PetroShale
Calgary • Denver

**Consolidated Interim Financial Statements**

As at June 30, 2017
and for the three and six months ended June 30, 2017 and 2016

PetroShale
Calgary • Denver

## CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
**(Unaudited)**

| As at<br>(thousands of Canadian dollars) | NOTE | June 30, 2017 | December 31, 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | | $ 2,130 | $ 1,134 |
| Accounts receivable | | 4,360 | 4,662 |
| Prepaid expenses and deposits | 9 | 293 | 268 |
| | | 6,783 | 6,064 |
| **Non-current assets** | | | |
| Restricted cash | 9 | 98 | 101 |
| Property, plant and equipment | 4 | 145,194 | 139,866 |
| | | 145,292 | 139,967 |
| | | $152,075 | $146,031 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | | $ 5,147 | $ 29,573 |
| Financial derivative liability | | - | 61 |
| Senior loan | 6 | - | 30,209 |
| Subordinated loan | 6, 10 | 39,697 | 94,372 |
| | | 44,844 | 154,215 |
| **Non-current liabilities** | | | |
| Senior loan | 6 | 11,434 | - |
| Decommissioning obligation | 5 | 1,954 | 1,218 |
| | | 13,388 | 1,218 |
| Total liabilities | | 58,232 | 155,433 |
| **SHAREHOLDERS' EQUITY (DEFICIT)** | | | |
| Share capital | 7 | 141,793 | 35,658 |
| Warrants | 6, 7, 10 | 684 | 684 |
| Contributed surplus | | 3,787 | 3,597 |
| Deficit | | (52,733) | (51,976) |
| Accumulated other comprehensive income | | 312 | 2,635 |
| | | 93,843 | (9,402) |
| Commitments | 9 | | |
| | | $152,075 | $146,031 |

See accompanying notes to the consolidated financial statements.

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## CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
**(Unaudited)**

| (thousands of Canadian dollars, except per share amounts) | NOTE | Three months ended June 30, 2017 | Three months ended June 30, 2016 | Six months ended June 30, 2017 | Six months ended June 30, 2016 |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Oil and natural gas | | $10,786 | $ 5,966 | $25,964 | $ 9,970 |
| Royalties | | (2,229) | (1,209) | (5,387) | (2,031) |
| | | 8,557 | 4,757 | 20,577 | 7,939 |
| Unrealized gain on financial derivatives | | - | - | 61 | - |
| | | 8,557 | 4,757 | 20,638 | 7,939 |
| **Expenses** | | | | | |
| Production and operating | | 2,909 | 1,493 | 6,122 | 3,002 |
| General and administrative | 4 | 1,168 | 670 | 1,945 | 1,425 |
| Depletion and depreciation | 4 | 3,429 | 2,391 | 7,463 | 4,378 |
| Finance | 6, 10 | 1,882 | 3,268 | 5,753 | 6,031 |
| Foreign exchange gain | | (71) | (140) | (71) | (520) |
| Share-based compensation | 7 | 87 | 22 | 183 | 50 |
| | | 9,404 | 7,704 | 21,395 | 14,366 |
| **Net loss for the period** | | (847) | (2,947) | (757) | (6,427) |
| Currency translation adjustment | | (2,454) | (216) | (2,323) | (1,277) |
| **Comprehensive loss for the period** | | $ (3,301) | $(3,163) | $ (3,080) | $(7,704) |
| **Net loss per share, basic and diluted** | 8 | **$ (0.01)** | **$ (0.09)** | **$ (0.01)** | **$ (0.19)** |

See accompanying notes to the consolidated financial statements.

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## CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY
### For the six months ended June 30, 2017 and 2016
### (Unaudited)
### (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 | | Shareholders' Equity (Deficit) |
| Balances, December 31, 2015 | 6,700,000 | $ - | 27,507,574 | $ 35,658 | $ - | $ 3,344 | $ (39,114) | $ 4,128 | $ 4,016 |
| Issuance of warrants | - | - | - | - | 684 | - | - | - | 684 |
| Share-based compensation | - | - | - | - | - | 50 | - | - | 50 |
| Net loss | - | - | - | - | - | - | (6,427) | - | (6,427) |
| Other comprehensive loss | - | - | - | - | - | - | - | (1,277) | (1,277) |
| Balances, June 30, 2016 | 6,700,000 | $ - | 27,507,574 | $ 35,658 | $ 684 | $ 3,394 | $ (45,541) | $ 2,851 | $ (2,954) |
| | | | | | | | | | |
| Balances, December 31, 2016 | 6,700,000 | $ - | 27,507,574 | $ 35,658 | $ 684 | $ 3,597 | $ (51,976) | $ 2,635 | $ (9,402) |
| Issuance of voting common shares for cash, net | - | - | 122,649,615 | 106,135 | - | - | - | - | 106,135 |
| Share-based compensation, gross | - | - | - | - | - | 190 | - | - | 190 |
| Net loss | - | - | - | - | - | - | (757) | - | (757) |
| Other comprehensive loss | - | - | - | - | - | - | - | (2,323) | (2,323) |
| Balances, June 30, 2017 | 6,700,000 | $ - | 150,157,189 | $ 141,793 | $ 684 | $ 3,787 | $ (52,733) | $ 312 | $ 93,843 |

See accompanying notes to the consolidated financial statements.

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## CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

**(Unaudited)**

| (thousands of Canadian dollars) | NOTE | Six months ended June 30, 2017 | 2016 |
|---|---|---|---|
| | | | (note 2) |
| **Operating Activities** | | | |
| Net loss | | $ (757) | $ (6,427) |
| Operating items not affecting cash: | | | |
| Depletion and depreciation | | 7,463 | 4,378 |
| Unrealized gain on financial derivatives | | (61) | - |
| Share-based compensation | | 183 | 50 |
| Finance expense | | 5,753 | 6,031 |
| Change in non-cash working capital | 11 | 729 | (139) |
| | | 13,310 | 3,893 |
| **Investing Activities** | | | |
| Acquisition of property, plant and equipment | 3 | (12,416) | (8,382) |
| Additions to property, plant and equipment | | (4,402) | (4,774) |
| Proceeds from disposition of property, plant and equipment | | - | 648 |
| Change in non-cash working capital | 11 | (5,966) | (5,533) |
| | | (22,784) | (18,041) |
| **Financing Activities** | | | |
| Proceeds from share issuances, net | 7 | 106,135 | - |
| (Repayment of) proceeds from subordinated loan, net | 6 | (53,332) | 17,327 |
| (Repayment of) proceeds from senior loan, net | 6 | (18,138) | 452 |
| Payment of interest | | (1,709) | (637) |
| Payment of previously deferred interest | | (22,330) | - |
| Change in non-cash working capital | 11 | - | 644 |
| | | 10,626 | 17,786 |
| **Change in cash and cash equivalents** | | 1,152 | 3,638 |
| **Effect of foreign exchange rate changes** | | (156) | (432) |
| **Cash and cash equivalents, beginning of period** | | 1,134 | 822 |
| **Cash and cash equivalents, end of period** | | $ 2,130 | $ 4,028 |

See accompanying notes to the consolidated financial statements.

## 1. BUSINESS AND NATURE OF OPERATIONS

PetroShale Inc. (the "Company") is an oil company engaged in the acquisition, development and consolidation of interests in the North Dakota Bakken/Three Forks.

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

## 2. BASIS OF PREPARATION

These consolidated interim financial statements and the notes thereto should be read in conjunction with the Company's audited consolidated financial statements as at and for the year ended December 31, 2016 and do not include all of the information required for full annual financial statements.

These consolidated interim financial statements are unaudited and have been prepared in accordance with IAS 34 – "Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

The accounting policies applied for the consolidated interim financial statements as at and for the three and six months ended June 30, 2017 are consistent with those applied for the financial statements as at and for the most recent audited period, except as follows. Effective as at June 30, 2017, the Company voluntarily changed its accounting policy in relation to classification of finance expense in its statements of cash flows. Effective this reporting period, the Company has presented interest paid as a financing activity, instead of as an operating activity. The Company believes that the revised presentation better reflects the results of its operating activities and more properly reflects interest associated with the senior and subordinated loans as a financing activity. The Company has restated the consolidated statement of cash flows for the corresponding period in 2016 to reflect this change. There is no impact to the Company's statements of financial position or statements of operations.

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

For the six months ended June 30, 2017, the change in accounting policy had the following impact on the consolidated interim statement of cash flows:

| | Under previous accounting policy | Effect of change of accounting policy | As currently reported |
|---|---|---|---|
| Operating Activities: | | | |
| Net Loss | $ (757) | $ - | $ (757) |
| Operating items not affecting cash: | | | |
| Depletion and depreciation | 7,463 | - | 7,463 |
| Accretion of decommissioning obligation | 4 | (4) | - |
| Amortization of deferred finance costs | 367 | (367) | - |
| Unrealized gain on financial derivatives | (61) | - | (61) |
| Share-based compensation | 183 | - | 183 |
| Deferred finance expense | 3,673 | (3,673) | - |
| Finance expense | - | 5,753 | 5,753 |
| Changes in non-cash working capital | (21,601) | 22,330 | 729 |
| | $ (10,729) | $ 24,039 | $ 13,310 |
| Financing Activities: | | | |
| Proceeds from share issuances, net | $ 106,135 | $ - | $ 106,135 |
| (Repayment of) proceeds from subordinated loan, net | (53,332) | - | (53,332) |
| (Repayment of) proceeds from senior loan, net | (18,138) | - | (18,138) |
| Payment of interest | - | (1,709) | (1,709) |
| Payment of previously deferred interest | - | (22,330) | (22,330) |
| | $ 34,665 | $ (24,039) | $ 10,626 |

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

For the six months ended June 30, 2016, the change in accounting policy had the following impact on the consolidated interim statement of cash flows:

| | As previously reported | Effect of change of accounting policy | As currently reported |
|---|---|---|---|
| Operating Activities: | | | |
| Net Loss | $ (6,427) | $ - | $ (6,427) |
| Operating items not affecting cash: | | | |
| Depletion and depreciation | 4,378 | - | 4,378 |
| Accretion of decommissioning obligation | 5 | (5) | - |
| Amortization of deferred finance costs | 256 | (256) | - |
| Share-based compensation | 50 | - | 50 |
| Deferred finance expense | 5,133 | (5,133) | - |
| Finance expense | - | 6,031 | 6,031 |
| Changes in non-cash working capital | (139) | - | (139) |
| | $ 3,256 | $ 637 | $ 3,893 |
| Financing Activities: | | | |
| (Repayment of) proceeds from subordinated loan, net | 17,327 | - | 17,327 |
| (Repayment of) proceeds from senior loan, net | 452 | - | 452 |
| Payment of interest | - | (637) | (637) |
| Changes in non-cash working capital | 644 | - | 644 |
| | $ 18,423 | $ (637) | $ 17,786 |

These financial statements have been prepared using the historical cost basis.

The Company's reporting and measurement currency is the Canadian dollar. The functional currency of the Company's US subsidiary is the US dollar, and its results and balance sheet items are translated to Canadian dollars for purposes of these consolidated financial statements, in accordance with the Company's foreign currency translation accounting policy.

These consolidated interim financial statements were approved by the Company's Board of Directors on August 17, 2017.

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 standards that are 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 is not expected to be material.

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

IFRS 15 – "Revenue from Contracts with Customers" was issued in May 2014 to replace IAS 11 – "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, 2018 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 been fully assessed at this time.

IFRS 16 – "Leases" is a new standard which introduces a single lessee accounting model with required recognition of assets and liabilities for most leases. It is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted, and is to be applied retrospectively. The extent of the impact of adoption of this new standard on the Company has not been fully assessed at this time.

IAS 38 – amends the existing standard "Clarification of Acceptable Methods of Depreciation and Amortization" and is effective for periods beginning January 1, 2018. The extent of the impact of the implementation of these changes is not anticipated to be material.

## 3. ACQUISITIONS

*Non-Producing Property Acquisitions*

During the six months ended June 30, 2017, the Company purchased oil and gas leases in its focus area in North Dakota. This represents increased working interests in potential drilling units with associated proved undeveloped and probable reserves. The consideration for these leases was approximately US$0.6 million. There were no assumptions of liabilities associated with these purchases.

*Producing Property Acquisition*

In June 2017, the Company acquired certain leases with associated proved undeveloped and probable reserves and oil and natural gas producing properties. The Company has treated the transaction as a business combination and has accounted for it using the acquisition method to reflect the fair value of the assets acquired and liabilities assumed. The decommissioning obligation was determined using the Company's estimated timing and costs to remediate, reclaim and abandon the related wells and production infrastructure, discounted at a market rate. Results of operations from the assets acquired were included in the financial statements from the closing date of the transaction. The total purchase price of US$8.7 million was settled with cash funded through the Company's credit facilities and indirectly with proceeds from an equity offering (Note 7).

The aggregate purchase price was allocated as follows:

| | | |
|---|---|---|
| ***CONSIDERATION (US$8,659)*** | $ | 11,647 |
| **NET ASSETS ACQUIRED AT FAIR VALUE** | | |
| Developed and producing assets | $ | 11,942 |
| Decommissioning obligation | | (295) |
| | $ | 11,647 |

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

The following reflects selected pro forma financial information for the six months ended June 30, 2017 as if the acquisition had occurred on January 1, 2017 instead of the closing date of the transaction:

| | Six months ended June 30, 2017 |
|---|---|
| Oil and natural gas revenue, net of royalties | $ 801 |
| Production and operating expenses | (297) |
| Operating income | 504 |
| Operating income reported for the period | 14,455 |
| Pro forma operating income for the period | $ 14,959 |

## 4. PROPERTY, PLANT AND EQUIPMENT

| | Developed and Producing Assets | Other | Total |
|---|---|---|---|
| Balances as at December 31, 2015 | $ 123,896 | $ 47 | $ 123,943 |
| Acquisitions | 8,505 | - | 8,505 |
| Additions | 20,909 | - | 20,909 |
| Disposition | (651) | - | (651) |
| Depletion and depreciation | (8,903) | (20) | (8,923) |
| Effect of foreign exchange rate changes | (3,915) | (2) | (3,917) |
| Balances as at December 31, 2016 | 139,841 | 25 | 139,866 |
| Acquisitions | 12,856 | - | 12,856 |
| Additions | 4,763 | - | 4,763 |
| Depletion and depreciation | (7,453) | (10) | (7,463) |
| Effect of foreign exchange rate changes | (4,828) | - | (4,828) |
| Balances as at June 30, 2017 | $ 145,179 | $ 15 | $ 145,194 |

*Depletion, Depreciation, and Future Development Costs*

For the six months ended June 30, 2017 and 2016, the Company recorded $7.5 million and $4.4 million, respectively, of depletion and depreciation expense, which reflected an estimated US$263.1 million and US$228.0 million, respectively of future development costs associated with proven plus probable reserves.

*Impairment Charges*

As at June 30, 2017, management determined there were no indicators of impairment of the Company's Developed and Producing Assets.

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

*Capitalized Overhead*

During the six months ended June 30, 2017, the Company capitalized $62,000 (six months ended June 30, 2016 – nil) of general and administrative costs and $7,000 (six months ended June 30, 2016 – nil) of share-based compensation, which are directly attributable to the activities of certain of its personnel in relation to the development of the Company's operated property.

## 5. DECOMMISSIONING OBLIGATION

| | | |
|---|---|---|
| Balance as at December 31, 2015 | $ | 834 |
| Acquisition of petroleum and natural gas properties | | 113 |
| Additions | | 127 |
| Obligations Settled | | (14) |
| Disposition | | (3) |
| Revisions of estimated cash flows | | 173 |
| Accretion | | 8 |
| Effect of foreign exchange rate changes | | (20) |
| Balance as at December 31, 2016 | | 1,218 |
| Acquisition of petroleum and natural gas properties (Note 3) | | 295 |
| Additions | | 131 |
| Revisions of estimated cash flows | | 368 |
| Accretion | | 4 |
| Effect of foreign exchange rate changes | | (62) |
| Balance as at June 30, 2017 | $ | 1,954 |

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 as at June 30, 2017 is $3.5 million (December 31, 2016 – $2.4 million) which includes an annual inflation factor of 2.4% (December 31, 2016 – 1.7%) on the costs of decommissioning and assumes that the liabilities are settled over approximately the next 35 years in accordance with estimates prepared by independent engineers. The estimated future cash flows as at June 30, 2017 have been discounted at the risk-free interest rate of 2.6% (December 31, 2016 – 2.6%).

## 6. DEBT

*Senior Loan*

The Company's senior loan is a revolving credit facility, which as at June 30, 2017 had a borrowing base of US$30.9 million (Cdn$40.7million equivalent). The facility was amended subsequent to June 30, 2017 to increase the borrowing base to US$39.9 million. The facility, as amended, will revolve until June 30, 2018, at which point, the facility will either be extended or, at the option of the lender, converted to a non-revolving facility with a term of 12 months. This facility is secured by all of the Company's assets. The facility bears interest at the bank's prime lending rate, bankers' acceptance rates or US$ LIBOR rates plus a margin which is determined by the Company's senior debt to EBITDA ratio.

The borrowing base capacity of the senior loan facility is subject to a review performed at least twice annually by the bank, based on reserve reports associated with the Company's U.S. petroleum and natural gas properties. A decrease in the borrowing base could result in the requirement to make a repayment to the bank. The next borrowing base review is scheduled to be completed before the end of October 2017.

The credit facility, as subsequently amended is subject to certain financial and non-financial covenants. 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; and (ii) a requirement that the ratio of the senior loan amount to EBITDA, on a rolling four quarter basis, not exceed 3.0 to 1. The consolidated cash flow to interest expense ratio is calculated on the basis that interest expense reflects cash interest paid and excludes deferred and unpaid interest on the subordinated credit facility and other non-cash amortization expense included in finance expense on the company's statements of operations. Consolidated cash flow is defined as consolidated net income plus finance expense, taxes, and other non-cash expenses, adjusted to reflect the pro forma effects of asset acquisitions and dispositions, plus the proceeds of any equity issued by the Company. The consolidated cash flow to interest expense ratio at June 30, 2017 was 9.9 to 1, and the senior loan to EBITDA ratio was 0.6 to 1. As a result, the Company is in compliance with the financial covenants as at that date, and is also in compliance with all of the other covenants under the senior loan as at June 30, 2017.

The facility was drawn approximately US$8.8 million as at June 30, 2017 (December 31, 2016 – US$22.5 million).

*Subordinated Loan*

The Company has a secured, subordinated, revolving credit facility which may be drawn in US dollars and which has a capacity of US$80.0 million (Cdn$104 million equivalent) as at June 30, 2017. The maturity date of the facility is December 31, 2017. The credit facility bears interest at a rate of 12% per annum, and a 2.5% loan origination fee. The credit facility is provided by two significant shareholders of the Company, one of whom is the executive Chairman of our Board of Directors. 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. This facility was drawn US$30.9 million as at June 30, 2017 (December 31, 2016 - US$70.9 million).

The Company deferred cash interest and origination fee payments under the facility from April 2015 to April 10, 2017 as a condition of the senior loan facility. Following completion of an equity offering in April 2017 (Note 7), the Company settled outstanding deferred interest of $22.3 million. The Company has resumed interest payments on a monthly basis effective April 30, 2017.

In April 2016, the lenders agreed to an increase in capacity of the facility to US$80.0 million from US$60 million, the extension of the term to December 31, 2017 and the continued deferral of interest payments (for the term of the subordinated loan or until such time as the bank permitted cash interest to be paid, if earlier). As partial consideration for the enhanced terms and continued interest deferral, the Company issued 2.0 million common share purchase warrants to the subordinated lenders effective May 10, 2016, pro rata to their participation in the revised commitment amount. Each warrant will entitle the holder to exercise and purchase one common share of the Company at $0.75 for a period of two years from the date of issuance. The warrants have been ascribed a fair value of $684,000 (see Note 7) and are being amortized to finance expense over the remaining term of the subordinated loan.

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

## 7. 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 non-voting common shares, convertible into voting common shares on a 1 for 1 basis, and unlimited voting common shares. As at June 30, 2017, the Company had 150,157,189 voting common shares (December 31, 2016 – 27,507,574) and 6,700,000 non-voting common shares issued and outstanding (December 31, 2016 – 6,700,000).

The following table reflects the Company's outstanding common shares as at June 30, 2017:

| | Number of Voting and Non-Voting Shares | Share Capital |
|---|---|---|
| Balance as at December 31, 2016 | 34,207,574 | $ 35,658 |
| Issuance of common shares by prospectus, net of issue costs | 122,265,000 | 105,639 |
| Issuance of common shares by private placement, net of issue costs | 384,615 | 496 |
| Balance as at June 30, 2017 | 156,857,189 | $141,793 |

On April 11, 2017, the Company completed an equity offering resulting in the issuance of 122,265,000 voting common shares at a price of $0.90 per share for gross proceeds of approximately $110 million. Additionally, in June 2017, the Company completed a private placement of 384,615 voting common shares to the Company's new President and CEO for gross proceeds of $500,000.

b) Stock options

The following table presents stock option transactions for the periods ended June 30, 2017 and December 31, 2016:

| | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) |
|---|---|---|---|
| Balance as at December 31, 2015 | 2,295,205 | $ 1.16 | 3.36 |
| Granted | 1,350,000 | 0.70 | 5.00 |
| Forfeited | (908,469) | (1.46) | (1.34) |
| Balance as at December 31, 2016 | 2,736,736 | 0.83 | 3.01 |
| Balance as at June 30, 2017 | 2,736,736 | $ 0.83 | 2.51 |

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

As at June 30, 2017, the following stock options were outstanding:

| Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Number of Outstanding Options | Number of Options Exercisable |
|---|---|---|---|
| $0.70 | 2.96 | 2,293,264 | 943,264 |
| $1.50 | 0.17 | 443,472 | 443,472 |
| $0.83 | 2.51 | 2,736,736 | 1,386,736 |

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.

c) Warrants

The Company issued 2 million common share purchase warrants to the Company's subordinated lenders (see Notes 6 and 10) on May 10, 2016. Each warrant entitles the holder to exercise and acquire one common share for $0.75 for a period of two years from the date of grant.

## 8. NET LOSS PER COMMON SHARE

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *(thousands, except for share and per share data)* | 2017 | 2016 | 2017 | 2016 |
| Net loss for the period | $ (847) | $ (2,947) | $ (757) | $ (6,427) |
| Weighted average number of basic common shares | 143,070,672 | 34,207,574 | 88,939,850 | 34,207,574 |
| Net loss per weighted average basic and diluted common share | $ (0.01) | $ (0.09) | $ (0.01) | $ (0.19) |

## 9. COMMITMENTS

The Company has an outstanding letter of credit in favor of an energy regulator in North Dakota in the amount of US$75,000. As security, the Company has set aside an equivalent amount in cash at the financial institution that issued the letter of credit. In addition, the Company has advanced funds to other regulatory agencies in the amount of US$125,000 as security in order to operate in North Dakota.

The Company is committed to monthly rental payments for office space of US$12,000 through July 2020.

## 10. 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.

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

The Company has a secured, subordinated, revolving credit facility which is provided by two significant shareholders of the Company, one of whom is also the executive Chairman of our Board of Directors. See further details in Note 6 – Debt - Subordinated loan. During the six months ended June 30, 2017, fees and the value of the warrants associated with this facility were amortized to finance expense in the amount of $367,000 (June 30, 2016 – $256,000). The Company had deferred payment of interest and fees related to the facility from April 1, 2015 through April 10, 2017. Following completion of an equity offering in April 2017, the Company settled accrued interest and origination fees of $22.3 million and paid principal of $53.3 million. Payments of interest have since resumed on a monthly basis.

The lenders to this facility agreed to enhance its terms in April 2016. As partial consideration for extending the term of the subordinated loan, increasing the facility capacity and agreeing to continue to defer cash interest payments, the Company granted 2 million common share purchase warrants to the subordinated lenders, pro rata to their participation in the revised commitment amount. Each warrant entitles the holder to acquire one common share at $0.75 for a period of two years from the date of issuance. These warrants were valued at $684,000 on the date of issuance and reflected in shareholders' equity on the statements of financial position.

## 11. SUPPLEMENTAL CASH FLOW DISCLOSURES

Changes in non-cash working capital is comprised of:

| | Six months ended June 30, 2017 | 2016 |
|---|---|---|
| Source / (use) of cash: | | |
| Accounts receivable | $ 302 | $ 518 |
| Prepaid expenses | (25) | (131) |
| Accounts payable | (24,426) | (921) |
| | $ (24,149) | $ (534) |
| Related to operating activities | $ 729 | $ (139) |
| Related to investing activities | (5,966) | (5,533) |
| Related to financing activities | - | 644 |
| Payment of previously deferred interest | (22,330) | - |
| Deferred finance expense during the period | 3,673 | 5,133 |
| Assumed working capital on asset acquisition | - | 10 |
| Difference due to foreign exchange | (255) | (649) |
| | $ (24,149) | $ (534) |
| Current period interest paid | $ 1,709 | $ 637 |
| Previously deferred interest paid | $ 22,330 | $ - |
| Income taxes paid | nil | nil |

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

## 12. 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 operated in two geographical segments during the periods reported below, being Canada and the United States.

| | Six months ended June 30, 2017 | Six months ended June 30, 2016 |
|---|---|---|
| Revenue, net of royalties | | |
| United States | $ 20,543 | $ 7,910 |
| Canada | 34 | 29 |
| | $ 20,577 | $ 7,939 |
| Net loss for the period | | |
| United States | $ (203) | $ (6,220) |
| Canada | (554) | (207) |
| | $ (757) | $ (6,427) |

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| Property, plant and equipment | | |
| United States | $ 144,563 | $ 139,215 |
| Canada | 631 | 651 |
| | $ 145,194 | $ 139,866 |