

PetroShale

C a l g a r y • D e n v e r

Consolidated Interim Financial Statements

As at March 31, 2018
and for the three months ended March 31, 2018 and 2017



CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
(Unaudited)

As at (thousands of Canadian dollars)	NOTE	March 31, 2018	December 31, 2017
ASSETS			
Current assets			
Cash and cash equivalents		\$ 3,665	\$ 18,421
Accounts receivable		17,059	10,178
Prepaid expenses and deposits		461	384
		21,185	28,983
Non-current assets			
Restricted cash	12	97	94
Property, plant and equipment	3, 4	239,536	184,172
		239,633	184,266
		\$260,818	\$213,249
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		\$ 31,582	\$ 38,447
Financial derivative liability	7	4,157	3,149
		35,739	41,596
Non-current liabilities			
Senior loan	6	34,067	49,891
Subordinated loan	6, 13	-	30,640
Preferred share obligation	8	82,354	
Decommissioning obligation	3, 5	2,663	2,473
		119,084	83,004
Total liabilities		154,823	124,600
SHAREHOLDERS' EQUITY			
Common shares	9	144,599	142,379
Preferred share equity component	8	10,041	-
Warrants	9	-	684
Contributed surplus	9	4,182	3,547
Deficit		(52,718)	(55,069)
Accumulated other comprehensive loss		(109)	(2,892)
		105,995	88,649
Commitments	12		
		\$260,818	\$213,249

See accompanying notes to the consolidated financial statements.



CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

(thousands of Canadian dollars, except per share amounts)	NOTE	Three months ended March 31,	
		2018	2017
Revenue			
Oil and natural gas	10	\$ 19,273	\$ 15,061
Royalties		(3,699)	(3,158)
		15,574	11,903
Realized loss on financial derivatives	7	(1,095)	-
Unrealized gain (loss) on financial derivatives	7	(902)	61
		(1,997)	61
		13,577	11,964
Expenses			
Production and operating		2,735	2,814
Transportation	10	280	282
General and administrative	4	554	777
Depletion and depreciation	4	4,421	4,034
Finance	6, 8	2,586	3,871
Share-based compensation	9	650	96
		11,226	11,874
Net income for the period		2,351	90
Currency translation adjustment		2,783	131
Comprehensive income for the period		\$ 5,134	\$ 221
Net income per share, basic and diluted	11	\$ 0.01	\$ -

See accompanying notes to the consolidated financial statements.

CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

For the three months ended March 31, 2018 and 2017

(Unaudited)

(thousands of Canadian dollars, except share amounts)

	Non Voting Common Shares		Voting Common Shares		Warrants	Preferred Share	Contributed Surplus	Deficit	Accumulated Other	Shareholders' Equity (Deficit)
	Shares	Amount	Shares	Amount		Equity Component			Comprehensive Income (Loss)	
Balances, December 31, 2016	6,700,000	\$ -	27,507,574	\$ 35,658	\$ 684	\$ -	\$ 3,597	\$ (51,976)	\$ 2,635	\$ (9,402)
Share-based compensation	-	-	-	-	-	-	96	-	-	96
Net income	-	-	-	-	-	-	-	90	-	90
Other comprehensive income	-	-	-	-	-	-	-	-	131	131
Balances, March 31, 2017	6,700,000	\$ -	27,507,574	\$ 35,658	\$ 684	\$ -	\$ 3,693	\$ (51,886)	\$ 2,766	\$ (9,085)
Balances, December 31, 2017	-	\$ -	157,137,767	\$ 142,379	\$ 684	\$ -	\$ 3,547	\$ (55,069)	\$ (2,892)	\$ 88,649
Issuance of Preferred shares - equity component	-	-	-	-	-	10,041	-	-	-	10,041
Exercise of warrants to purchase common shares for cash	-	-	2,000,000	2,184	(684)	-	-	-	-	1,500
Exercise of options to purchase common shares for cash	-	-	30,000	36	-	-	(15)	-	-	21
Share-based compensation	-	-	-	-	-	-	650	-	-	650
Net income	-	-	-	-	-	-	-	2,351	-	2,351
Other comprehensive income	-	-	-	-	-	-	-	-	2,783	2,783
Balances, March 31, 2018	-	\$ -	159,167,767	\$ 144,599	\$ -	\$ 10,041	\$ 4,182	\$ (52,716)	\$ (109)	\$ 105,995

See accompanying notes to the consolidated financial statements.

CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

(Unaudited)

(thousands of Canadian dollars)	NOTE	Three months ended March 31,	
		2018	2017
			(note 2)
Operating Activities			
Net income		\$ 2,351	\$ 90
Operating items not affecting cash:			
Depletion and depreciation		4,421	4,034
Unrealized (gain) loss on financial derivatives		902	(61)
Share-based compensation		650	96
Finance expense		2,586	3,871
Change in non-cash working capital	14	(3,054)	(4,070)
		<u>7,856</u>	<u>3,960</u>
Investing Activities			
Acquisition of property, plant and equipment	3	(22,916)	-
Additions to property, plant and equipment	4	(30,657)	(1,720)
Change in non-cash working capital	14	(13,135)	(2,380)
		<u>(66,708)</u>	<u>(4,100)</u>
Financing Activities			
Proceeds from convertible preferred share issuance, net	8	89,991	-
Proceeds from exercise of warrants	9	1,500	-
Proceeds from exercise of options		21	-
Repayment of subordinated loan, net	6, 13	(30,993)	-
Proceeds from (repayment of) senior loan, net	6	(16,881)	1,644
Payment of interest		(557)	(392)
		<u>43,081</u>	<u>1,252</u>
Change in cash and cash equivalents		(15,771)	1,112
Effect of foreign exchange rate changes		1,015	(27)
Cash and cash equivalents, beginning of period		<u>18,421</u>	<u>1,134</u>
Cash and cash equivalents, end of period		<u>\$ 3,665</u>	<u>\$ 2,219</u>

See accompanying notes to the consolidated financial statements.

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

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 3230, 421 - 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, 2017 and do not include all 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 months ended March 31, 2018 are consistent with those applied for the financial statements as at and for the most recent audited period, except as follows.

Accounting for New Hybrid Financial Instrument

In January 2018, the Company's wholly-owned subsidiary (the "Subsidiary Issuer") issued preferred shares which are convertible at the option of the holder into common voting shares of the Company at a fixed price per share. The terms of the preferred shares include a redemption feature which, in the absence of a conversion of the preferred shares, require the Subsidiary Issuer to redeem the preferred shares at a price equal to the issue price plus any accrued and unpaid dividends. Because the Subsidiary Issuer has a contractual obligation to deliver cash to settle the preferred shares, they are accounted for as a financial liability. The existence of the equity conversion feature makes the preferred shares a hybrid financial instrument for accounting purposes and requires that the Company value each of the liability and equity residual components of the instrument and present them separately on the statement of financial position. The Company determined the fair value of the liability component by discounting the contractual dividend and redemption payments over the term of the preferred shares at the rate of interest that would apply to an identical financial instrument without a conversion option. The Company determined that such interest rate was 12% per annum. The liability component is presented as "Preferred Share Obligation" under Non-current liabilities on the statement of financial position and the equity residual component is presented as "Preferred Share Equity Component" under Shareholders' Equity on the statement of financial position. Related transaction and issuance costs reduce the carrying amounts of each of the liability and equity residual components on a pro rata basis. The liability component is accreted to the redemption amount of the preferred shares over the term of the preferred shares to maturity, with the related accretion expense included in "Finance Expense" on the statement of operations.

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

Adoption of IFRS 15 – “Revenue from Contracts with Customers”

Effective January 1, 2018, the Company adopted IFRS 15 using the retrospective method. The new standard did not have a material impact on net income on the statement of operations. However, the Company has provided enhanced disclosures related to its Revenue which are reflected in Note 10 to these consolidated interim financial statements.

The Company's revenue recognition accounting policy, as revised with the adoption of IFRS 15, is as follows:

Revenues associated with the production and sale of petroleum products owned by the Company are recognized at the point in which control of the products is transferred to the buyer, which may be when the production enters that party's pipeline or processing facility. Processing or transportation costs associated with petroleum production are netted against the related revenue if they are incurred following the transfer of control to the entity who has purchased the commodity. If transportation or processing costs are incurred prior to the sale of the relevant commodity, such costs are reflected separately as an expense in the statement of operations.

In addition, the Company is required to evaluate its arrangements with its joint venture partners to determine if the Company acts as the principal or as an agent in respect of the sale of the partner's interest in production. In making this evaluation, management considers if the Company obtains control of the product delivered, which is indicated by the Company having the primary responsibility for the delivery of the products, having the ability to establish prices or assuming inventory risk. In the Company's case, it is acting in the capacity of an agent rather than as a principal in commodity sales transactions on its operated properties, and the revenue is recognized on a net basis.

Adoption of IFRS 9 – “Financial Instruments”

The Company adopted IFRS 9 effective January 1, 2018. IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost; fair value through other comprehensive income (“FVOCI”); or fair value through profit or loss (“FVTPL”). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and by contractual cash flow characteristics.

IFRS 9 replaces the “incurred loss” model in IAS 39 with an “expected credit loss” model. The new impairment model applies to financial assets measured at amortized cost, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. There was no impact on the Company's financial statements as a result of adopting this new standard.

Cash and cash equivalents and trade and other receivables continue to be measured at amortized cost and are now classified as “amortized cost”. The Company's financial liabilities continue to be measured at amortized cost. The Company has not designated any financial instruments as FVOCI or FVTPL, nor does the Company use hedge accounting for any of its commodity financial derivatives.

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

Change in Presentation of Finance Expense

Effective as at June 30, 2017, the Company voluntarily changed its accounting policy in relation to classification of finance expense in its statement of cash flows. The Company now presents 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, excluding the impact of how these activities are financed, and more properly reflects interest associated with its financing liabilities as a financing activity. The Company has restated the consolidated statement of cash flows for the corresponding period in 2017 to reflect this change. There was no impact to the Company's statements of financial position or statements of operations.

For the three months ended March 31, 2017, the change in accounting policy had the following impact on the consolidated statement of cash flows:

	Under previous accounting policy	Effect of change of accounting policy	As currently reported
Operating Activities:			
Net income	\$ 90	\$ -	\$ 90
Operating items not affecting cash:			
Depletion and depreciation	4,034	-	4,034
Accretion of decommissioning obligation	3	(3)	-
Amortization of deferred finance costs	182	(182)	-
Unrealized gain on financial derivatives	(61)	-	(61)
Share-based compensation	96	-	96
Deferred finance expense	3,294	(3,294)	-
Finance expense	-	3,871	3,871
Change in non-cash working capital	(4,070)	-	(4,070)
	<u>\$ 3,568</u>	<u>\$ 392</u>	<u>\$ 3,960</u>
Financing Activities:			
Proceeds from senior loan, net	\$ 1,644	\$ -	\$ 1,644
Payment of interest	-	(392)	(392)
	<u>\$ 1,644</u>	<u>\$ (392)</u>	<u>\$ 1,252</u>

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

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

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, PetroShale (US), Inc. The Company's presentation and functional 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.

The Company has reclassified certain comparative amounts to conform to the current period presentation.

These consolidated interim financial statements were approved by the Company's Board of Directors on May 22, 2018.

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 is as follows:

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.

3. ACQUISITIONS

Non-Producing Property Acquisitions

During the three months ended March 31, 2018, the Company purchased oil and gas leases in its focus areas 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\$0.2 million (\$0.3 million). There were no assumptions of liabilities associated with these purchases.

Producing Property Acquisition

In March 2018, 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\$17.9 million was settled with cash funded through the Company's credit facilities. The operating income from the associated producing property was immaterial for the three months ended March 31, 2018, and therefore we have not presented pro forma operating income for the period.

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

The aggregate purchase price was allocated as follows:

CONSIDERATION (US\$17,900)	\$	22,668
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	\$	22,721
Decommissioning obligation		(53)
	\$	22,668

4. PROPERTY, PLANT AND EQUIPMENT

	Developed and Producing Assets	Other	Total
Balances as at December 31, 2016	\$ 139,841	\$ 25	\$ 139,866
Acquisitions	15,897	-	15,897
Additions	51,121	91	51,212
Depletion and depreciation	(12,608)	(23)	(12,631)
Effect of foreign exchange rate changes	(10,170)	(2)	(10,172)
Balances as at December 31, 2017	184,081	91	184,172
Acquisition	22,969	-	22,969
Additions	30,723	-	30,723
Depletion and depreciation	(4,412)	(9)	(4,421)
Effect of foreign exchange rate changes	6,091	2	6,093
Balances as at March 31, 2018	\$ 239,452	\$ 84	\$ 239,536

Depletion, Depreciation, and Future Development Costs

For the three months ended March 31, 2018 and 2017, the Company recorded \$4.4 million and \$4.0 million, respectively, of depletion and depreciation expense, which reflected an estimated US\$283.9 million and US\$227.4 million, respectively of future development costs associated with proven plus probable reserves.

Impairment Charges

As at March 31, 2018 there were no facts or circumstances which suggested there is a trigger for impairment of the Company's Developed and Producing Assets. Therefore an impairment test was not required.

Capitalized Overhead

During the three months ended March 31, 2018, the Company capitalized \$369,000 of general and administrative costs, which are directly attributable to the acquisition and exploitation activities of certain of its personnel in relation to the Company's operated property (nil for the three months ended March 31, 2017).

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

5. DECOMMISSIONING OBLIGATION

Balance as at December 31, 2016	\$ 1,218
Acquisition of petroleum and natural gas properties	295
Additions	721
Revisions of estimated cash flows	369
Accretion	5
Effect of foreign exchange rate changes	<u>(135)</u>
Balance as at December 31, 2017	2,473
Acquisition of petroleum and natural gas properties (Note 3)	53
Additions	7
Revisions of estimated cash flows	59
Accretion	1
Effect of foreign exchange rate changes	<u>70</u>
Balance as at March 31, 2018	\$ 2,663

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 March 31, 2018 is \$5.4 million (December 31, 2017 – \$5.1 million) which includes an annual inflation factor of 2.4% (December 31, 2017 – 2.4%) 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 March 31, 2018 have been discounted at the risk-free interest rate of 2.6% (December 31, 2017 – 2.6%).

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

6. DEBT

	Subordinated		
	Senior Loan	Loan	Total Debt
Balances as at December 31, 2016	\$ 30,209	\$ 94,372	\$ 124,581
Proceeds from (repayment of loans), net	20,831	(61,142)	(40,311)
Net change in unamortized fees	-	733	733
Effect of foreign exchange rate changes	(1,149)	(3,323)	(4,472)
Balances as at December 31, 2017	49,891	30,640	80,531
Repayment of loans, net	(16,881)	(30,993)	(47,874)
Net change in unamortized fees	-	108	108
Effect of foreign exchange rate changes	1,057	245	1,302
Balances as at March 31, 2018	\$ 34,067	\$ -	\$ 34,067

Senior Loan

The Company's senior loan is a revolving credit facility, which as at March 31, 2018 had a borrowing base of US\$39.9 million (\$51.5 million), but which was subsequently increased to US\$49.9 million (\$64.4 million). The facility revolves until June 30, 2018, at which point, the facility can be extended at the option of the lender, or if not extended, the facility is converted to a non-revolving facility with a term of 12 months maturing on June 30, 2019. 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 June 2018.

The credit facility 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 any deferred and unpaid interest on the subordinated credit facility and other non-cash amortization expense included in finance expense on the Company's statement 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 March 31, 2018 was 38.1 to 1, and the senior loan to EBITDA ratio was 1.4 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 March 31, 2018.

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

The facility was drawn approximately US\$26.4 million as at March 31, 2018 (December 31, 2017 – US\$39.8 million).

Subordinated Loan

As at December 31, 2017, the Company had a secured, subordinated, revolving credit facility which was available to be drawn in US dollars and which had a capacity of US\$80.0 million as at December 31, 2017. Effective November 17, 2017, the Company amended the terms of the facility to extend the maturity date from December 31, 2017 to January 15, 2019. The credit facility bore interest at a rate of 12% per annum, and the Company incurred a 2.5% loan origination fee. The credit facility was provided by two significant shareholders of the Company, one of whom is the Executive Chairman of our Board of Directors. This loan was secured by all of the assets of the Company, but subordinated to the senior loan facility. Among certain non-financial covenants, the subordinated loan required 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\$24.5 million as at December 31, 2017.

As described further in Note 8, the subordinated loan facility was settled with the proceedings of a preferred share financing completed in January 2018, and as a condition of that financing, the subordinated loan facility was terminated.

7. FINANCIAL DERIVATIVE INSTRUMENTS

The Company may use swaps and options to reduce the effect of commodity price changes on a portion of its future oil production. 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 counterparty to such instruments will be unable to meet the financial terms of such contracts. The Company's derivative contracts are currently with its senior lender, a Schedule A Canadian Bank, and management does not believe the risk of counterparty failure to be significant.

The Company's commodity derivative instruments are measured at fair value and are included in the accompanying statements of financial position as financial derivative assets and liabilities. 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 statement of operations.

The amount of unrealized loss recognized in the statement of operations related to the Company's derivative financial instruments was \$902,000 for the three months ended March 31, 2018 (\$61,000 gain – March 31, 2017).

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

The Company's outstanding commodity derivative contracts are summarized below (in thousands except for volumes and price per Bbl):

Term	Type	Volumes⁽¹⁾	Price (per Bbl \$US)	Reference	Fair Value
April 1, 2018 to December 31, 2018	Collar	500 Bopd	\$45.00 - \$55.70	WTI	\$(1,503)
April 1, 2018 to December 31, 2018	Collar	500 Bopd	\$45.00 - \$57.00	WTI	(1,318)
April 1, 2018 to December 31, 2018	Collar	500 Bopd	\$47.00 - \$56.75	WTI	(1,336)
Outstanding as at March 31, 2018					\$ (4,157)

⁽¹⁾ Bopd is barrels of oil per day

8. PREFERRED SHARES

	Number of Preferred Shares	Liability Component	Equity Component
Balances as at December 31, 2017	-	\$ -	\$ -
Issuance of preferred shares	75,000	79,949	10,041
Accretion	-	355	-
Effect of foreign exchange rate changes	-	2,050	-
Balances as at March 31, 2018	75,000	\$ 82,354	\$ 10,041

In January 2018, the Company's wholly-owned subsidiary (the "Subsidiary Issuer") issued 75,000 preferred shares to one Investor at a price of US\$1,000 per share for gross proceeds of US\$75 million. The preferred shares have a maturity date of January 25, 2023, which may be extended at the option of the Investor by one year. The preferred shares entitle the Investor to a cumulative annual dividend of 9.0% per annum, payable quarterly, except that no dividends shall be payable for the extension year, if any. The Company may elect to defer up to two quarterly dividend payments per twelve month period, subject to a cumulative limit of six quarterly dividend payments over the term of the preferred shares and only following the first anniversary of the issuance date. Any deferred dividend payments accrue at a rate of 12.0% per annum and are added to the issuance amount of the preferred shares to determine the redemption obligation at maturity or the amount which may be converted to common shares as follows. The preferred shares may be converted by the Investor, in whole or in part, into common voting shares of the Company at a price of \$2.40 per share and using an exchange rate of C\$1.00 = US\$0.795, following the first anniversary of the issuance date. As part of the financing, the Investor also acquired voting preferred shares of the Company which entitle the Investor to the "as-exchanged" voting rights of the preferred shares. The Company may elect to redeem the preferred shares prior to the maturity date, by making a "make-whole" premium payment in addition to the maturity redemption amount otherwise determined. The make-whole premium is 5% of the redemption amount otherwise determined if redemption occurs prior to the third anniversary of the issuance date, 2.5% if made after the third anniversary date but before the fourth anniversary date and is nil if made after the fourth anniversary. The right of the Company to exercise this early redemption right is conditional on the Company's

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

common shares having a certain minimum amount of trading liquidity in the thirty days preceding the optional redemption date.

The preferred shares are a hybrid financial instrument for accounting purposes and the Company has separately accounted for the liability component and the equity residual component in accordance with its accounting policy described in Note 2.

The net proceeds from the preferred share offering were used to repay amounts outstanding under the senior loan and subordinated loan.

9. 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 March 31, 2018, the Company had 159,167,767 voting common shares (December 31, 2017 – 157,137,767).

The following table reflects the Company's outstanding common shares as at March 31, 2018:

	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
Exercise of options to purchase common shares	280,578	586
Balance as at December 31, 2017	157,137,767	142,379
Exercise of warrants to purchase common shares	2,000,000	2,184
Exercise of options to purchase common shares	30,000	36
Balance as at March 31, 2018	159,167,767	\$144,599

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. The Company's Executive Chairman participated in this offering, purchasing 44,444,500 voting common shares. Additionally, in June 2017, the Company completed a private placement of 384,615 voting common shares to the Company's President and CEO for gross proceeds of \$500,000. During 2017, 280,578 stock options were exercised at \$0.70 per share for cash proceeds of \$196,000. During 2017, the Company's outstanding 6,700,000 non-voting common shares were converted to an equivalent number of voting common shares.

During the three months ended March 31, 2018, 30,000 stock options were exercised to purchase common shares at \$0.70 per share for cash proceeds of \$21,000. Under the Company's accounting policy,

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

upon exercise of stock options, related amounts previously credited to contributed surplus are transferred to share capital. The Company also issued 2,000,000 voting common shares upon exercise of warrants discussed below.

b) Stock options

The following table presents stock option transactions for the periods ended March 31, 2018 and December 31, 2017:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Balance as at December 31, 2016	2,736,736	\$ 0.83	3.01
Exercised	(280,578)	(0.70)	(3.53)
Settled	(75,000)	(0.70)	(0.96)
Forfeited and expired	(832,894)	(1.13)	(1.74)
Balance as at December 31, 2017	1,548,264	0.70	2.13
Exercised	(30,000)	(0.70)	(1.28)
Balance as at March 31, 2018	1,518,264	\$ 0.70	1.88

As at March 31, 2018, 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	1.88	1,518,264	1,087,427

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 Note 13) on May 10, 2016. Each warrant entitled the holder to exercise and acquire one common share for \$0.75 for a period of two years from the date of grant. In March 2018, the holders of warrants exercised their right to acquire 2 million common shares resulting in net proceeds to the Company of \$1.5 million.

d) Restricted awards

The Company granted 2,625,000 restricted bonus awards ("awards") to certain directors, officers and employees of PetroShale in November 2017. These awards expire in December 2020 and vest in equal tranches in March 2019, March 2020 and December 2020. The estimated fair value of the awards of \$4.3

PetroShale Inc.**Notes to the Consolidated Interim Financial Statements**

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

million was determined based on the current market value of the Company's common shares at the date of grant of \$1.80 per share, and giving consideration to anticipated forfeiture rates. A charge to income is reflected in share-based compensation in the statement of operations over the vesting period with a corresponding increase to contributed surplus.

10. REVENUE

The following reflects the breakdown of our oil and natural gas revenue by commodity type:

	Three months ended	
	March 31,	
	2018	2017
Oil	\$ 18,513	\$ 14,427
Natural gas	265	353
Natural gas liquids	495	281
	\$ 19,273	\$ 15,061

The Company has a number of different commodity sales as well as transportation and processing contracts related to production from its properties. To the extent control of the relevant commodity is transferred to the purchaser prior to transportation or processing fees are incurred, such fees are netted against the relevant revenue in the statement of operations. To the extent control of the relevant commodity is transferred to a purchaser after transportation or processing fees are incurred, such fees are reflected separately as an expense in the statement of operations.

The Company sells its production pursuant to variable-priced contracts. The transaction price is based on the relevant commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Commodity prices are based on market indices that are determined on a monthly or daily basis.

11. NET INCOME PER COMMON SHARE

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

<i>(thousands, except for share and per share data)</i>	Three months ended	
	March 31,	
	2018	2017
Net income	\$ 2,351	\$ 90
Weighted average number of basic common shares	157,605,212	34,207,574
Weighted average number of diluted common shares	162,832,577	34,207,574
Net income per weighted average basic and diluted common share	\$ 0.01	\$ -

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

The Company has issued 75,000 preferred shares which are convertible at the Investor's option, to 39,308,176 common shares at a fixed price of \$2.40 per share, subject to certain conditions. The preferred shares are not currently considered dilutive.

The net income per weighted average basic and diluted common share are essentially the same and presented together.

12. 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.

13. 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.

As at December 31, 2017, the Company had a secured, subordinated, revolving credit facility which was 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 year ended December 31, 2017, fees and the value of warrants issued in connection with this facility were amortized to finance expense in the amount of \$726,000. 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 related to this facility.

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 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 entitled 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 statement of financial position. During the three months ended March 31, 2018, the lenders to the subordinated loan facility exercised their right to acquire 2 million common shares pursuant to these warrants, resulting in net proceeds to the Company of \$1.5 million.

During the three months ended March 31, 2018, the Company repaid outstanding balances under, and terminated, the subordinated loan facility following completion of a US\$75 million preferred equity financing. See Note 8.

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017
(tabular amounts in \$000's of Canadian dollars, unless otherwise noted)

14. SUPPLEMENTAL CASH FLOW DISCLOSURES

Changes in non-cash working capital is comprised of:

	Three months ended March 31,	
	2018	2017
Source / (use) of cash:		
Accounts receivable	\$ (6,881)	\$ (5,188)
Prepaid expenses and deposits	(77)	(90)
Accounts payable and accrued liabilities	(6,865)	1,878
	<u>\$ (13,823)</u>	<u>\$ (3,400)</u>
Related to operating activities	\$ (3,054)	\$ (4,070)
Related to investing activities	(13,135)	(2,380)
Accrued and unpaid dividends on preferred shares	1,565	-
Deferred interest and fees	-	3,294
Difference due to foreign exchange	801	(244)
	<u>\$ (13,823)</u>	<u>\$ (3,400)</u>
Interest paid	\$ 557	\$ 392
Income taxes paid	nil	nil

PetroShale Inc.

Notes to the Consolidated Interim Financial Statements

As at March 31, 2018 and for the three months ended March 31, 2018 and 2017

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

15. SEGMENT DISCLOSURES

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

The Company and its subsidiary operated in two geographical segments during the periods reported below, being Canada and the United States.

	Three months ended March 31,	
	2018	2017
Revenue, net of royalties		
United States	\$ 15,560	\$ 11,883
Canada	14	20
	<u>\$ 15,574</u>	<u>\$ 11,903</u>
Net income (loss) for the period		
United States	\$ 3,276	\$ 250
Canada	(925)	(160)
	<u>\$ 2,351</u>	<u>\$ 90</u>
	March 31,	December 31,
	2018	2017
Property, plant and equipment		
United States	\$ 238,938	\$ 183,567
Canada	598	605
	<u>\$ 239,536</u>	<u>\$ 184,172</u>