PetroShale
Calgary • Denver

Consolidated Interim Financial Statements

As at September 30, 2018
and for the three and nine months ended September 30, 2018 and 2017

PetroShale
Calgary • Denver

CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
(Unaudited)

As at (thousands of Canadian dollars)	NOTE	**September 30, 2018**	**December 31, 2017**
ASSETS			
Current assets			
Cash and cash equivalents		$ 5,294	$ 18,421
Accounts receivable		21,791	10,178
Prepaid expenses and deposits		238	253
		27,323	28,852
Non-current assets			
Restricted cash	12	261	225
Property, plant and equipment	3, 4	337,245	184,172
		337,506	184,397
		$ 364,829	$ 213,249
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		$ 31,638	$ 38,447
Financial derivative liability	7	2,966	3,149
		34,604	41,596
Non-current liabilities			
Senior loan	6	61,587	49,891
Subordinated loan	6, 13	-	30,640
Preferred share obligation	8	84,379	-
Decommissioning obligation	3, 5	4,685	2,473
		150,651	83,004
Total liabilities		185,255	124,600
SHAREHOLDERS' EQUITY			
Common shares	9	199,514	142,379
Preferred share equity component	8	10,041	-
Warrants	9, 13	-	684
Contributed surplus	9	5,325	3,547
Deficit		(35,995)	(55,069)
Accumulated other comprehensive income (loss)		689	(2,892)
		179,574	88,649
Commitments	12		
Subsequent event	16		
		$ 364,829	$ 213,249

See accompanying notes to the consolidated interim financial statements.

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CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

(thousands of Canadian dollars, except per share amounts)	NOTE	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Revenue					
Oil and natural gas	10	$ 40,123	$ 7,292	$ 95,566	$ 32,939
Royalties		(8,143)	(1,554)	(18,766)	(6,941)
		31,980	5,738	76,800	25,998
Other income and loss					
Realized loss on financial derivatives	7	(2,348)	-	(5,453)	-
Unrealized gain (loss) on financial derivatives	7	2,222	(181)	350	(120)
		(126)	(181)	(5,103)	(120)
		31,854	5,557	71,697	25,878
Expenses					
Production and operating	10	5,191	1,559	12,937	6,814
Transportation	10	979	209	1,837	759
General and administrative	4	1,444	1,016	3,320	2,961
Depletion and depreciation	4	9,855	2,333	23,195	9,796
Finance	6, 8	3,559	1,325	9,784	7,078
Foreign exchange gain		-	-	-	(71)
Share-based compensation	9	377	(31)	1,550	152
		21,405	6,411	52,623	27,489
Net income (loss) for the period		10,449	(854)	19,074	(1,611)
Currency translation adjustment		(1,808)	(3,714)	3,581	(6,037)
Comprehensive income (loss) for the period		$ 8,641	$ (4,568)	$ 22,655	$ (7,648)
Net income (loss) per common share, basic	11	$ 0.06	$ (0.01)	$ 0.12	$ (0.01)
Net income (loss) per common share, diluted	11	$ 0.06	$ (0.01)	$ 0.11	$ (0.01)

See accompanying notes to the consolidated interim financial statements.

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CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

For the nine months ended September 30, 2018 and 2017

(Unaudited)

(thousands of Canadian dollars, except share amounts)

	Non Voting Common Shares		Voting Common Shares			Preferred Share			Accumulated Other	
	Shares	Amount	Shares	Amount	Warrants	Equity Component	Contributed Surplus	Deficit	Comprehensive Income (Loss)	Shareholders' Equity (Deficit)
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 by prospectus, net of issue costs	-	-	122,649,615	106,135	-	-	-	-	-	106,135
Exercise of optons to purchase voting common shares for cash	-	-	240,578	538	-	-	(370)	-	-	168
Share-based compensation, gross	-	-	-	-	-	-	159	-	-	159
Net loss	-	-	-	-	-	-	-	(1,611)	-	(1,611)
Other comprehensive loss	-	-	-	-	-	-	-	-	(6,037)	(6,037)
Balances, September 30, 2017	6,700,000	$ -	150,397,767	$ 142,331	$ 684	$ -	$ 3,386	$ (53,587)	$ (3,402)	$ 89,412
Balances, December 31, 2017	-	$ -	157,137,767	$ 142,379	$ 684	$ -	$ 3,547	$ (55,069)	$ (2,892)	$ 88,649
Issuance of voting common shares by prospectus, net of issue costs	-	-	24,865,300	42,455	-	-	-	-	-	42,455
Issuance of voting common shares by private placement, net of issue costs	-	-	6,756,905	12,460	-	-	-	-	-	12,460
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, gross	-	-	-	-	-	-	1,793	-	-	1,793
Net income	-	-	-	-	-	-	-	19,074	-	19,074
Other comprehensive income	-	-	-	-	-	-	-	-	3,581	3,581
Balances, September 30, 2018	-	$ -	190,789,972	$ 199,514	$ -	$ 10,041	$ 5,325	$ (35,995)	$ 689	$ 179,574

See accompanying notes to the consolidated interim financial statements.

PetroShale
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CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

(Unaudited)

(thousands of Canadian dollars)	NOTE	Nine months ended September 30, 2018	2017
Operating Activities			
Net income (loss)		$ 19,074	$ (1,611)
Operating items not affecting cash:			
Depletion and depreciation		23,195	9,796
Unrealized (gain) loss on financial derivatives		(350)	120
Share-based compensation		1,550	152
Finance		9,784	7,078
Change in non-cash working capital	14	(3,551)	1,402
		49,702	16,937
Investing Activities			
Acquisition of property, plant and equipment	3	(92,090)	(15,899)
Additions to property, plant and equipment	4	(73,201)	(15,684)
Change in non-cash working capital	14	(18,084)	3,469
		(183,375)	(28,114)
Financing Activities			
Proceeds from convertible preferred share issuance, net	8	89,990	-
Proceeds from share issuances, net	9	54,915	106,135
Proceeds from exercise of warrants	9	1,500	-
Proceeds from exercise of options		21	168
Repayment of subordinated loan, net	6, 13	(30,993)	(75,886)
Proceeds from senior loan, net	6	9,401	8,279
Payment of interest and preferred dividends		(5,944)	(2,855)
Payment of previously deferred interest	14	-	(22,330)
		118,890	13,511
Change in cash and cash equivalents		(14,783)	2,334
Effect of foreign exchange rate changes		1,656	(845)
Cash and cash equivalents, beginning of period		18,421	1,134
Cash and cash equivalents, end of period		$ 5,294	$ 2,623

See accompanying notes to the consolidated interim 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 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 and nine months ended September 30, 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 Compound 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 (see Note 8). 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 compound 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.

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 in 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 partners' interest in production. In making this evaluation, management considers whether the Company obtains control of the product delivered, which is indicated by the Company having the primary responsibility for the delivery of the products, its ability to establish prices or assumption of 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 so revenue is recognized on a Company 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.

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

These consolidated interim 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 November 28, 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 IFRS 16.

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. The Company plans to adopt this new standard effective January 1, 2019 using the modified retrospective method. The extent of the impact of adoption of IFRS 16 is not expected to be material.

3. ACQUISITIONS

Non-Producing Property Acquisitions

During the nine months ended September 30, 2018, the Company purchased oil and gas leases in its focus areas in North Dakota. These acquisitions represent increased working interests in potential drilling units with associated proved undeveloped and probable reserves. The consideration for these leases was approximately US$1.4 million ($1.8 million). There were no assumptions of liabilities associated with these purchases.

Producing Property Acquisitions

In August 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 assumed 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$51.7 million was settled with a draw on the Company's senior credit facility and net proceeds from the Equity Offerings completed in August (see Note 9). The operating income from the associated producing properties included in these consolidated interim financial statements is US$0.7 million ($0.9 million). Revenue from the producing properties included in these consolidated interim financial statements is US$1.0 million ($1.3 million).

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

The aggregate purchase price was allocated as follows:

CONSIDERATION (US$51,714)	$	67,590
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	68,967
Decommissioning obligation		(1,377)
	$	67,590

The following reflects selected pro forma financial information for the period ended September 30, 2018 as if the acquisition had occurred on January 1, 2018 instead of the closing date of the transaction:

		Nine months ended September 30, 2018
Oil and natural gas revenue, net of royalties	$	8,020
Production and operating expenses		(1,755)
Transportation expenses		(340)
Operating income		5,925
Operating income reported for the period		62,026
Pro forma operating income for the period	$	67,951
Revenue, net of royalties	$	8,020
Revenue, net of royalties reported for the period	$	76,800
Pro forma revenue, net of royalties for the period	$	84,820

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 assumed 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 a draw on the Company's senior credit facility. The revenue and operating income from the associated producing property was immaterial for the period prior to the acquisition date and from the date of closing of the acquisition to September 30, 2018, and therefore we have not presented pro forma revenue or operating income for the period nor have we separately disclosed the associated revenue or operating income from the property included in the statement of operations.

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

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

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
Acquisitions	93,520	-	93,520
Additions	74,024	62	74,086
Depletion and depreciation	(23,165)	(30)	(23,195)
Effect of foreign exchange rate changes	8,660	2	8,662
Balances as at September 30, 2018	$ 337,120	$ 125	$ 337,245

Depletion, Depreciation, and Future Development Costs

For the nine months ended September 30, 2018 and 2017, the Company recorded $23.2 million and $9.8 million, respectively, of depletion and depreciation expense, which reflected an estimated US$367 million and US$264 million, respectively of future development costs associated with proven plus probable reserves.

Impairment Charges

As at September 30, 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 nine months ended September 30, 2018, the Company capitalized $1,026,000 of general and administrative costs and $243,000 of share-based compensation, which are directly attributable to the acquisition and exploitation activities of certain of its personnel in relation to the Company's operated properties ($171,000 and $7,000 respectively for the nine months ended September 30, 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	(135)
Balance as at December 31, 2017	2,473
Acquisitions of petroleum and natural gas properties (Note 3)	1,430
Additions	433
Revisions of estimated cash flows	208
Accretion	49
Effect of foreign exchange rate changes	92
Balance as at September 30, 2018	$ 4,685

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 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 September 30, 2018 is $9.1 million (December 31, 2017 – $5.1 million) which includes an annual inflation factor of 2.4% (December 31, 2017 – 2.4%) applied to the estimated future 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 September 30, 2018 have been discounted at the risk-free interest rate of 3.1% (December 31, 2017 – 2.6%).

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

6. DEBT

	Senior Loan	Subordinated 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
Proceeds from (repayment of) loans, net	9,401	(30,993)	(21,592)
Net change in unamortized fees	-	108	108
Effect of foreign exchange rate changes	2,295	245	2,540
Balances as at September 30, 2018	$ 61,587	$ -	$ 61,587

Senior Loan

The Company's senior loan is a revolving credit facility, which as at September 30, 2018 had a borrowing base of US$92.0 million ($120.0 million). The term of the facility revolves until June 30, 2019, at which point, the facility can be extended at the option of the lenders, or if not extended, the facility would be converted to a non-revolving facility with a term maturing on June 30, 2020. This facility is secured by all of the Company's assets. The facility bears interest at the bank's prime lending rate, bankers' acceptance rates or US$ LIBOR rates plus a margin which is determined by the Company's senior debt to EBITDA ratio. EBITDA used for determining this ratio is defined in our senior loan agreement ("bank EBITDA") and may be different from that measurement referred to in the Company's other disclosures including its Management's Discussion & Analysis. During the three months ended September 30, 2018, the effective interest rate for the Company's LIBOR borrowings was 4.3% per annum (3.7% - September 30, 2017).

The borrowing base capacity of the senior loan facility is subject to a review performed at least twice annually by the lenders, 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 lenders. The senior lenders recently completed their mid-year 2018 review and agreed to increase the borrowing base capacity of the facility to US$125 million (see Note 16).

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 2.5 to 1 on a rolling four-quarter basis; and (ii) a requirement that the ratio of the senior loan amount to bank 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. Bank EBITDA is defined as net income plus interest expense (as defined above), any provision for income tax, and adjusted for non-cash items, cash payments to settle non-cash items and EBITDA attributable to assets acquired or sold during the period. The consolidated cash flow to interest expense ratio at September 30, 2018 was 23 to 1, and the senior loan to bank EBITDA ratio was 0.9 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 September 30, 2018.

The facility was drawn approximately US$47.2 million as at September 30, 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 and a maturity date of 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 of 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 proceeds 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 one of its senior lenders, a Schedule A Canadian Bank, and management does not believe the risk of counterparty failure to be significant.

The Company's commodity derivative financial instruments are measured at fair value and are included in the statements of financial position as financial derivative assets or 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 gain recognized in the statement of operations related to the Company's derivative financial instruments was $350,000 for the nine months ended September 30, 2018 ($120,000 loss – September 30, 2017).

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
October 1, 2018 to December 31, 2018	Collar	500 Bopd	$45.00 - $55.70	WTI	$(1,035)
October 1, 2018 to December 31, 2018	Collar	500 Bopd	$45.00 - $57.00	WTI	(958)
October 1, 2018 to December 31, 2018	Collar	500 Bopd	$47.00 - $56.75	WTI	(973)
Outstanding as at September 30, 2018					$(2,966)

[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	-	1,481	-
Effect of foreign exchange rate changes	-	2,949	-
Balances as at September 30, 2018	75,000	$ 84,379	$ 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 at the option of the Investor. 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 Company's ability to exercise this early redemption right is conditional on the Company's common shares having a certain minimum amount of trading liquidity in the thirty days preceding the optional redemption date.

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

The preferred shares are a compound 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, and as a condition of completing the offering, the subordinated loan facility was terminated.

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 September 30, 2018, the Company had 190,789,972 voting common shares (December 31, 2017 – 157,137,767), no non-voting common shares and 39,308,176 special voting preferred shares (December 31, 2017 – nil) outstanding. The special voting preferred shares were issued in conjunction with the preferred shares issued by the Subsidiary Issuer in January 2018 (see Note 8). The special voting preferred shares issued to the Investor entitle the Investor to the "as-exchanged" voting rights of the preferred shares but no other redemption or distribution rights and no claims on the Company's assets.

The following table reflects the Company's outstanding common shares as at September 30, 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
Issuance of common shares by prospectus, net of issue costs	24,865,300	42,455
Issuance of common shares by private placement, net of issue costs	6,756,905	12,460
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 September 30, 2018	190,789,972	$199,514

On August 14, 2018, the Company closed a $46.0 million subscription receipt prospectus financing through a syndicate of underwriters (the "Public Offering") at a price of $1.85 per share. The result of this transaction was the issuance of 24.9 million common shares for net proceeds of $42.5 million.

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

The Company also completed a separate private placement of subscription receipts, which closed at the same time and at the same price per share as the Public Offering, resulting in the issuance of 6.8 million common shares for net proceeds of $12.5 million (the "Private Offering", and together with the Pubic Offering, the "Equity Offerings"). The Company's Executive Chairman and the Investor in the Company's preferred shares each purchased 2.7 million common shares pursuant to the Private Offering at a price of $1.85 per share for $5.0 million.

On April 11, 2017, the Company completed an equity offering resulting in the issuance of 122.3 million common shares at a price of $0.90 per share for net proceeds of approximately $106 million. The Company's Executive Chairman participated in this offering, purchasing 44.4 million common shares. Additionally, in June 2017, the Company completed a private placement of 384,615 common shares to the Company's President and CEO for net proceeds of $500,000.

During the nine months ended September 30, 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, upon the exercise of stock options, related amounts previously credited to contributed surplus are transferred to share capital. The Company also issued 2.0 million common shares upon exercise of warrants discussed below. 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 6.7 million non-voting common shares were converted to an equivalent number of voting common shares.

During the nine months ended September 30, 2018, the average trading price for the Company's common shares on the TSX Venture Exchange was $2.05.

b) Stock options

The following table presents stock option transactions for the periods ended September 30, 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 September 30, 2018	1,518,264	$	0.70	1.12

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

As at September 30, 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	1.12	1,518,264	1,388,263

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 is 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 2.0 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 2.0 million common shares resulting in net proceeds to the Company of $1.5 million.

d) Restricted awards

The Company has granted restricted share bonus awards ("awards") to certain directors, officers and employees. These awards expire before the end of the third year from the date of grant and vest annually in three equal tranches following the date of issuance. The estimated fair value of the awards is determined based on the current market value of the Company's common shares at the dates of grant and giving consideration to anticipated forfeiture rates. A charge to income is reflected as share based compensation expense in the statement of operations over the vesting period with a corresponding increase to contributed surplus.

	Number of Awards		Estimated Fair Value Price
Balance as at December 31, 2016	-	$	-
Granted	2,625,000		1.80
Balance as at December 31, 2017	2,625,000		1.80
Granted	235,000		1.98
Forfeited and expired	(108,333)		(1.80)
Balance as at September 30, 2018	2,751,667	$	1.81

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

10. REVENUE

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

	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Oil	$ 38,189	$ 7,206	$ 91,995	$ 31,806
Natural gas	627	24	1,276	652
Natural gas liquids	1,307	62	2,295	481
Total revenue	$ 40,123	$ 7,292	$ 95,566	$ 32,939

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 as transportation expense and as operating expense, respectively 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.

The Company's commodity sales contracts are cancellable on 30 days notice.

11. NET INCOME (LOSS) PER COMMON SHARE

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

(thousands, except for share and per share data)	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Net income (loss)	$ 10,449	$ (854)	$ 19,074	$ (1,611)
Weighted average number of basic common shares	175,322,589	156,990,553	164,068,659	111,872,688
Weighted average number of diluted common shares	179,017,367	156,990,553	167,820,840	111,872,688
Net income (loss) per weighted average basic common share	$ 0.06	$ (0.01)	$ 0.12	$ (0.01)
Net income (loss) per weighted average diluted common share	$ 0.06	$ (0.01)	$ 0.11	$ (0.01)

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.

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 2.0 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 nine months ended September 30, 2018, the lenders to the subordinated loan facility exercised their right to acquire 2.0 million common shares pursuant to these warrants, resulting in net proceeds to the Company of $1.5 million.

In January 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.

(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:

	Nine months ended September 30, 2018	2017
Source / (use) of cash:		
Accounts receivable	$ (11,613)	$ 463
Prepaid expenses and deposits	(17)	(164)
Accounts payable and accrued liabilities	(6,809)	(15,002)
	$ (18,439)	$ (14,703)
Related to operating activities	$ (3,551)	$ 1,402
Related to investing activities	(18,084)	3,469
Accrued and unpaid dividends on preferred shares	2,206	-
Payment of previously deferred interest	-	(22,330)
Deferred interest and fees	-	3,673
Difference due to foreign exchange	990	(917)
	$ (18,439)	$ (14,703)
Interest and preferred dividends paid	$ 5,944	$ 25,185
Income taxes paid	nil	nil

(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 September 30,		Nine months ended September 30,	
	2018	**2017**	**2018**	**2017**
Revenue, net of royalties				
United States	$ 31,964	$ 5,724	$ 76,752	$ 25,950
Canada	16	14	48	48
	$ 31,980	$ 5,738	$ 76,800	$ 25,998
Net income (loss)				
United States	$ 10,958	$ (765)	$ 21,175	$ (968)
Canada	(509)	(89)	(2,101)	(643)
	$ 10,449	$ (854)	$ 19,074	$ (1,611)

	September 30,	December 31,
As at	**2018**	**2017**
Property, plant and equipment		
United States	$ 336,663	$ 183,567
Canada	582	605
	$ 337,245	$ 184,172

16. SUBSEQUENT EVENT

Following its semi-annual review of the Company's borrowing base, the lenders to the senior loan facility agreed to increase the borrowing base capacity of the facility to US$125 million ($162.5 million). As at the date of these financial statements, the facility is drawn US$44 million ($57 million).