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		$ 19,329	$ 1,702
Senior Loan	10	11,363	-
Note payable	10	-	2,245
Total current liabilities		30,692	3,947
Non-current liabilities			
Subordinated loan	10	36,568	-
Senior loan	10	-	1,056
Decommissioning obligation	9	892	552
		37,460	1,608
Total liabilities		68,152	5,555
SHAREHOLDERS' EQUITY			
Share capital	12	35,658	28,948
Contributed surplus	12	3,111	2,587
Deficit		(30,167)	(25,113)
Accumulated other comprehensive income		1,681	954
		10,283	7,376
Commitments	15		
Subsequent Events	10, 21		
		$ 78,435	$ 12,931

See accompanying notes to the consolidated financial statements.

Approved by Board of Directors

(Signed) "Brett Herman"
Director

(Signed) "M. Bruce Chernoff"
Chairman

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(thousands of Canadian dollars, except per share amounts)	NOTE	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Revenue				
Oil and natural gas revenue		$ 9,264	$ 3,065	$ 3,712
Royalties		(2,030)	(635)	(831)
		7,234	2,430	2,881
Realized (loss) gain on financial derivatives	5,11	(53)	8	-
Unrealized (loss) gain on financial derivatives	5,11	(17)	17	-
		(70)	25	-
		7,164	2,455	2,881
Expenses				
Production and operating		1,811	493	749
General and administrative		2,706	1,461	1,395
Depletion and depreciation	8	2,407	835	1,063
Finance		3,184	224	187
Foreign exchange loss		-	-	349
Impairment of exploration and evaluation assets	7	680	1,653	15,625
Impairment of property, plant and equipment	8	906	294	3,749
Share-based compensation	12	524	179	893
		12,218	5,139	24,010
Net loss for the period		(5,054)	(2,684)	(21,129)
Currency translation adjustment		727	585	374
Comprehensive loss for the period		$ (4,327)	$ (2,099)	$ (20,755)
Net loss per share				
Basic and diluted	13	**(0.16)**	**(0.09)**	**(0.73)**

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the year ended December 31, 2014, the six months ended December 31, 2013 and for the year ended June 30, 2013

(thousands of Canadian dollars, except share amounts)

	Non Voting Common Shares		Voting Common Shares					Accumulated Other Comprehensive Income	
	Shares	Amount	Shares	Amount	Warrants	Contributed Surplus	Deficit		Total
Balances, June 30, 2012	6,700,000	$ -	22,173,552	$ 28,909	$ 1,002	$ 567	$ (1,354)	$ (5)	$ 29,119
Issuance of common shares	-	-	134,000	39	-	-	-	-	39
Share-based compensation	-	-	-	-	-	893	-	-	893
Net loss for the year	-	-	-	-	-	-	(21,129)	-	(21,129)
Other comprehensive income for the year	-	-	-	-	-	-	-	374	374
Balances, June 30, 2013	6,700,000	$ -	22,307,552	$ 28,948	$ 1,002	$ 1,460	$ (22,483)	$ 369	$ 9,296
Share-based compensation	-	-	-	-	-	179	-	-	179
Expiration of warrants	-	-	-	-	(1,002)	1,002	-	-	-
Cancellation of stock options	-	-	-	-	-	(54)	54	-	-
Net loss for the period	-	-	-	-	-	-	(2,684)	-	(2,684)
Other comprehensive income for the period	-	-	-	-	-	-	-	585	585
Balances, December 31, 2013	6,700,000	$ -	22,307,552	$ 28,948	$ -	$ 2,587	$ (25,113)	$ 954	$ 7,376
Share-based compensation	-	-	-	-	-	524	-	-	524
Issuance of common shares for cash, net	-	-	5,000,000	6,442	-	-	-	-	6,442
Issuance of common shares for acquisition	-	-	200,000	268	-	-	-	-	268
Net loss for the year	-	-	-	-	-	-	(5,054)	-	(5,054)
Other comprehensive income for the year	-	-	-	-	-	-	-	727	727
Balances, December 31, 2014	6,700,000	$ -	27,507,552	$ 35,658	$ -	$ 3,111	$ (30,167)	$ 1,681	$ 10,283

See accompanying notes to the consolidated financial statements

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(thousands of Canadian dollars)	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Operating Activities			
Net loss for the period	$ (5,054)	$ (2,684)	$ (21,129)
Items not affecting cash:			
Depletion and depreciation	2,407	835	1,063
Impairment of exploration and evaluation assets	680	1,653	15,625
Impairment of property, plant and equipment	906	294	3,749
Accretion of decommissioning obligation	7	4	6
Amortization of loan fees	552	-	-
Unrealized (gain) loss on financial derivatives	17	(17)	-
Share-based compensation	524	179	893
Decommissioning expenditures	(84)	-	-
Change in non-cash working capital	(802)	(173)	85
	(847)	91	292
Investing activities			
Acquisition of property, plant and equipment	(34,787)	(965)	(5,844)
Additions to exploration and evaluation assets	(136)	(271)	(3,159)
Additions to property, plant and equipment	(27,713)	(1,973)	(642)
Change in non-cash working capital	14,295	1,131	-
	(48,341)	(2,078)	(9,645)
Financing activities			
Proceeds from share issuance, net	6,442	-	-
Proceeds from subordinated loan, net	34,251	-	-
Proceeds from (repayment of) note payable	(2,316)	-	2,208
Proceeds from senior loan, net of repayment	9,727	1,093	-
Restricted cash	(87)	-	-
	48,017	1,093	2,208
Changes in cash and cash equivalents	(1,171)	(894)	(7,145)
Effect of foreign exchange rates on cash and cash equivalents	198	14	155
Cash and cash equivalents, beginning of period	1,312	2,192	9,182
Cash and cash equivalents, end of period	$ 339	$ 1,312	$ 2,192

See accompanying notes to the consolidated financial statements.

1. BUSINESS AND NATURE OF OPERATIONS

PetroShale Inc. (the "Company") is a growing oil company engaged in the acquisition, development and consolidation of interests in the North Dakota Bakken.

The Company's head office is located at Suite 3900, 350-7th Avenue SW, Calgary, Alberta.

2. BASIS OF PREPARATION

These consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and were authorized for issue by the Board of Directors on March 27, 2015.

These financial statements have been prepared using the historical cost basis, except for financial derivative instruments which are measured at fair value.

The Company's presentation currency is the Canadian dollar. Certain reclassifications have been made to prior period's figures to conform to the current period's presentation.

Change in year end

During 2013, the Company changed its financial year-end from June 30 to December 31 in order to align its continuous disclosure reporting and shareholder meeting schedule with the majority of its oil and gas peer group, and to facilitate peer comparisons. As a result of changing the Company's year-end, the current reporting period for the year ended December 31, 2014 has been presented with comparative information for the six month period ended December 31, 2013 and for the year ended June 30, 2013.

Critical judgments in applying accounting policies

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

The Company's assets are aggregated into cash generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit's ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances and as to whether economic quantities of reserves will be found so as to assess if technical feasibility and commercial viability has been achieved.

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key sources of estimation uncertainty

The following are key estimates and assumptions made by management affecting the measurement of balances and transactions in these financial statements.

Estimation of recoverable quantities of proven and probable oil and gas reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion and depreciation of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations in accordance with National Instrument 51-101.

The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, future removal technologies in determining the removal cost, and the estimate of the liability specific discount rates to determine the present value of these cash flows.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proven and probable reserves being acquired.

The Company's estimate of share-based compensation expense is dependent upon estimates of historic volatility of the Company's share price and anticipated forfeiture rates.

The Company's estimate of the fair value of derivative financial instruments is dependent on estimated forward prices and volatility in those prices.

The Company's deferred tax asset or liability is based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates and the likelihood of assets being realized.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to the periods presented in the financial statements by the Company.

a) Business Combinations and Consolidation

i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of an acquisition over the fair value of the identifiable assets acquired net of liabilities assumed is recorded as goodwill. If the cost of an acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of operations and comprehensive income.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, PetroShale (US), Inc., GEL Exploration Limited and Zama Production Limited. During the year, the Company merged two of its wholly-owned subsidiaries, PetroShale (US) Production LLC and PetroShale (US) Land 1 LLC, into PetroShale (US), Inc.

ii) Jointly controlled operations and jointly controlled assets

The Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

iii) Transactions eliminated on consolidation

All intercompany balances and transactions have been eliminated upon consolidation.

b) Revenue Recognition

Revenues associated with the production and sale of petroleum products owned by the Company are recognized when the significant risks and rewards of ownership are transferred to the buyer, which is typically when the production enters a third party pipeline or loading facility, and provided the amount to be received can be reasonably estimated and collection is reasonably assured.

Royalty payments received from projects in which the Company has an interest are recorded when received or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured.

c) Foreign Currency Translation

The Company's consolidated financial statements are reported in Canadian dollars, which is the Company's presentation currency. Transactions of the Company's US subsidiary are recorded in US dollars, as this is the primary economic environment in which this subsidiary operates. The US subsidiary has a US dollar functional currency. In translating the financial results from US dollars to Canadian dollars, the Company uses the following method: assets and liabilities are translated at the exchange rate in effect as at the date of the consolidated statement of financial position; revenues and expenses are translated at the rate effective at the time of the transaction or the average rate for the period; and changes in shareholders' equity are translated at the rate effective at the time of the transaction. Unrealized gains and losses resulting from the translation to the Canadian dollar presentation currency are included in other comprehensive income.

d) Cash and Cash Equivalents

Cash and cash equivalents comprise cash and short-term investments that have a fixed maturity date less than three months from the date of acquisition.

e) Exploration and Evaluation of Oil and Gas Assets

i) Capitalization

Under the method of accounting for Exploration and Evaluation ("E&E") costs, expenditures made on the exploration for and evaluation of oil and gas properties are capitalized on a cost center basis from the time the Company obtains the legal rights to explore in an area until completion of the evaluation of the property. Such costs include costs of drilling, land acquisition and annual lease costs, geological consulting and the cost of equipment and general and administrative overhead charges directly related to the exploration and evaluation of the properties. Costs that qualify for capitalization are recorded as an intangible E&E asset until a determination is made about the future of the asset. E&E assets are not depleted until the exploration phase is complete and are subject to impairment testing described below. Costs incurred prior to obtaining the legal right to explore an area are expensed immediately.

Upon completion of the exploration phase, and when technically feasible and commercially viable reserves are discovered, the capitalized assets are reclassified to property, plant and equipment in the statement of financial position after being tested for impairment. The technical feasibility and commercial viability are considered to be determinable when proven and/or probable reserves are determined to exist. Any impairment loss would be immediately recognized as a charge to income prior to reclassification. Depletion and depreciation of the assets would commence subsequent to this date. The cost of undeveloped land that expires is charged as additional depletion expense.

ii) Impairment

As facts and circumstances suggest, the Company tests its E&E assets for impairment by comparing the carrying amount against the assets' recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. If the carrying value exceeds the recoverable amount, the difference is written off to the statement of operations in that period. E&E assets are aggregated within the associated CGU for purposes of impairment testing. In addition, once technical feasibility and commercial viability of production are demonstrated, E&E assets are tested for impairment and any net amounts are reclassified to property, plant and equipment.

f) Property, Plant and Equipment

There are two categories of Property, Plant and Equipment ("PP&E"): Developed and Producing ("D&P") assets and Other PP&E assets.

D&P assets include capital costs (i) related to drilling projects where the drilling location is already determined to hold proven and/or probable reserves, (ii) that have been reclassified from E&E assets because proven and/or probable reserves have been determined, and (iii) incurred to improve an already technically feasible and commercially viable well.

Other PP&E assets typically include furniture, fixtures, leasehold improvements and office equipment.

For statement of financial position presentation, both D&P assets and Other PP&E assets are included in the PP&E category.

i) Recognition and measurement

PP&E is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. For purposes of determining depletion and depreciation expense, when significant parts of PP&E have different useful lives, they are accounted for separately so that depletion and depreciation rates appropriately reflect useful lives.

Gains and losses on disposal of PP&E, property swaps and farm-outs, are determined by comparing the proceeds from disposal with the carrying amount of the PP&E sold, and are recognized on a net basis in profit or loss.

The net carrying value of D&P assets is depleted using the unit-of-production method by calculating the ratio of production in the period to the related proven and probable reserves. The net carrying value to be depleted includes an estimate of future development costs required to produce the related reserves, which may include the costs of drilling and completing wells. These estimates are reviewed at least annually by independent engineers in conjunction with their review of the Company's proven and probable reserves.

For Other PP&E assets, depreciation is recognized in the statement of operations and comprehensive income on a straight-line basis over their estimated useful lives. Finance lease assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

ii) Impairment

An assessment is made at each reporting period as to whether there are any facts or circumstances which suggest there may be an impairment of D&P assets. If such facts and circumstances exist, the Company would compare the carrying amount of D&P assets to their recoverable amount, on a CGU by CGU basis. The recoverable amount of a CGU is the greater of (i) its value in use, and (ii) its fair value less selling costs. In assessing value in use for D&P assets, the estimated future cash flows from the production of proven and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses recognized in prior periods are assessed at each reporting date to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the D&P asset carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation expense, if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the statement of operations and comprehensive income.

iii) Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as D&P assets only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized costs generally represent costs incurred in developing proven and/or probable reserves and bringing in or enhancing production from such reserves, and is accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day to day servicing of property, plant and equipment are recognized in profit or loss as incurred.

g) Decommissioning Obligation

An obligation is recognized if, as a result of a past event, the Company has a future legal or constructive obligation resulting from the retirement and reclamation of tangible long-lived assets and this obligation can be reliably estimated. The obligation is measured at the present value of management's best estimate of the expected expenditures required to settle this obligation and is recorded in the period the related assets are put into use with a corresponding increase to the carrying amount of the related assets. This increase in capitalized costs is depleted and depreciated on a basis consistent with the underlying assets. Subsequent changes in the estimated fair value of the provision are capitalized and depleted over the remaining useful life of the underlying asset.

The obligation is carried in the statement of financial position at its discounted present value and is accreted over time for the change in its present value. The obligation is discounted at a rate that reflects the current market assessments of the time value of money and the risks specific to the obligation.

h) Income Taxes

Current income taxes are measured at the amount expected to be payable on taxable income for the period, using tax rates enacted or substantively enacted at the end of the reporting period.

The Company follows the asset and liability method of accounting for deferred income taxes. Under this method, deferred income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of statement of financial position items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is not probable that the related tax benefit will be realized.

i) Share-based Payments

The Company uses the fair value method to recognize the cost associated with stock options granted to employees, directors and other service providers. The fair value of the stock options granted is measured using the Black-Scholes option pricing model. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Under the fair value method, the Company recognizes estimated compensation expense related to stock options over the vesting period of the options granted, with the related credit being charged to contributed surplus. Fair value is measured at the grant date and each tranche is recognized using the graded vesting method over the period during which the options vest. At each reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. Upon exercise of any stock options, amounts previously credited to contributed surplus are reversed and credited to share capital.

j) Earnings per Share

Basic earnings per common share are calculated by dividing the net earnings for the period by the weighted average number of common shares outstanding in each respective period. Diluted earnings per common share reflect the maximum possible dilution from other securities, if dilutive.

k) Financial Instruments

i) Non-derivative Financial Instruments

These comprise cash and cash equivalents including bank overdrafts, accounts receivable, accounts payable and loans and borrowings. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

a. Cash and cash equivalents in the statement of financial position comprise cash at banks and on hand and short term deposits with an original maturity of three months or less.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents defined above, net of outstanding bank overdrafts. These balances are reflected at cost.

b. Other non-derivative financial instruments, such as loans and borrowings, accounts receivable and accounts payable, are measured at amortized cost using the effective interest method, less any impairment losses.

ii) Derivative Financial Instruments

The Company may enter into certain financial derivative contracts in order to manage its exposure to market risks from fluctuations in commodity prices, interest rates and foreign exchange rates. These instruments are not used for trading or speculative purposes. The Company will not designate its financial derivative contracts as effective accounting hedges, and thus will not apply hedge accounting, even though the Company considers all commodities contracts to be economic hedges. As a result, all financial derivative contracts will be classified as fair value through profit and loss and recorded in the statement of financial position at fair value. Related transaction costs such as trading commissions will be recognized in the statement of operations and comprehensive income when incurred.

Forward physical delivery and sales contracts of oil and natural gas products are entered into under the normal course of business and therefore not recorded at fair value in the statement of financial position. These physical delivery contracts are not considered to be derivative financial instruments or hedges. Settlements on these physical delivery contracts are recognized in oil and natural gas revenue in the statement of operations and comprehensive income. Unrealized gains and losses are recorded based on the changes in the fair values of the derivative instruments. Both the unrealized and realized gains and losses resulting from the contract settlement of derivatives are recorded in the statements of operations.

iii) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and stock options are recognized as a reduction from equity, net of any tax effects.

l) New Accounting Standards

On January 1, 2014, the Company adopted amendments to "Offsetting Financial Assets and Financial Liabilities" addressed within IAS 32 - "Financial Instruments: Presentation", which provides guidance regarding when it is appropriate and permissible for an entity to disclose offsetting financial assets and financial liabilities on a net basis. The Company also adopted IFRIC 21 - "Levies", which establishes guidelines for the recognition and accounting treatment of a liability relating to a levy imposed by a government. The adoption of these standards had no impact on the amounts recorded in the financial statements as at January 1, 2014 or on the comparative periods.

4. FUTURE ACCOUNTING PRONOUNCEMENTS

Certain new accounting standards, interpretations and amendments to existing standards, with future effect, have been issued by the IASB or the International Financial Reporting Interpretation Committee ("IFRIC"). The standard that is applicable to the Company are as follows:

IFRS 9 - "Financial Instruments", is the result of the first phase of the IASB's project to replace IAS 39 - "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The standard will come into effect on January 1, 2018 with early adoption permitted. The extent of the impact of the adoption of IFRS 9 has not yet been determined.

IFRS 11 – "Accounting for Acquisitions of Interests in Joint Operations" is being amended. The impact of this amended accounting standard has not yet been determined.

IFRS 15 – "Revenue from Contracts with Customers" was issued in May 2014 to replace IAS11 – "Construction Contracts" and IAS 18 – "Revenue" and related interpretive guidance. IFRS 15 provides a single, principles based model to be applied to all contracts with customers as well as new disclosure requirements with the objective of a more structured approach, improving comparability across entities and industries. Under IFRS 15, an entity will recognize revenue at the amount to which it expects to be entitled in exchange for goods or services on their transfer. IFRS 15 is effective for annual periods beginning on or after January 1, 2017 with earlier adoption permitted and is to be applied retrospectively. The extent of the impact of the adoption of IFRS 15 on the Company has not yet been determined.

5. FAIR VALUE HIERARCHY

Several of the Company's accounting policies require a determination of fair value for certain assets and liabilities. Fair value for measurement or disclosure purposes is determined on the following basis.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques include the market, income and cost approach. The market approach uses information generated by market transactions involving identical or comparable assets or liabilities; the income approach converts estimated future amounts to a present value; and the cost approach is based on the amount that currently would be required to replace an asset.

The Company is required to classify their financial instruments within a hierarchy that prioritizes the inputs to fair market value. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in an active market for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and,

Level 3 – Inputs that are not based on observable market data.

a) Exploration and evaluation assets, and property, plant and equipment

The fair value of exploration and evaluation assets and property, plant and equipment recognized in a business combination, is based on market value. The market value of E&E assets and PP&E is the estimated amount for which E&E assets and PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted with knowledge and prudence and without compulsion. The market value of oil and natural gas interests included in E&E assets and PP&E is estimated with reference to the discounted future cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

b) Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, note payable, senior loan and subordinated loan.

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, note payable, senior loan and subordinated loan are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. As at December 31, 2014, December 31, 2013 and June 30, 2013, the fair value of cash and cash equivalents, accounts receivable, and accounts payable approximated their carrying value due to their short term maturity. The fair value of the note payable, senior and subordinated loans approximated their carrying values as their interest rates reflect market.

c) Derivatives

The Company does not engage in the use of any derivative instruments for speculative purposes. If it enters into any contracts for the future delivery of non-financial assets, these are done in accordance with its expected sale requirements. As such, these contracts are not considered to be derivative instruments and have not been recorded at fair value in the financial statements. As the Company delivers petroleum products in accordance with the terms of these contracts, any associated revenue will be recorded as oil and natural gas revenue. The fair value of financial forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk free interest rate. The fair value of costless collars is based on option models that use published information with respect to volatility, prices and interest rates. The Company classifies its derivatives as Level 2 in the fair value hierarchy.

The following table sets forth, by level within the fair value hierarchy, the fair value on a recurring basis of the Company's financial derivatives as of December 31, 2013 and June 30, 2013.

Assets at fair values:	Total	Level 1	Level 2	Level 3
December 31, 2013	$ 17	$ -	$ 17	$ -
Decrease	(17)	-	(17)	-
December 31, 2014	$ -	$ -	$ -	$ -

d) Share-based compensation

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility of the underlying share price, weighted average expected life of the option (based on historical experience and general option holder behavior), expected dividends, forfeiture rate and the risk-free interest rate (based on government bonds).

6. ACQUISITIONS

During the year ended December 31, 2014, through various transactions, the Company purchased oil and gas leases in McKenzie, Williams and Mountrail counties in North Dakota. This represents various working interests in potential drilling units, as well as Federal land, with associated proved undeveloped and probable reserves. There were no producing wells or other facilities associated with these purchases. The Company paid an aggregate consideration of approximately US$26.8 million for these leases, funded through a combination of credit facilities, existing cash resources and the issuance of 200,000 common shares. There were no assumptions of liabilities associated with these purchases.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

In addition to the oil and gas lease purchases described above, the Company also purchased working interests in wells, which were in the process of being drilled, and assumed capital obligations related to drilling and completion of these wells for consideration of approximately US$1.3 million which includes assumption of decommissioning liabilities.

In aggregate for these transactions, which have been accounted for as business combinations, total consideration paid and the net assets acquired is as follows:

CONSIDERATION			***NET ASSETS ACQUIRED***		
Cash	$	29,609	Developed and producing assets	$	31,060
Shares issued		268	Decommissioning obligations assumed		(17)
Accounts payable assumed		1,166			
	$	31,043		$	31,043

Producing Properties

The Company acquired certain oil and gas producing properties during the fourth quarter of 2014. The Company has treated these transactions as business combinations and has accounted for them using the acquisition method to reflect the fair value of the assets and liabilities assumed. The decommissioning obligation was determined using the fair value as of the respective acquisition date of the Company's estimated timing and costs to remediate, reclaim and abandon the related wells and production infrastructure. Results of operations from the assets acquired were included in the financial statements beginning on the closing date of the transactions. The total purchase price of US$4.7 million was settled with cash funded through credit facilities.

The aggregate purchase price was allocated as follows:

CONSIDERATION (US$4,710)	$	5,201
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	5,188
Accounts receivable		27
Accounts payable		(4)
Decommissioning obligation		(10)
	$	5,201

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The following reflects selected pro forma financial information for the year ended December 31, 2014 as if the acquisitions had occurred on January 1, 2014 instead of the closing date of each transaction:

		Year Ended December 31, 2014
Oil and natural gas revenue, net of royalties	$	3,053
Production and operating		(360)
Depletion and depreciation		(689)
Finance		(499)
		1,505
Net loss for the period		(5,054)
Adjusted net loss for the period	$	(3,549)
Adjusted basic and diluted net loss per share	$	(0.11)

Stockyard Acquisition

On August 19, 2013 the Company entered into a purchase and sale agreement ("Stockyard Acquisition") with a third party (the "Seller") to purchase certain assets within the Stockyard Creek field, Williams County, North Dakota, for a purchase price of US$934,000.

The net assets to the Company consisted of: (i) an approximately 5.5% working interest in 106 net leased acres, (ii) an interest in a drilled, and yet to be completed, middle Bakken well, and (iii) a share of the related salt water gathering and disposal system.

The purchase price was allocated as follows:

CONSIDERATION (US$934)	$	965
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	972
Decommissioning obligation		(7)
	$	965

MJ Angus Acquisition

On May 17, 2013 the Company completed an acquisition of land in McKenzie County, including an average 1.5% working interest in 11 wells either recently completed or in the drilling process at the date of the acquisition ("MJ Angus Acquisition").

The purchase price was allocated as follows:

CONSIDERATION (US$1,049)	$	1,103
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	1,617
Accounts receivable		82
Accounts payable		(588)
Decommissioning obligation		(8)
	$	1,103

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The following reflects selected pro forma financial information for the year ended June 30, 2013 as if the acquisitions had occurred on July 1, 2012 instead of the closing date of May 17, 2013:

		Year Ended June 30, 2013
Oil and natural gas revenue, net of royalties	$	493
Production and operating		(22)
Depletion and depreciation		(254)
		217
Net loss for the period		(21,129)
Adjusted net loss for the period	$	(20,912)
Adjusted basic and diluted net loss per share	$	(0.72)

Melbby, North Dakota Production Acquisition

On October 17, 2012 the Company acquired certain oil and gas producing assets in Mountrail County, North Dakota with an effective date of August 1, 2012 ("Melbby Acquisition"). The purchase price of US$4.0 million was settled with cash.

The purchase price was allocated as follows:

CONSIDERATION (US$4,057)	$	4,007
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	4,048
Accounts payable		(10)
Decommissioning obligation		(31)
	$	4,007

The following reflects selected pro forma financial information for the year ended June 30, 2013 as if the acquisition had occurred on July 1, 2012 instead of the closing date of October 17, 2012:

		Year Ended June 30, 2013
Oil and natural gas revenue, net of royalties	$	1,300
Production and operating expense		(162)
Depletion and depreciation expense		(420)
Financial expense		(202)
		516
Net loss for the period		(21,129)
Adjusted net loss for the period	$	(20,613)
Adjusted basic and diluted net loss per share	$	(0.71)

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

7. EXPLORATION AND EVALUATION ASSETS

Balance as at June 30, 2012	$	18,909
Additions		3,159
Transfers		(4,665)
Impairment		(15,625)
Effect of foreign exchange rate		132
Balance as at June 30, 2013	$	1,910
Additions		271
Impairment		(1,653)
Effect of foreign exchange rate		(1)
Balance as at December 31, 2013	$	527
Additions		136
Impairment		(680)
Effect of foreign exchange rate		17
Balance as at December 31, 2014	$	-

For the year ended December 31, 2014, the six months ended December 31, 2013 and the year ended June 30, 2013, the Company recognized $0.7 million, $1.7 million and $15.6 million, respectively, of impairment expense related to one of its CGUs located in the United States. The Company no longer has any development plans within this CGU, therefore, all of the leases and related costs were written down to nil during the year ended December 31, 2014.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

8. PROPERTY, PLANT AND EQUIPMENT

	Other	Developed and Producing Assets	Total
Balance as at June 30, 2012	$ 15	$ 2,032	$ 2,047
Acquisition of petroleum and natural gas properties	-	5,665	5,665
Additions	21	673	694
Transfers	-	4,665	4,665
Impairment	-	(3,749)	(3,749)
Depletion and depreciation	(6)	(1,057)	(1,063)
Effect of foreign exchange rate	-	2	2
Balance as at June 30, 2013	$ 30	$ 8,231	$ 8,261
Acquisition of petroleum and natural gas properties	-	972	972
Additions	18	2,204	2,222
Impairment	-	(294)	(294)
Depletion and depreciation	(14)	(821)	(835)
Effect of foreign exchange rate	-	5	5
Balance as at December 31, 2013	$ 34	$ 10,297	$ 10,331
Acquisition of petroleum and natural gas properties	-	36,248	36,248
Additions	30	28,047	28,077
Impairment	-	(906)	(906)
Depletion and depreciation	(11)	(2,396)	(2,407)
Effect of foreign exchange rate	4	3,689	3,693
Balance as at December 31, 2014	$ 57	$ 74,979	$ 75,036

Depletion, Depreciation, and Future Development Costs

For the year ended December 31, 2014, the six months ended December 31, 2013 and the year ended June 30, 2013 the Company recorded $2,407,000, $835,000 and $1,063,000, respectively, of depletion and depreciation expense, which reflected an estimated US$118.7 million, US$5.9 million and US$1.3 million, respectively of future development costs associated with proven plus probable reserves.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

Impairment Charges

At December 31, 2014, the Company determined that indicators of impairment exist for all of its CGUs due to the recent decline in the current and forward commodity prices for oil and natural gas. The Company has performed an impairment test on each of its CGUs as at December 31, 2014 using a discount rate of 10 percent on its U.S. CGUs and 15 percent on its Canadian non-core CGU, and the following commodity price estimates from the Company's independent reserve evaluators:

	Oil (WTI - US$) ($/bbl)	Natural Gas (Henry Hub - US$) ($/mmbtu)
2015	64.88	3.390
2016	75.35	3.825
2017	81.23	4.075
2018	84.95	4.388
2019	88.57	4.700
2020	92.25	4.919
2021	94.97	5.138
2022	96.74	5.320
2023	98.57	5.527
2024	100.41	5.692
2025	102.29	5.803
2026	104.21	5.940
2027	106.17	6.090
2028	108.18	6.204
2029 (escalated 2% thereafter)	110.20	6.331

For the year ended December 31, 2014, the six months ended December 31, 2013 and the year ended June 30, 2013 the Company recognized $906,000, $294,000 and $3.7 million, respectively of impairment expense related to two of its CGUs.

The impairment was based on the difference between the period-end net book value of the assets and the estimated recoverable amount and was recorded as impairment expense in the statement of operations with the offset charged against property, plant and equipment.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

9. DECOMMISSIONING OBLIGATION

Balance as at June 30, 2012	$	207
Acquisition of petroleum and natural gas properties		39
Additions		15
Revisions of estimated cash flows		15
Accretion		6
Effect of foreign exchange rate		1
Balance as at June 30, 2013	$	283
Acquisition of petroleum and natural gas properties		7
Additions		-
Revisions of estimated cash flows		255
Accretion		4
Effect of foreign exchange rate		3
Balance as at December 31, 2013	$	552
Acquisition of petroleum and natural gas properties		27
Additions		198
Obligations Settled		(84)
Revisions of estimated cash flows		166
Accretion		7
Effect of foreign exchange rate		26
Balance as at December 31, 2014	$	892

The Company's decommissioning obligation consists of remediation obligations resulting from its ownership interests in petroleum and natural gas assets. The total obligation is estimated based on the Company's net working interest in wells and related facilities, estimated costs to return these sites to their original condition, costs to plug and abandon the wells and the estimated timing of the costs to be incurred in future years.

The total undiscounted amount of estimated future cash flows required to settle the obligation at December 31, 2014 is $1.4 million (December 31, 2013 – $0.7 million, June 30, 2013 – $0.3 million) which includes inflation factors ranging between 1.7% to 2.0% (December 31, 2013 – 1.5%, June 30, 2013– 2%) on the costs of decommissioning and assumes that the liabilities are settled over the next 40 years in accordance with estimates prepared by independent engineers. The estimated future cash flows at December 31, 2014 have been discounted at the risk-free interest rate of 2.4% to 2.8% (December 31, 2013 and June 30, 2013 – 2.4% to 2.9%). Decommissioning obligations at December 31, 2014 have been revised by ($3,000) (2013 - $22,000) due to changes in estimates of the risk free rate and $169,000 (2013 - $233,000) due to revisions in abandonment and reclamation cost estimates.

10. DEBT

Senior Loan

In September 2014, the Company replaced its then existing senior loan facility with a new senior credit facility from a Canadian bank. The current senior loan is a revolving credit facility with a borrowing base of US$10.0 million as at December 31, 2014. This facility is due on demand, but has a renewal date of July 23, 2015, at which point, at the bank's option, it may be renewed on terms to be agreed upon at that time, or converted to a non-revolving term facility. This facility is secured by all of the Company's assets and bears interest at the bank's prime lending rate plus 1% or the relevant bankers acceptance fee plus 2.75% if drawn in Canadian dollars, or the bank's U.S. dollar base rate plus 0.50% or U.S. dollar LIBOR rate plus 3.75% if drawn in U.S. dollars. The borrowing base is subject to a borrowing base test performed at least twice annually by the bank, based on reserve reports. A decrease in the borrowing base could result in a repayment to the bank. A standby fee of 0.50% per annum is applied to any undrawn balance. The credit facility is subject to financial and non-financial covenants applied to the Company, on a consolidated basis. The financial covenants consist of: (i) a consolidated cash flow to interest expense ratio, as defined in the loan agreement, which is not to be less than 2.50 to 1 on a rolling four-quarter basis, with any equity injections included in the calculation of consolidated cash flow and interest expense excluded from the definition of consolidated cash flow; and (ii) a requirement that total debt not exceed the borrowing base by more than 133%, while excluding the subordinated loan from the definition of total debt. The bank recently increased the borrowing base to US$15.5 million and extended the renewal date to March 24, 2016. The next borrowing base review will be performed by the bank based upon the receipt of an updated reserve report as of June 30, 2015.

As at December 31, 2014, the Company was approximately fully drawn and is in compliance with all of its financial and non-financial covenants under the facility. However, management anticipates that, absent an equity offering, sustained low oil prices may result in a breach of the consolidated cash flow to interest expense covenant under the senior loan during the latter half of 2015. Management has obtained a waiver from this covenant from the senior lender on the condition that interest payments under the subordinated loan are deferred until such time as the covenant is back in compliance, or until April 1, 2016, whichever is earlier. Management has notified the subordinated lenders that interest payments will be deferred commencing April 1, 2015. If the Company is successful in raising equity capital later in the year, proceeds therefrom can be added to cash flow for purposes of this covenant, which may allow interest payments on the subordinated loan to recommence at that time.

Until September 2014, the Company had a three year revolving line of credit with a U.S. financial institution, which was scheduled to mature on July 31, 2016. The borrowing base of US$3.0 million was secured by the assets of one of the Company's wholly-owned U.S. subsidiaries. The amount of the facility was subject to a borrowing base test performed on a periodic basis and at least twice annually by the lender, based primarily on reserves and using commodity prices estimated by the lender as well as other factors. This facility included a 1% origination fee, a 0.5% standby fee on available but undrawn funds, and interest on outstanding balances at US prime rate plus 0.5% with a 4.0% minimum rate.

Subordinated Loan

On January 17, 2014, the Company entered into a secured, subordinated, revolving credit facility which may be drawn in US dollars. The maturity date of the facility was recently extended to December 31, 2016. The amount available under the facility was increased to US$50.0 million on November 14, 2014. The credit facility bears interest at a rate of 12% per annum, with interest payments due monthly, and includes a 2.5% loan origination fee. The credit facility is provided by two significant shareholders of the Company, one of whom is also a director and the CEO. This loan is secured by all of the assets of the Company, but subordinated to the senior loan facility. Among certain non-financial covenants, the subordinated loan requires the Company to comply with the financial covenants required by the senior loan agreement. Thus, a default under the terms of the senior loan would create a default under the subordinated loan agreement. A deferral of interest payments, as a condition of the covenant waiver under the senior loan described above, would result in an increase in the accrued interest rate under the subordinated loan of 5% per annum during the period that interest payments are deferred. However, the subordinated lenders have agreed to waive the interest rate increase in this circumstance, and for the period the interest deferral is required under the senior loan agreement. Loan origination fees of US$1.25 million have been reflected net of the outstanding debt balance on the statement of financial position and are being amortized over the term of the credit facility and charged to finance expense using the effective interest rate method. Total fees amortized to finance expense for the year ended December 31, 2014 were US$500,000. This facility was drawn approximately US$32.3 million as at December 31, 2014 and as at March 27, 2015 was approximately fully drawn.

Note Payable

On October 17, 2012 the Company entered into a debt instrument with a trust, whose trustee is an individual that is a principal of an entity which owns 6.7 million non-voting shares of the Company. On July 25, 2013 the Company entered into an amendment, which restructured the note. The principal terms of the note were as follows; (i) US$2.1 million dollar revolving capacity, maturing on October 12, 2014, (ii) a 0.75% loan origination fee, interest of 0.5% per annum on available but undrawn funds and 12% per annum on any outstanding balance with interest payments only due quarterly. The note was secured by the assets of PetroShale (US) Land 1 LLC. This note was settled in February 2014.

11. FINANCIAL DERIVATIVE INSTRUMENTS

The Company had utilized swaps to reduce the effect of commodity price changes on a portion of its future oil production. A swap requires the Company to pay the counterparty if the settlement price exceeds the strike price, and the same counterparty is required to pay the Company if the settlement price is less than the strike price. The objective of the Company's use of derivative financial instruments is to achieve more predictable cash flows in an environment of volatile oil and natural gas prices and to manage its exposure to commodity price risk. While the use of these derivative instruments limits the downside risk of adverse price movements, such use may also limit the Company's ability to benefit from favorable price movements. The Company may, from time to time, add incremental derivatives to hedge additional production, restructure existing derivative contracts or enter into new transactions to modify the terms of current contracts in order to realize the current value of the Company's existing positions. The Company does not enter into derivative contracts for speculative purposes.

The use of derivatives involves the risk that the counterparties to such instruments will be unable to meet the financial terms of such contracts. The Company's derivative contracts entered into previously were with one counterparty, which is a large multi-national energy company, and management did not believe the risk of counterparty failure to be significant. The Company has netting arrangements with the counterparty that provide for the offset of payables against receivables from separate derivative arrangements with the counterparty.

The following table details the fair value of the financial derivatives recorded in the applicable statements of financial position, by category:

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

Underlying Commodity	Location in Statement of Financial Position	As at December 31, 2014	As at December 31, 2013	As at June 30, 2013
Crude oil derivative contracts	Current Assets	$ -	$ 17	$ -

The amount of gains recognized in the statements of operations related to the Company's derivative financial instruments are as follows:

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Realized gain (loss) on financial derivatives	$ (53)	$ 8	$ -
Unrealized gain (loss) on financial derivatives	(17)	17	-
Gain (loss) on commodity price risk management activities	$ (70)	$ 25	$ -

The Company settled all of its outstanding commodity derivative contracts during 2014 and none are outstanding currently or as at December 31, 2014.

12. SHARE CAPITAL

a) Share capital

The Company's authorized share capital includes unlimited Class A preferred shares with rights and privileges to be determined by the Board of Directors prior to issuance, unlimited common non-voting shares, convertible into common voting shares on a l for 1 basis, and unlimited common voting shares. As at December 31, 2014, the Company had 27,507,552 (December 31, 2013 and June 30, 2013- 22,307,552) voting and 6,700,000 (December 31, 2013 and June 30, 2013- 6,700,000) non-voting common shares issued and outstanding.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The following table reflects the Company's outstanding common shares as at December 31, 2014:

	Number of Voting and Non-Voting Shares	Share Capital
Balance as at June 30, 2012	28,873,552	$ 28,909
Issuance of common shares - related party	134,000	39
Balance as at June 30, 2013 and December 31, 2013	29,007,552	$ 28,948
Issuance of common shares for cash, net of issuance costs	5,000,000	6,442
Issuance of common shares - acquisition of property (Note 6)	200,000	268
Balance as at December 31, 2014	34,207,552	$ 35,658

In June 2014, the Company closed a non-brokered private placement of 5 million voting common shares at $1.30 per share for gross proceeds of $6.5 million with 3.4 million shares subscribed for by directors and officers of the Company.

b) Stock Options

In the year ended December 31, 2014, the Company issued 275,000 stock options to employees. The stock options are exercisable for a five year term at an average price of $1.40 per share. The options vest in three equal tranches beginning one year from the effective date and then on each of the two following anniversaries.

During the six months ended December 31, 2013, the Company issued an aggregate of 943,264 stock options to certain employees and directors. The stock options are exercisable for a five year term at a price of $0.70 per share. The options vest in three equal tranches beginning one year from the effective date and then on each of the two following anniversaries.

On May 6, 2013, in connection with the private placement of common shares to the Company's then CEO, the board of directors of the Company also granted the then CEO 443,470 options to purchase common shares of the Company at an exercise price of $0.29 per common share. The options were scheduled to vest on each of the next three anniversaries of the date of grant and expire on May 6, 2018. These options were all forfeited upon the CEO's cessation of employment in October 2013.

The stock options, and any common shares issued upon exercise of the stock options are subject to a four month resale restriction.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The following table presents stock option transactions for the periods ended December 31, 2014, December 31, 2013 and June 30, 2013:

	Number of Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Balance as at June 30, 2012	1,441,281	$	1.50	4.72
Granted	443,470		0.29	5.00
Balance as at June 30, 2013	1,884,751		1.22	3.98
Granted	943,264		0.70	5.00
Forfeited or expired	(827,810)		(0.85)	-
Balance as at December 31, 2013	2,000,205		1.12	4.01
Granted	275,000		1.40	5.00
Balance as at December 31, 2014	2,275,205	$	1.16	3.15

As at December 31, 2014, the following stock options were outstanding:

Exercise Prices	Weighted Average Remaining Contractual Term	Number of Outstanding Options	Number of Options Exercisable	Weighted Average Exercise Price
$0.70	3.90	943,264	314,419	$0.70
$1.40	4.19	275,000	-	$1.40
$1.50	2.21	1,056,941	1,056,941	$1.50
	3.15	2,275,205	1,371,360	$1.16

The Company uses the fair value method to account for all share-based awards granted to employees, officers and directors. The estimated fair value of stock option grants was determined using the Black-Scholes option pricing model and is recorded as a charge to income over the vesting period with a corresponding increase to contributed surplus.

During the year ended December 31, 2014, the six months ended December 31, 2013 and the year ended June 30, 2013, the Company recorded $524,000, $179,000 and $893,000, respectively in share-based compensation expense.

The fair value of the stock options granted has been estimated on the date of grant using the following assumptions:

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Expected volatility	115%	114%	213%
Option life	5 years	5 years	5 years
Expected dividends	nil	nil	nil
Risk-free interest rate	1.57% to 1.73%	1.73%	1.02%
Forfeiture rate	0% to 20%	0% to 20%	0%

The expected volatility used in the Black Scholes option pricing model is based on the volatility of the Company's share price.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

13. NET LOSS PER COMMON SHARE

The following table presents the Company's net loss per common share:

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Net loss for the period	$ (5,054)	$ (2,684)	$ (21,129)
Weighted average number of basic common shares	32,102,895	29,007,552	28,893,744
Net loss per weighted average basic and diluted common share	$ (0.16)	$ (0.09)	$ (0.73)

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

14. INCOME TAXES

The provision for income taxes recorded in the financial statements varies from the amount that would be computed by applying the Canadian statutory income tax rate of 26.50% as a result of the following:

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Loss before income tax provision	$ (5,054)	$ (2,684)	$ (21,129)
Statutory rate	26.50%	26.50%	26.50%
Income tax recovery at statutory rate	(1,339)	(711)	(5,599)
Tax effect on the following:			
Effect of higher corporate tax rate in US	(333)	(219)	(1,807)
Nondeductible expense	140	52	236
Impact of rate change and other	(343)	(200)	(331)
Change in unrecognized deferred tax asset	1,875	1,078	7,501
Provision for income taxes	$ -	$ -	$ -

The components of the Company's deferred tax liability are as follows:

	December 31, 2014	December 31, 2013	June 30, 2013
Exploration and evaluation assets and property, plant and equipment	$ (3,957)	$ -	$ -
Non-capital losses (Federal)	3,957	-	-
	$ -	$ -	$ -

The deductible temporary differences included in the Company's unrecognized deferred income tax assets are as follows:

	December 31, 2014	December 31, 2013	June 30, 2013
Exploration and evaluation assets and property, plant and equipment	$ -	$ 11,096	$ 14,543
Decommissioning obligation	892	552	283
Capital losses	-	-	599
Non-capital losses (Federal)	31,819	14,292	7,730
Non-capital losses (State)	24,279	6,486	4,075
Share issue costs	5	6	18
Other	1	(17)	-
	$ 56,996	$ 32,415	$ 27,248

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The unused tax losses that have not been recognized are as follows:

		December 31, 2014	Expiration Dates
Non-capital losses (U.S.)	$	39,329	2031 to 2034
Non-capital losses (CAN)	$	2,862	2030 to 2034
Non-capital losses (Montana)	$	7,371	2018 to 2020
Non-capital losses (North Dakota)	$	16,908	2031 to 2033

15. COMMITMENTS

The Company has two outstanding letters of credit in favor of energy regulators in Ontario and North Dakota, respectively in the amount of $58,000 and US$75,000. As security for these letters of credit, the Company has set aside these amounts in cash at the financial institutions that issued the letters of credit. In addition, the Company has set aside $12,000 as cash security for credit cards held by the Company.

The Company is committed to rental payments of $11,000 per year on its Ontario operations and office space until November 2015. The Company also leases office space in Denver, Colorado and is committed to monthly payments of an average of US$7,500 until August 2017.

16. RELATED PARTY TRANSACTIONS

Related party transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties

Compensation of key management personnel

Key management personnel include the Chief Executive Officer of the Company, the President of PetroShale (U.S.), Inc., the Chief Financial Officer and the directors and other officers of the Company.

		Year Ended December 31, 2014		Six Months Ended December 31, 2013		Year Ended June 30, 2013
Salaries and other short-term benefits	$	287	$	365	$	37
Consulting fees		330		251		488
Share-based compensation		422		179		893
	$	1,039	$	795	$	1,418

A payment of USD$250,000 was made to the former President and Chief Executive Officer with respect to his cessation of employment during the six month period ended December 31, 2013.

The Company paid $150,000 and $40,000 for accounting and CFO services to a company owned by the former Chief Financial Officer during the six month period ended December 31,2013 and the year ended June 30, 2013, respectively.

Also, see Note 10 – Debt - Subordinated loan regarding loan with a related party.

17. RISK MANAGEMENT

a) Overview

The Company's activities expose it to a variety of financial risks such as credit risk, liquidity risk and market risk that arise as a result of its exploration, development, production and financing activities.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls and to monitor risks and market conditions.

b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The carrying amount of the Company's cash and cash equivalents, accounts receivable, and financial derivative contract assets represent the maximum credit exposure.

With respect to accounts receivable, the Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

As the majority of the Company's current oil and natural gas operations are conducted on a non-operated basis, its accounts receivable mainly reflect joint venture receivables from the operators of each of its respective properties. The Company attempts to mitigate the risk from joint venture receivables by working with large reputable industry operators. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise, increasing the risk of non-collection.

The Company does not typically obtain collateral from joint venture partners and believes that operators of its properties, who are responsible for marketing the production from those properties, do not typically obtain collateral from petroleum and natural gas marketers they may utilize. However, the Company mitigates this risk by working with large reputable operators.

With respect to its operated assets, the Company does not anticipate any default on collection of accounts receivable as it transacts with credit-worthy customers. As such, a provision for doubtful accounts has not been recorded as at December 31, 2014, December 31, 2013 and June 30, 2013.

All of the Company's accounts receivables are from the production of oil and natural gas. There are no receivables that are greater than 90 days outstanding.

c) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial obligations as they come due. The financial liabilities in the statement of financial position consist of accounts payable, which are all considered due within one year, the senior and subordinated loans and the note payable.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities as they come due. The Company forecasts its cash flows from operating activities as well as obligations related to capital spending and settlement of accounts payable in relation to available liquidity from its revolving credit facilities. The Company's accounts payable and accrued liabilities balance at December 31, 2014 is approximately $19.3 million (December 31, 2013 - $1.7 million). It is the Company's practice to pay suppliers within 45-90 days. As at December 31, 2014, substantially all of the account balances were less than 90 days.

The following are the contractual maturities of the Company's debt obligations and anticipated timing of settlements of its other financial liabilities as at December 31, 2014, including estimated interest payments:

	Carrying Amount	Contractual Cash Flow	Less than 1 Year	1-2 Years	3-5 Years	Thereafter
Accounts payable and accrued liabilities	$ 19,329	$ 19,329	$19,329	$ -	$ -	$ -
Senior loan[1]	11,363	11,617	11,617	-	-	-
Subordinated loan [2]	36,568	46,423	4,493	41,930	-	-
Total	$ 67,260	$ 77,369	$35,439	$ 41,930	$ -	$ -

[1] Includes interest expense at 4.0% being the rate applicable to the senior loan at December 31, 2014.

[2] Includes interest expense at 12.0% being the fixed rate applicable to the subordinated loan at December 31. 2014.The impact of a deferral of interest payments as described in Note 10 has not been reflected here.

d) Market risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its assets and liabilities. The objective of market risk management is to manage and control market risk exposure within acceptable parameters.

Although the Company does not generally sell or transact in foreign currencies, its US subsidiaries conduct their operations primarily in US dollars. Furthermore, exchange rate fluctuations can affect the fair value and cash flow from derivative contracts. For the periods ended December 31, 2014, December 31, 2013 and June 30, 2013, the Company did not enter into any foreign currency derivative contracts.

Commodity prices for crude oil, natural gas liquids and natural gas are also impacted by political events, meteorological conditions and changes in supply and demand. The Company may enter into commodity derivative contracts that provide downside price protection in order to provide some stability of cash flows for capital spending and planning purposes. The Company's risk management activities are conducted pursuant to its risk management policies approved by the Board of Directors.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. The Company's interest rate risk arises from its floating rate senior loan. For the periods ended December 31, 2014, December 31, 2013 and June 30, 2013, the Company did not enter into any interest rate derivative contracts. The impact of a 1% increase in the interest rate associated with the senior loan for the year ended December 31, 2014, would have been an increase in net loss of approximately $50,000 (December 31, 2013 - $10,000.)

18. CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital expenditure program, which includes expenditures on oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including: current economic conditions; the risk characteristics of the Company's petroleum and natural gas assets; the depth of its investment opportunities; current and forecasted net debt levels; current and forecasted commodity prices; and other factors that influence realized commodity prices and funds flow from operations such as quality and basis differential, royalties, operation costs and transportation costs. The Company considers its capital structure to include working capital, any debt and shareholders' equity. The Company monitors capital based on current funds flow from operations compared to forecasted capital and operating requirements.

In order to maintain or adjust the capital structure, the Company will consider: its forecasted funds flow from operations while attempting to finance an acceptable capital expenditure program which may in the future include acquisition opportunities; the current level of credit available from its lenders; the level of credit that may become available from its lenders as a result of oil and gas reserve growth; the availability of other sources of debt with different characteristics than bank debt or the existing subordinated loan; the sale of assets; limiting the size of the capital expenditure program and new equity if available on favorable terms. The Company's share capital is not subject to external restrictions. Access to any bank credit facility is determined by the lenders and is generally based upon the lenders' borrowing base models which are based upon the Company's petroleum and natural gas reserves. The Company's subordinated loan is provided by two parties being its largest shareholders, including the CEO and Executive Chairman.

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

19. SUPPLEMENTAL CASH FLOW DISCLOSURES

Changes in non-cash working capital is comprised of:

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Source/(use) of cash:			
Accounts receivable	$ (2,121)	$ 146	$ (617)
Prepaid expenses	(108)	(25)	(13)
Accounts payable	17,627	261	394
Effect of foreign currency	-	576	321
	15,398	958	85
Related to operating activities	$ (802)	$ (173)	$ 85
Related to investing activities	14,295	1,131	-
Assumed accounts payable on acquisition of assets	1,166	-	-
Difference due to foreign exchange	739	-	-
	15,398	958	85
Interest paid	$ 2,625	$ 154	$ 181
Income taxes paid	nil	nil	nil

(tabular amounts in $000's of Canadian dollars, unless otherwise noted)

20. SEGMENT DISCLOSURES

The Company operates in one industry segment, the production of petroleum and natural gas and the exploration for and development of oil and natural gas properties.

The Company and its subsidiaries operate in two geographical segments, Canada and the United States.

	Year Ended December 31, 2014	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Revenue, net of royalties			
United States	$ 6,575	$ 1,995	$ 2,106
Canada	659	435	775
	$ 7,234	$ 2,430	$ 2,881
Net loss for the period			
United States	$ (3,065)	$ (2,317)	$ (19,475)
Canada	(1,989)	(367)	(1,654)
	$ (5,054)	$ (2,684)	$ (21,129)
Exploration and evaluation assets			
United States	$ -	$ 527	$ 1,910
Canada	-	-	-
	$ -	$ 527	$ 1,910
Property, plant and equipment			
United States	$ 73,920	$ 8,381	$ 6,449
Canada	1,116	1,950	1,812
	$ 75,036	$ 10,331	$ 8,261