PetroShale

Calgary • Denver

# Second Quarter Report

## For the three and six months ended June 30, 2020 and 2019

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# Management's Discussion and Analysis

This Management's Discussion and Analysis (the "MD&A") has been prepared by management and was reviewed and approved by the Board of Directors of PetroShale Inc. ("PetroShale" or the "Company") on August 19, 2020. This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements as at June 30, 2020 and for the three and six months ended June 30, 2020 and 2019, and the audited consolidated financial statements as at and for the years ended December 31, 2019 and 2018. The reader should be aware that the operating results discussed below may not be indicative of future performance.

The financial data presented below has been prepared in accordance with International Financial Reporting Standards ("IFRS"), unless otherwise indicated.

## Frequently Used Terms:

| Term | Description |
|---|---|
| Bbl | Barrel(s) |
| Boe | Barrel(s) of oil equivalent |
| Bopd | Barrels of oil per day |
| Boepd | Barrels of oil equivalent per day |
| Mboe | Thousand barrels of oil equivalent |
| Mcf | Thousand cubic feet |
| Mcfpd | Thousand cubic feet per day |
| Mmcf | Million cubic feet |
| Mmcfd | Million cubic feet per day |
| Mmboe | Million barrels of oil equivalent |
| Mmbtu | Million British Thermal Units |
| NGLs | Natural gas liquids |
| WTI | West Texas Intermediate, reference price paid in US$ for crude oil of standard grade |
| HH | Henry Hub, reference price paid in US$ for natural gas deliveries |
| PV10 | Present value, reflecting a 10% discount rate |

## Barrel of Oil Equivalent Advisory

Where amounts are expressed on a Boe basis, natural gas volumes have been converted to Boe using a ratio of 6,000 cubic feet of natural gas to one barrel of oil (6 Mcf:1 Bbl). This Boe conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. The value ratio between the commodities, based on the price of crude oil compared to natural gas, could be significantly different from the energy equivalency of 6 Mcf: 1 Bbl, and therefore utilizing this conversion ratio may be misleading as an indication of value.

## Presentation of Volumes

The Company's reserves have been categorized as Tight Oil and Shale Gas pursuant to National Instrument 51-101, *Standards of Disclosure for Oil and Gas Activities* ("NI 51-101"). Rather than Tight Oil and Shale Gas, the Company has used the terms "crude oil" and "natural gas", respectively, as it feels such terms are more easily understood by users of these interim consolidated financial statements and MD&A as well as consistent with disclosures by industry peers.

Production volumes and per Boe calculations are presented on a gross working interest basis, before royalty interests, unless otherwise stated.

## Functional and Presentation Currency

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

## Non-IFRS Measurements and Changes in Accounting Policies

This MD&A contains the terms "*operating netback*", "*operating netback prior to hedging*", "*net debt*" and "*adjusted EBITDA*" which are not defined by IFRS and therefore may not be comparable to performance measures presented by others.

**Operating netback** represents petroleum and natural gas revenue, plus or minus any realized gain or loss on financial derivatives, less royalties, lease operating costs, workover expense, production taxes and transportation expense. The operating netback is then divided by the working interest production volumes to derive the operating netback on a per Boe basis.

**Operating netback prior to hedging** represents operating netback prior to any realized gain or loss on financial derivatives.

**Net debt** represents total liabilities, excluding decommissioning obligation, deferred income tax liability, lease liability and financial derivative liability, less current assets, excluding financial derivative asset.

**Adjusted EBITDA** represents cash flow provided by operating activities prior to changes in non-cash working capital.

The Company believes that adjusted EBITDA provides useful information to the reader in that it measures the Company's ability to generate funds to service its debt and other obligations and to fund its operations, without the impact of changes in non-cash working capital which can vary based solely on timing of settlement of accounts receivable and accounts payable. Management believes that in addition to net income (loss) and cash flow provided by operating activities, operating netback and adjusted EBITDA are useful supplemental measures as they assist in the determination of the Company's operating performance, leverage, and liquidity. Operating netback is commonly used by investors to assess performance of oil and gas properties and the possible impact of future commodity price changes on energy producers. Investors should be cautioned, however, that these measures should not be construed as an alternative to either net income (loss) or cash flow from operating activities, which are determined in accordance with IFRS, as indicators of the Company's performance.

The reconciliation between cash flow from operating activities, as defined by IFRS, and adjusted EBITDA, as defined herein, is as follows:

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **2020** | **2019** |
| Cash flow provided by (used in) operating activities | 16,336 | (1,626) | 55,173 | 18,584 |
| Change in non-cash working capital | (8,058) | 17,970 | (21,868) | 7,341 |
| **Adjusted EBITDA** | **8,278** | **16,344** | **33,305** | **25,925** |

Net debt, as defined above, is calculated as follows:

| | **As at June 30,** | |
|---|---|---|
| *($ thousands)* | **2020** | **2019** |
| Total liabilities | 403,975 | 310,460 |
| Decommissioning obligation | (7,144) | (5,402) |
| Financial derivative liability | (6,916) | - |
| Lease liability | (617) | (202) |
| Total current assets | (33,700) | (46,319) |
| **Net Debt** | **355,598** | **258,537** |

The calculation of operating netback and operating netback prior to hedging is found elsewhere within this MD&A.

## Forward Looking Statements

*This MD&A contains forward looking statements and forward-looking information (collectively, "forward looking statements") within the meaning of applicable Canadian securities laws. Management's assessment of future plans and operations, drilling plans and the timing thereof, plans for the tie-in and completion of wells and the timing thereof, capital expenditures, timing of capital expenditures and methods of financing capital expenditures and the ability to fund financial liabilities, use of proceeds from any financing, production estimates, expected commodity mix and prices, expectations as to differentials relative to benchmark commodity prices received for our production, reserve estimates, future lease operating, workover and transportation costs, anticipated production taxes, expected royalty rates, anticipated timing and impact of new gas transportation and processing facilities in North Dakota, expected general and administrative expenses, expected interest rates, debt levels, cash flow from operations and the timing of and impact of implementing new accounting policies, estimates regarding its undeveloped land position, expected changes to amounts and terms of available debt financing and estimated future drilling, recompletion or reactivation activities and anticipated impact upon PetroShale's forecasts in respect of production, cash flow and resulting net debt for any periods subsequent to June 30, 2020 may constitute forward looking statements and necessarily involve risks including, without limitation, risks associated with oil and gas development, exploitation, production, marketing and transportation of oil, natural gas, and natural gas liquids, loss of markets, volatility of commodity prices, currency fluctuations, inability to transport or process natural gas at economic rates or at all, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services at reasonable costs or at all, unforeseen challenges or circumstances in drilling, equipping and completing wells leading to higher capital costs than anticipated, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions or drilling operations, risks associated with PetroShale's non-operated status on some of its properties, production delays resulting from an inability to obtain required regulatory approvals or services, unfavorable weather, or the tie-in of associated natural gas production and an inability to access sufficient capital from internal and external sources.*

*The Company's actual results may differ materially from those expressed in, or implied by, the forward-looking statements. Forward looking statements or information is based on several factors and assumptions which have been used to develop such statements and information, but which may prove to be incorrect. Although PetroShale believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this document and other documents filed by the Company, assumptions have been made regarding, among other things: the impact of increasing competition; the general stability of the economic, regulatory and political environment in which PetroShale operates; the ability of the Company to obtain and retain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the Company and the operators of its non-operated properties to operate in the field in a safe, efficient, compliant and effective manner; PetroShale's ability to obtain financing on acceptable terms or at all; changes in the Company's credit facilities including changes to borrowing base and maturity dates; receipt of regulatory approvals; field production rates and decline rates; the ability of the Company, and the operators of its non-operated properties, to tie-in associated natural gas production in an economic manner, or at all; the ability to manage lease operating and transportation costs; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the ability to convert non-producing proved and undeveloped or probable oil and natural gas reserves to producing reserves; the timing and costs of pipeline, storage and facility construction and expansion; the ability of the Company to secure adequate transportation for commodity production; future petroleum and natural gas prices; differentials between benchmark commodity prices and those received by the Company for its production in the field; currency exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates; PetroShale's ability to successfully drill, complete and commence production at commercial rates from its operated wells; and PetroShale's ability, or those of the operators of its non-operated properties, to successfully market its petroleum and natural gas products. Readers are cautioned that the foregoing list of factors is not exhaustive.*

*Additional information on these and other factors that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the System for Electronic Document Analysis and Retrieval ("SEDAR") website (www.sedar.com) or at the Company's website (www.petroshaleinc.com). Furthermore, the forward looking statements contained in this document are made as at the date of this document and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.*

# Financial and Operational Highlights

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2020** | **2019** | **2020** | **2019** |
| **Financial** *($ thousands, except share amounts)* | | | | |
| Petroleum and natural gas revenue | 24,200 | 30,476 | 73,310 | 51,802 |
| Cash provided by (used in) operating activities | 16,336 | (1,626) | 55,173 | 18,584 |
| Net income (loss) | (23,169) | 1,733 | (40,435) | 737 |
| Per share - diluted | (0.12) | 0.01 | (0.21) | 0.00 |
| Adjusted EBITDA (1) | 8,278 | 16,344 | 33,305 | 25,925 |
| Capital expenditures | 6,358 | 61,251 | 29,895 | 107,340 |
| Net debt (1) | | | 355,598 | 258,537 |
| Number of common shares outstanding: | | | | |
| Weighted average - basic | 187,615,253 | 192,133,374 | 188,276,150 | 191,989,090 |
| Weighted average - diluted | 187,615,253 | 194,631,212 | 188,276,150 | 194,488,268 |
| | | | | |
| **Operating** | | | | |
| Number of days | 91 | 91 | 182 | 181 |
| | | | | |
| Daily production: (2) | | | | |
| Crude oil (Bbls) | 9,415 | 4,447 | 9,785 | 4,020 |
| Natural gas (Mcf) | 11,002 | 4,470 | 11,616 | 4,680 |
| Natural gas liquids (Bbls) | 2,043 | 748 | 2,062 | 692 |
| Barrels of oil equivalent | 13,291 | 5,940 | 13,783 | 5,493 |
| | | | | |
| Average realized price: | | | | |
| Crude oil ($/Bbl) | 30.56 | 76.48 | 42.72 | 70.99 |
| Natural gas ($/Mcf) | 1.11 | 2.35 | 1.61 | 3.04 |
| Natural gas liquids ($/Bbl) | 2.47 | 12.79 | 5.17 | 15.51 |
| | | | | |
| Netback ($ per Boe): (1) | | | | |
| Petroleum and natural gas revenue | 20.01 | 56.38 | 29.22 | 52.13 |
| Royalties | (3.62) | (11.20) | (5.41) | (10.22) |
| Realized gain on financial derivatives | 1.36 | - | 0.91 | - |
| Lease operating costs | (5.44) | (6.69) | (5.23) | (6.08) |
| Workover expense | (0.35) | 0.25 | (0.52) | (1.40) |
| Production taxes | (1.72) | (4.38) | (2.44) | (4.00) |
| Transportation expense | (2.45) | (2.14) | (2.42) | (2.03) |
| Operating netback (1) | 7.79 | 32.22 | 14.11 | 28.40 |
| Operating netback prior to hedging (1) | 6.43 | 32.22 | 13.20 | 28.40 |

(1) Non-IFRS measure – see page 4 for a reconciliation of adjusted EBITDA and net debt and a description of operating netback and netback prior to hedging.

(2) The Company's reserves have been categorized as Tight Oil and Shale Gas pursuant to National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities ("NI 51-101"). Rather than Tight Oil and Shale Gas, the Company has used the terms "crude oil" and "natural gas", respectively, as it feels such terms are more easily understood by users of these interim consolidated financial statements and MD&A as well as consistent with disclosures by industry peers.

# Management's Discussion and Analysis

## Description of Business

PetroShale Inc. (the "Company") is an independent oil company focused on the acquisition, development, and production of oil-weighted assets in the Bakken and Three Forks formations in the Williston Basin area of North Dakota. The Company's common shares are listed on the TSX Venture Exchange under the symbol "PSH".

The Company has corporate offices located at 421 - 7th Avenue SW, Suite 3230, Calgary, Alberta T2P 4K9 and at 303 E. 17th Avenue, Suite 940, Denver, CO 80203.

## Commodity Prices, COVID-19 and Impact on Operations

As the COVID-19 pandemic persists, PetroShale's top priority has been to maintain a safe working environment for all employees and business partners. The Company has implemented preventative measures and developed corporate and field response plans to minimize risk of exposure and prevent infection. Certain business practices, including remote working and restricted employee business travel, have been modified to conform to government restrictions and best practices encouraged by the Centers for Disease Control and Prevention, the World Health Organization, and other governmental and regulatory agencies.

Large-scale travel bans, stay-at-home orders, border closures and similar protective measures enacted by federal, foreign, state, and local governments to slow the spread of COVID-19 have contributed to a significant deterioration in domestic and global demand for crude oil, and to a lesser extent, natural gas. Compounding the impact of COVID-19, the oil production output alliance between Russia, Saudi Arabia and other oil producing nations ("OPEC+") broke down in March 2020 as members were unable to reach agreement over how much to restrict production in order to stabilize crude oil prices. As a result, Saudi Arabia and Russia both initiated efforts to increase production, further driving down oil prices and increasing the global oversupply of crude oil. The supply and demand imbalance resulted in the WTI calendar month average crude oil prices, the price on which most of the Company's crude production is sold, declining from US$57.53/Bbl in January 2020 to US$16.70/Bbl in April 2020. OPEC+ subsequently reached an agreement in April 2020 which included significant production cuts extending through April 2022. Crude oil prices have responded accordingly recovering to US$38.31/bbl in June 2020. Despite the OPEC+ agreement, significant uncertainty remains as to whether OPEC+ members will comply with the agreed production cuts over the term of the agreement and whether such cuts will be adequate to offset the demand deterioration caused by COVID-19. As a result, crude oil prices could remain under pressure for a prolonged period and continue to be volatile.

As a result of the depressed commodity prices and oversupply of crude oil, certain of the Company's wells, primarily those which are operated by other companies, have been shut-in resulting in a reduction in the Company's daily production volumes of approximately 500 barrels a day of crude oil during the second quarter.

The extent to which the Company's operating and financial results for the remainder of 2020 and beyond are affected by COVID-19 will depend on various factors and consequences beyond its control such as the duration and scope of the pandemic; additional actions taken by business and government in response to the pandemic and the speed and effectiveness of responses to combat the virus.

As a result of the reduction in oil prices and revenues in the second quarter, the Company took steps to minimize the impact on the Company's operating results and financial liquidity. The Company reduced discretionary capital expenditures, operating costs and general and administrative expenditures, and entered into an active hedging program for the remainder of 2020 and into 2021.

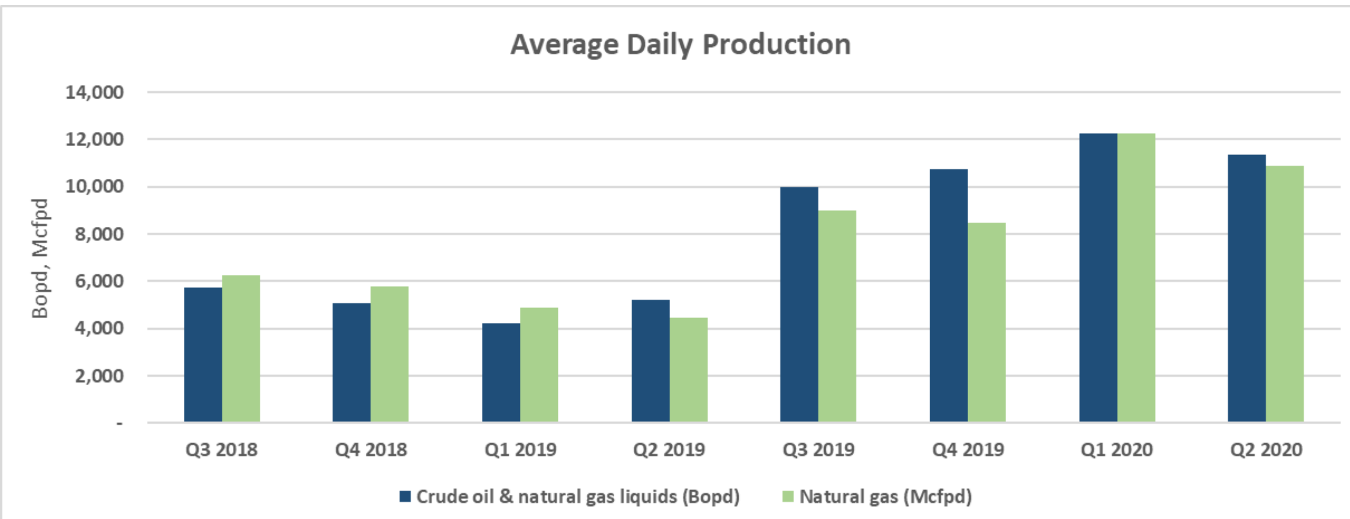
In May 2020, the Company's lenders confirmed the amount of the existing borrowing base capacity under the senior credit facility of US $177.5 million. The Company's next borrowing base redetermination is scheduled to occur in the fourth quarter of 2020. A decrease in the borrowing base determined by the senior lenders in the future could result in a reduction to the credit facility, which may require a repayment to the lenders. The Company was drawn US$161.3 million under the senior credit facility as at June 30, 2020, net of cash of US$12.9 million, compared to US$154.1 million as at March 31, 2020, net of cash on hand of US$13.0 million, and has reduced accounts payable and accrued liabilities by $21.4 million since March 31, 2020.

## Results of Operations

### Production

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2020 | 2019 | % change | 2020 | 2019 | % change |
| Crude oil (Bbls per day) | 9,415 | 4,447 | 111.7 | 9,785 | 4,020 | 143.4 |
| Natural gas (Mcf per day) | 11,002 | 4,470 | 146.1 | 11,616 | 4,680 | 148.2 |
| Natural gas liquids (Bbls per day) | 2,043 | 748 | 173.1 | 2,062 | 692 | 198.0 |
| Total (Boe per day) | 13,291 | 5,940 | 123.8 | 13,783 | 5,493 | 150.9 |
| Liquids percentage of total | 86.2 | 87.5 | (1.3) | 85.9 | 85.8 | 0.1 |

The increase in production for both the three-month and six-month periods ended June 30, 2020 compared to the prior periods is due to new wells that were brought online during mid to late 2019, slightly offset by natural declines and shut-in production. A total of 62 gross (16.3 net) wells had first sales during 2019. During the second quarter of 2020, the Company participated in 7 gross (0.4 net) wells that commenced production in the quarter. Production during the six months ended June 30, 2020 was comprised of 71.0% crude oil, 15.0% natural gas liquids, and 14.0% natural gas compared to 73.2% crude oil, 12.6% natural gas liquids and 14.2% natural gas in the corresponding period.



## Pricing

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2020 | 2019 | % change | 2020 | 2019 | % change |
| **Average Benchmark Prices (US$)** | | | | | | |
| Crude oil – WTI (per Bbl) | 27.85 | 59.88 | (53.5) | 37.01 | 57.39 | (35.5) |
| Natural gas – HH spot (per Mmbtu) | 1.71 | 2.57 | (33.5) | 1.81 | 2.74 | (33.9) |
| | | | | | | |
| **Average Differential (US$)** | | | | | | |
| Crude oil (per Bbl) | (5.79) | (2.02) | 186.9 | (5.71) | (3.68) | 55.2 |
| Natural gas (per Mcf) (1) | (0.91) | (0.82) | 10.1 | (0.63) | (0.46) | 36.0 |
| | | | | | | |
| **Average Realized Prices (US$) (2)** | | | | | | |
| Crude oil (per Bbl) | 22.06 | 57.86 | (61.9) | 31.30 | 53.71 | (41.7) |
| Natural gas (per Mcf) | 0.80 | 1.75 | (54.0) | 1.18 | 2.28 | (48.1) |
| Natural gas liquids (per Bbl) | 1.79 | 9.52 | (81.2) | 3.79 | 11.63 | (67.4) |
| | | | | | | |
| **Average Realized Prices (CAD$) (2)** | | | | | | |
| Crude oil (per Bbl) | 30.56 | 76.48 | (60.0) | 42.72 | 70.99 | (40.8) |
| Natural gas (per Mcf) | 1.11 | 2.35 | (52.5) | 1.61 | 3.04 | (47.7) |
| Natural gas liquids (per Bbl) | 2.47 | 12.79 | (80.7) | 5.17 | 15.51 | (67.2) |

(1) Includes conversion from Mmbtu to Mcf

(2) Excluding transportation and processing costs

As a result of the demand destruction due to COVID-19 and geopolitically driven supply volatility, WTI crude oil prices began to decline in March with the decline extending into the second quarter of 2020. Basis differentials for crude oil also widened during the 2020 periods compared to prior periods as a result of market and demand volatility.

Henry Hub benchmark natural gas prices were significantly lower in the three-month and six-month periods ended June 30, 2020, compared to the prior year periods. Realized natural gas prices in the Bakken remain discounted to Henry Hub benchmark prices reflecting the shortage of takeaway and processing capacity in the area.

## Revenues and Royalties

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | 2020 | 2019 | % change | 2020 | 2019 | % change |
| Petroleum and natural gas revenue | 24,200 | 30,476 | (20.6) | 73,310 | 51,802 | 41.5 |
| Less: royalties | (4,380) | (6,057) | (30.5) | (13,571) | (10,153) | 32.0 |
| Petroleum and natural gas revenue, net | 19,820 | 24,419 | (18.1) | 59,739 | 41,649 | 43.8 |
| | | | | | | |
| Royalties as a percentage of revenue | 18.1% | 19.9% | (9.0) | 18.5% | 19.6% | (5.6) |
| | | | | | | |
| Per Boe amounts: | | | | | | |
| Petroleum and natural gas revenue | 20.01 | 56.38 | (64.5) | 29.22 | 52.13 | (43.9) |
| Less: royalties | (3.62) | (11.20) | (67.7) | (5.41) | (10.22) | (47.1) |
| Petroleum and natural gas revenue, net | 16.39 | 45.18 | (63.7) | 23.81 | 41.91 | (43.2) |

The decrease in revenues during the quarter ended June 30, 2020 compared to the prior year quarter is primarily due to the substantial decline in crude oil prices partially offset by increases in production volumes as discussed above.

The Company's royalty rate as a percentage of revenues remained relatively consistent during the three and six-month periods ended June 30, 2020, compared to the prior year periods.

## Operating Expense

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Lease operating costs | 6,585 | 3,616 | 82.1 | 13,113 | 6,033 | 117.4 |
| Workover expense | 419 | (133) | 415.0 | 1,316 | 1,396 | (5.7) |
| Production taxes | 2,077 | 2,370 | (12.4) | 6,131 | 3,977 | 54.2 |
| Total operating expense | 9,081 | 5,853 | 55.2 | 20,560 | 11,406 | 80.3 |
| | | | | | | |
| Per Boe amounts: | | | | | | |
| Lease operating costs | 5.44 | 6.69 | (18.7) | 5.23 | 6.08 | (14.0) |
| Workover expense | 0.35 | (0.25) | 240.0 | 0.52 | 1.40 | (62.9) |
| Production taxes | 1.72 | 4.38 | (60.7) | 2.44 | 4.00 | (39.0) |
| Total operating expense | 7.51 | 10.82 | (30.6) | 8.19 | 11.48 | (28.7) |
| | | | | | | |
| Production taxes - % of revenue | 10.3 | 9.7 | 6.1 | 10.2 | 9.5 | 7.3 |

*Lease operating costs*

Lease operating costs for the three- and six-month periods ended June 30, 2020, increased over the prior year periods due primarily to increased well count and production volumes as discussed in the Production section above.

*Workover expense*

Workover expense by its nature can vary from period to period depending on the level of workover activity, which may not be consistent with production levels.

*Production taxes*

North Dakota assesses a 5% oil severance tax and a 5% oil extraction tax on the gross value of after-royalty volumes produced at the wellhead, with certain defined exemptions. Production taxes as a percentage of revenue less royalties were consistent with the statutory rates for the three and six months ended June 30, 2020. The fluctuations in production taxes per Boe are consistent with the fluctuations in the Company's average realized prices as discussed in the Pricing section above.

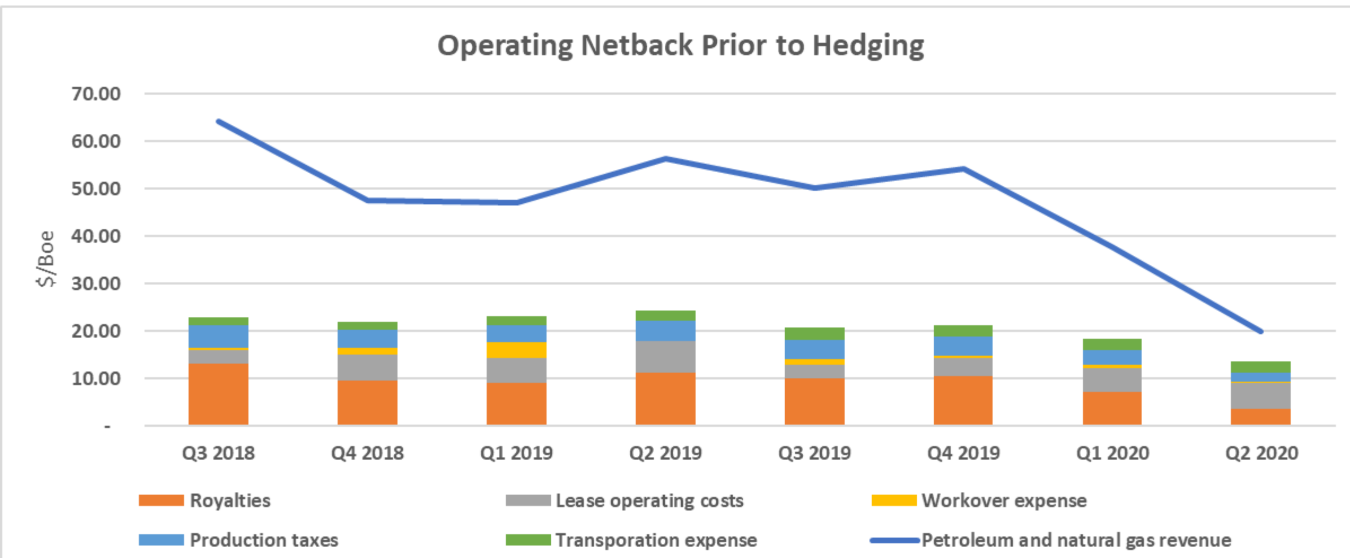
## Transportation expense

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Transportation expense | 2,966 | 1,157 | 156.4 | 6,069 | 2,019 | 200.6 |
| Transportation expense per Boe | 2.45 | 2.14 | 14.5 | 2.42 | 2.03 | 19.2 |

Transportation costs associated with the Company's petroleum production are netted against the related revenue if they are incurred following the transfer of control to the entity which has purchased the commodity. If transportation costs are incurred prior to the sale of the production, such costs are reflected separately as an expense in the interim consolidated statement of operations. Transportation costs are higher in the three- and six-month periods ended June 30, 2020 due to the increases in production volumes compared to the prior year periods as discussed in the Production section above, combined with a higher percentage of the Company's production being shipped in pipelines by midstream operators with the transportation costs being reflected as an expense. In the comparative prior periods, a higher percentage of the Company's operated production was sold at the wellhead with transportation costs reflected in the net price received from the purchaser.

## Operating Netback

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ per Boe)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Operating netback: | | | | | | |
| Petroleum and natural gas revenue | 20.01 | 56.38 | (65.6) | 29.22 | 52.13 | (43.9) |
| Royalties | (3.62) | (11.20) | (67.7) | (5.41) | (10.22) | (47.1) |
| Realized gain on financial derivatives | 1.36 | - | 100.0 | 0.91 | - | 100.0 |
| Lease operating costs | (5.44) | (6.69) | (18.7) | (5.23) | (6.08) | (14.0) |
| Workover expense | (0.35) | 0.25 | 240.0 | (0.52) | (1.40) | (62.9) |
| Production taxes | (1.72) | (4.38) | (60.7) | (2.44) | (4.00) | (39.0) |
| Transportation expense | (2.45) | (2.14) | 14.5 | (2.42) | (2.03) | 19.2 |
| Operating netback | 7.79 | 32.22 | (75.8) | 14.11 | 28.40 | (50.3) |
| Operating netback prior to hedging | 6.43 | 32.22 | (80.0) | 13.20 | 28.40 | (53.5) |




## General and Administrative ("G&A") Expense

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% Change** |
| Gross G&A expense | 1,447 | 1,580 | (8.4) | 2,853 | 3,303 | (13.6) |
| Capitalized G&A | (128) | (120) | 6.7 | (377) | (536) | (29.7) |
| Overhead recovery | (174) | (395) | (55.9) | (396) | (468) | (15.4) |
| Net G&A expense | 1,145 | 1,065 | 7.5 | 2,080 | 2,299 | (9.5) |
| Net G&A expense per Boe | 0.95 | 1.97 | (51.7) | 0.83 | 2.31 | (63.9) |

Overall, gross G&A for the three and six months ending June 30, 2020 is comparable to the prior year periods. Net G&A for the three months ended June 30, 2020 increased over the prior quarter due primarily to lower overhead recoveries and reduced capitalized G&A due to reduced capital activity in the current commodity price environment. Net G&A per Boe decreased year over year due to the significant increase in production without a commensurate increase in G&A expense.

### Depreciation and Depletion Expense

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Depreciation and depletion expense | 17,719 | 8,280 | 114.0% | 36,425 | 14,912 | 144.3% |
| Depreciation and depletion expense per Boe | 14.65 | 15.32 | -4.4% | 14.52 | 15.01 | -3.2% |

Depreciation and depletion expense increased during both the three- and six-month periods ended June 30, 2020, compared to the prior year periods, due to increased production volumes, and the significant capital expenditures incurred during 2019. The per Boe expense is relatively consistent for all periods presented.

### Impairment

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Impairment | - | - | - | 24,000 | - | 100.0 |
| Impairment per Boe | - | - | - | 9.57 | - | 100.0 |

The Company evaluates its developed and producing assets ("D&P") for impairment indicators that suggest the carrying value of a cash generating unit ("CGU") may not be recoverable. If such impairment indicators exist, any impairment necessary is determined by comparing the carrying amount of the CGU to the greater of the CGU's value in use ("VIU") or its estimated fair value less selling costs. If the carrying amount is in excess of the estimated recoverable value, the Company will then record an impairment expense related to the CGU. During the quarter ended March 31, 2020, the significant decline in oil prices experienced during the quarter was deemed an indicator of impairment and as a result, the Company performed an impairment test using its December 31, 2019 reserve report adjusted internally for activity during the three-month period ended March 31, 2020.

As a result of the impairment test, the Company recognized an impairment charge for the three months ending March 31, 2020 of $24.0 million on the Company's Bakken cash generating unit ("CGU"). The recoverable amount of the Bakken CGU of $569.1 million as at March 31, 2020 was estimated based on a value in use methodology using the estimated discounted cash flows from proved plus probable reserves at a discount rate of 14%.

Determining the estimated cash flows associated with the Company's proved plus probable reserves is an inherently complex process involving the exercise of professional judgment and the use of significant estimates, including future commodity prices, differentials, discount rates, production volumes, royalties, operating costs, foreign currency exchange rates and future capital expenditures.

At June 30, 2020, there were no impairment or impairment reversal indicators present.

### Finance Expense

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Preferred shares dividends | 3,188 | 2,257 | 41.2 | 5,455 | 4,502 | 21.2 |
| Senior loan interest | 2,329 | 1,237 | 88.3 | 4,534 | 2,080 | 118.0 |
| Preferred share accretion | 781 | 634 | 23.3 | 1,494 | 1,213 | 23.2 |
| Decommissioning obligation accretion | 43 | 57 | (25.0) | 85 | 65 | 29.4 |
| Operating lease and other | 677 | 382 | 77.2 | 688 | 474 | 45.0 |
| **Total finance expense** | **7,018** | **4,567** | **53.7** | **12,256** | **8,334** | **47.1** |

Finance expense reflects costs primarily associated with the Company's senior credit facility and the preferred shares, which were issued in January 2018 and are treated as a financial liability for accounting purposes. Finance expense was higher year over year reflecting higher senior debt levels following the Company's significant drilling and acquisition programs during 2018 and 2019.

### Deferred Income Tax Recovery

Deferred income taxes arise from differences between the accounting and tax bases of the Company's assets and liabilities. Deferred income tax assets are recognized to the extent that it is probable that future taxable income will be available against which the deductible temporary differences and the carryforward of unused tax losses can be utilized. At June 30, 2020, the Company determined that due to the challenging economic climate, the generation of future taxable income was not probable and has thus not recognized a deferred tax asset. The Company recorded a deferred income tax recovery of $2.1 million and $6.2 million for three and six months ended June 30, 2020, respectively, compared to an expense of $1.5 million and $1.2 million during the comparable prior year periods.

### Share-based Compensation

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Gross share-based compensation | 112 | 357 | (68.7) | 449 | 976 | (54.0) |
| Capitalized share-based compensation | (23) | (74) | (68.9) | (77) | (223) | (65.5) |
| **Net share-based compensation** | 89 | 283 | **(68.6)** | 372 | 753 | **(50.6)** |

The Company has granted restricted share bonus awards and performance share bonus awards (collectively, the "share bonus awards") to certain directors, officers, and employees. Share bonus awards granted according to the plan vest over three years from the date of grant and expire before the end of the third year from the date of grant. Restricted share bonus awards vest over time. Performance share bonus awards vest based on achievement of certain performance hurdles and are subject to a multiplier between 0 and 2 times based on relative performance. The share bonus awards may be settled by the Company, in its sole discretion, in cash and or common shares of the Company. The estimated fair value of the share bonus awards is determined based on the current market value of the Company's common shares at the dates of grant and considering anticipated forfeiture rates. For purposes of valuing performance share bonus awards, the Company assumes a multiplier of 1.0 times. A charge to income is reflected as share-based compensation expense in the consolidated statement of operations over the vesting period with a corresponding increase to contributed surplus.

### Foreign Currency Gain (Loss) and Translation Adjustment

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2020** | **2019** | **2020** | **2019** |
| Foreign currency translation rates – US$/CAD$: | | | | |
| Average period exchange rate | 1.3855 | 1.3377 | 1.3646 | 1.3337 |
| Ending period exchange rate | 1.3576 | 1.3095 | 1.3576 | 1.3095 |

The Company's interim consolidated financial statements are reported in Canadian dollars, which is the Company's presentation currency. Transactions of the Company's US subsidiary are recorded in US dollars, its functional currency, as this is the primary economic environment in which the subsidiary operates. The assets, liabilities and results of operations of the Company's US subsidiary are translated to Canadian dollars in the interim consolidated financial statements according to the Company's foreign currency translation policy, with any corresponding gain or loss reflected as a currency translation adjustment in other comprehensive income. The Company experienced a currency translation gain of $9.4 million for the six months ended June 30, 2020 (2019 – loss of $7.7 million), due to the weakening of the Canadian dollar relative to the US dollar from December 31, 2019 and the fact that the Company's US dollar-denominated assets exceed its liabilities.

### Realized and Unrealized Gain (Loss) on Financial Derivatives

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands except where noted)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Realized gain on financial derivatives | 1,650 | - | 100.0 | 2,275 | - | 100.0 |
| Unrealized loss on financial derivatives | (8,723) | - | (100.0) | (6,838) | - | (100.0) |
| | | | | | | |
| Realized gain on financial derivatives per Boe | 1.36 | - | 100.0 | 0.91 | - | 100.0 |

The Company realized gains on its financial derivatives in the three and six month periods ended June 30, 2020 due to declining oil prices. During the six months ended June 30, 2020, the Company entered into additional commodity price hedges to protect its operating cash flows for the remainder of the year and 2021. With oil prices improving during the period, the Company incurred an unrealized loss on those derivatives to June 30, 2020.

## Liquidity and Capital Resources

### Summary

PetroShale's capital resources consist primarily of cash flow provided by operating activities, cash and cash equivalents and availability under the Senior Loan.

The Company is dependent on cash on hand, operating cash flows and equity and/or debt issuances to finance capital expenditures and property acquisitions. The Company will manage borrowings in relation to credit capacity and ability to generate future operating cash flows to service such debt.

The Company continuously monitors production, commodity prices and/or resulting cash flows. Should the outlook for future cash flow be impacted in a negative way, the Company is capable of managing its cash flows by not consenting to participate in additional drilling proposed by operators of its non-operated properties, by reducing its drilling and completion activity on its operated properties and by entering into commodity price contracts. The Company will monitor its financial capacity before proceeding with additional wells on its operated lands.

As at June 30, 2020, the Company had a net working capital deficit of $23.4 million, excluding a financial derivative liability of $6.6 million, which is $18.9 million greater than the undrawn capacity of the senior credit facility of $4.5 million. Accounts payable and accrued liabilities consist of amounts relating to capital spending, field operating activities and general and administrative expenses.

### Cash Flow from Operating Activities

Cash flow provided by operating activities depends on several factors, including commodity prices, royalties, production volumes, operating expenses, transportation expenses, and production taxes. Net cash flow provided by operating activities was $55.2 million for the six months ended June 30, 2020 as compared to $18.6 million for the prior year period.

### Financial Derivative and Hedging Activities

The results of operations and cash flows of the Company are impacted by changes in market prices for oil, natural gas and NGLs. To mitigate a portion of its exposure to adverse market changes, the Company will, from time to time, enter various derivative instruments. These derivative instruments allow the Company to predict with greater certainty the total revenue it will receive, protect acquisition economics, and provide some stability of cash flows for capital spending planning purposes.

As at June 30, 2020, the Company had the following oil price derivatives outstanding:

**Q3 2020**

| Contract Type | Volume (Bbls/d) | Fixed (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Costless Collars | | | | |
| | 500 | - | 25.00 | 35.50 |
| | 500 | - | 25.00 | 37.50 |
| | 500 | - | 27.00 | 37.50 |
| | 500 | - | 29.00 | 35.00 |
| Swap | | | | |
| | 1,000 | 28.76 | - | - |
| | 1,000 | 30.70 | - | - |
| **Total** | **4,000** | **29.73** | **26.50** | **36.38** |

**Q4 2020**

| Contract Type | Volume (Bbls/d) | Fixed (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Costless Collars | | | | |
| | 500 | - | 25.00 | 35.25 |
| | 500 | - | 26.00 | 34.50 |
| | 500 | - | 27.00 | 35.00 |
| | 500 | - | 27.00 | 34.35 |
| | 500 | - | 29.00 | 36.60 |
| | 500 | - | 29.00 | 37.40 |
| | 500 | - | 30.00 | 38.25 |
| | 500 | - | 30.00 | 39.35 |
| **Total** | **4,000** | **-** | **36.34** | **27.88** |

**Q1 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 40.05 |
| | 500 | 25.00 | 37.50 | 43.60 |
| **Total** | **1,000** | **25.00** | **37.50** | **41.83** |

**Q2 – Q4 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 48.10 |
| **Total** | **500** | **25.00** | **37.50** | **48.10** |

**FY 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 46.50 |
| | 500 | 25.00 | 37.50 | 46.50 |
| | 500 | 25.00 | 37.50 | 43.90 |
| **Total** | **1,500** | **25.00** | **37.50** | **45.63** |

## Capital Expenditures

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **% change** | **2020** | **2019** | **% change** |
| Drilling and completion | 6,358 | 58,068 | (89.1) | 29,895 | 104,157 | (71.4) |
| Acquisitions | - | 3,183 | (100.0) | - | 3,183 | (100.0) |
| | 6,358 | 61,251 | (89.6) | 29,895 | 107,340 | (72.2) |
| Non-cash: | | | | | | - |
| Capitalized share-based compensation | 23 | 74 | (68.9) | 77 | 223 | (65.5) |
| Decommissioning obligation | 471 | - | - | 471 | 377 | 24.6 |
| **Total capital expenditures** | **6,852** | **61,325** | **(88.8)** | **30,443** | **107,940** | **(71.9)** |

Capital expenditures for the three and six months ended June 30, 2020 were funded from borrowings under the Company's senior loan facility, operating cash flows and working capital. Capital expenditures in 2020 were mainly related to completion activities on 3.2 net non-operated wells as well as operated well workover activities. In the current environment, the Company is minimizing discretionary capital expenditures.

## Senior Loan

The Company maintains a senior revolving credit facility, which is referred to as the senior loan in the interim consolidated statement of financial position. The capacity of this facility was US$177.5 million as at June 30, 2020. The term-out date is June 26, 2021, 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 25, 2022. The amount of the facility is subject to a borrowing base test performed on a periodic basis and at least twice annually by the lenders, based primarily on producing oil and natural gas reserves and using commodity prices estimated by the lender as well as other factors. A decrease in the borrowing base determined by the senior lenders in the future could result in a reduction to the credit facility, which may require a repayment to the lenders.

The credit facility is subject to certain non-financial covenants and the Company is in compliance with all of the covenants under the senior loan as at June 30, 2020. The credit facility has no financial covenants.

As at August 20, 2020, outstanding borrowings under the senior loan were US$173.6 million. The Company held cash of US$12.2 million for net borrowings of US$161.4 million. Oil prices declined significantly in March 2020. Capital expenditures in the second quarter mainly relate to participation in well completions undertaken by operators of certain of our non-operated properties. Recently, the operators of some of these properties have suspended further activities and we do not anticipate any material new drilling activity will occur until oil prices recover materially.

The current challenging economic climate may have significant adverse impacts on the Company, including material declines in revenue and cash flows, and related impacts to working capital levels and/or debt balances, which may also have a direct impact on the Company's operating results and financial position. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows to meet the Company's current and future obligations. Similar issues may be faced by the Company's customers, which could materially increase the risk of non-payment of accounts receivable and customer defaults. At June 30, 2020, the Company remains in compliance with all terms of our Senior Loan and based on current available information, management expects to comply with all terms during the subsequent 12-month period. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company is not known at this time. Estimates and judgements made by management in the preparation of the financial statements are increasingly difficult and subject to a higher degree of measurement uncertainty during this volatile period.

## Preferred Shares

The Company elected to pay its preferred share dividend due in May 2020, in kind, as a means of preserving liquidity. The Company has also elected to do the same in respect of its dividend due in August 2020. See Note 17 to the Company's interim consolidated financial statements.

## Share Capital

| | As at August 19, 2020 | As at June 30, 2020 | 2019 |
|---|---|---|---|
| Weighted average common shares outstanding: | | | |
| Basic | | 188,276,150 | 191,989,090 |
| Diluted | | 188,276,150 | 194,488,268 |
| | | | |
| Outstanding securities: | | | |
| Common shares | 187,705,035 | 187,621,722 | 192,171,175 |
| Preferred shares, convertible | 75,000 | 75,000 | 75,000 |
| Stock options | 550,000 | 550,000 | 550,000 |
| Restricted share bonus awards | 1,684,507 | 1,753,554 | 2,290,001 |
| Performance share bonus awards | 512,160 | 632,913 | - |

The preferred shares entitle the investor to voting rights as though the preferred shares were exchanged to common shares, but no other redemption or distribution rights and no claims on the Company's assets.

On February 7, 2019, the Company announced that the TSX Venture Exchange had accepted the Company's intention to commence a normal course issuer bid ("NCIB"). Pursuant to the NCIB, which was renewed in 2020, the Company is permitted to purchase up to 11,785,163 voting common shares of the Company between February 10, 2020 and February 8, 2021. During the three months ended March 31, 2020, the Company purchased and cancelled 3,865,000 shares at an average price of $0.48 per common share for a total repurchase cost of $1.9 million under the NCIB. On April 1, 2020, the Company ceased making further purchases under the NCIB until further notice. From February 7, 2019, through April 1, 2020, the Company purchased 4,939,615 shares under the NCIB at an average price of $0.50/share for a total repurchase cost of $2.5 million.

## Contractual Obligations, Commitments and Off-Balance Sheet Arrangements

### Contractual Obligations and Other Commercial Commitments

The following is a summary of the Company's contractual obligations and commitments as at June 30, 2020:

| *($ thousands)* | Contractual Cash Flow | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 56,967 | 56,967 | - | - | - | - |
| Lease liability | 617 | 167 | 314 | 136 | - | - |
| Senior loan [(1)] | 261,273 | 4,984 | 9,969 | 246,320 | - | - |
| Preferred share obligation [(2)] | 126,898 | 4,719 | 9,439 | 9,439 | 105,661 | - |

(1) Includes future interest expense at the rate of 4.3% being the rate applicable at June 30, to the current maturity date of June 25, 2022

(2) The amount differs from that presented on the interim consolidated statement of financial position due, in part, to the unamortized portion of issuance costs (which are offset against the preferred share obligation on the interim consolidated statement of financial position), the preferred share equity component (which is presented separately under Shareholders' Equity) and finance cost at the coupon rate of 9% per annum. The table reflects the full dividend payment obligation to the maturity date of January 25, 2023. These preferred shares may be converted to common shares at the option of the investor.

### Off-Balance Sheet Arrangements

The Company is not involved with any contractual arrangement under which a non-consolidated entity may have an obligation under certain guarantee contracts, a retained or contingent interest in assets transferred to a non-consolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets. PetroShale has no obligation under financial instruments or a variable interest in a non-consolidated entity that provides financing, liquidity, market risk or credit risk support to the Company.

### Letters of Credit

The Company has an outstanding letter of credit in favor of the 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 of US$160,000 as security in order to operate in North

Dakota.

## Summary of Quarterly Results

| *($ thousands except where noted)* | Jun 30 2020 | Mar 31 2020 | Dec 31 2019 | Sep 30 2019 | Jun 30 2019 | Mar 31 2019 | Dec 31 2018 | Sep 30 2018 |
|---|---|---|---|---|---|---|---|---|
| Revenues, net of royalty | 19,820 | 39,918 | 48,883 | 42,249 | 24,419 | 17,230 | 20,899 | 31,980 |
| Adjusted EBITDA | 8,278 | 25,027 | 35,566 | 29,996 | 16,344 | 9,581 | 11,684 | 22,018 |
| Cash flow – operating activities | 16,336 | 38,837 | - | - | (1,626) | 20,210 | 19,810 | 20,112 |
| Net income (loss) | (23,169) | (17,266) | 9,608 | 4,982 | 1,733 | (996) | 7,892 | 10,449 |
| Net income (loss) per share: | | | | | | | | |
| Basic and Diluted | (0.12) | (0.09) | 0.05 | 0.03 | 0.01 | - | 0.04 | 0.06 |

During the second quarter of 2020, revenues fell due to a significant decline in oil prices, which also contributed to a reduction in Adjusted EBITDA and cash flows, and a significant net loss.

Revenues, along with adjusted EBITDA and net income decreased in the first quarter of 2020 compared to the fourth quarter of 2019 due to a 29% decrease in average realized prices partially offset by a 17% increase in sales volumes. The first quarter of 2020 also included at $17.5 million impairment charge related to the Company's developed and producing assets.

Revenues in the fourth quarter of 2019 increased 15.7% over the third quarter of 2019 due primarily to a 6.9% increase in production volumes. Adjusted EBITDA and net income also improved in the fourth quarter of 2019 mainly as a result of production increases. Cash flow provided by operating activities fell in the fourth quarter due to changes in non-cash working capital.

Revenue in the third quarter of 2019 increased substantially compared to the second quarter of 2019 due to a 93.4% increase in production, partially offset by lower realized commodity prices. The same factors led to significant increases in adjusted EBITDA, cash flow from operating activities and net income.

Revenue in the second quarter of 2019 increased compared to the first quarter due to an 19.6% increase in production volumes and higher realized oil prices. This increase in revenue also resulted in net income in the second quarter of 2019 compared to a net loss in the first quarter of 2019. Cash flow from operations decreased in the second quarter of 2019 compared to the first quarter as a result of an increase in accounts receivable. Revenue in the first quarter of 2019 declined compared to the fourth quarter of 2018 due to lower production volumes as well as lower benchmark commodity prices. Despite a reduction in revenues, cash flow from operations increased due to a large decrease in working capital. Net income moved to a small loss in the first quarter of 2019 following the reduction in revenues and a large deferred tax recovery in the fourth quarter of 2018.

Revenue in the fourth quarter of 2018 declined compared to the third quarter due to lower production volumes and both weaker benchmark commodity prices and wider Bakken oil differentials. Net income decreased over the period as a result of the aforementioned factors. Revenue, cash flow from operations and net income saw significant growth in the third quarter of 2018 compared to prior periods due to increased production volumes resulting from the Company's operated drilling program and acquisitions.

## Critical Accounting Estimates

The timely preparation of the consolidated financial statements in accordance with IFRS requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. Actual results may differ from these estimates.

In early March 2020, the World Health Organization declared the COVID-19 coronavirus outbreak to be a pandemic. Responses to the spread of COVID-19 have resulted in significant disruption to business operations and a significant increase in economic uncertainty, with more volatile commodity prices and currency exchange rates, and a marked decline in long-term interest rates. These events are resulting in a challenging economic climate in which it is difficult to reliably estimate the length or severity of these developments and their financial impact. The results of the potential economic downturn and any potential resulting direct and indirect impact to the Company has been considered in management's estimates described in this section at the period end; however there could be a further prospective material impact in future periods.

Critical judgments that have the most significant effect on the amounts recognized in the interim consolidated financial statements include the following:

### Reserve Estimates

The estimation of recoverable quantities of proved and probable oil and natural gas reserves is an inherently complex process and involves the exercise of professional judgment. Estimates are based on projected future rates of production, estimated commodity prices and differentials, estimated production and transportation costs, engineering data and the timing and amount of future expenditures, all of which are subject to uncertainty. The Company's reserve estimates are evaluated by independent professional engineers and are determined in accordance with Canadian practices and specifically in accordance with National Instrument 51-101, *Standards of Disclosures for Oil and Gas Activities*, and the Canadian Oil and Gas Evaluation Handbook.

Reserve adjustments are made annually based on actual volumes produced, the results from capital expenditure programs, revisions to previous estimates, new discoveries and acquisitions and dispositions made during the year. Changes in reserve estimates can affect the impairment of assets, including the reversal of previously recorded impairment, the estimation of decommissioning obligations, and the amounts reported for depletion and depreciation of property, plant, and equipment.

### Impairment

Management reviews, each quarter, indicators of impairment including internal and external sources of information including changes to reserve estimates, drilling results, performance of its oil and gas producing assets and changes in commodity prices. Significant judgment is involved in assessing such indicators of impairment and if indicators do exist, to prepare estimates of value in use and fair value less selling costs. Related estimates include assumptions as to appropriate discount factors and future commodity prices.

### Decommissioning Obligation

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

### Business Combinations

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

### Share-Based Compensation

The Company's estimate of share-based compensation expense associated with stock option grants and the value of warrants issued is dependent upon estimates of expected volatility of the Company's share price and anticipated forfeiture rates of the related securities. The Company's estimate of share-based compensation expense associated with share-based awards is dependent on an estimate of anticipated forfeiture rates of such securities.

### Deferred Income Taxes

The calculation of deferred income taxes is based on a number of assumptions, including estimating the future periods in which temporary differences, tax losses and other tax credits will reverse, the use of substantively enacted tax rates at the balance sheet date and the likelihood of deferred tax assets being realized.

### Derivatives

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

### Preferred Shares

The Company's estimate of the preferred share obligation and preferred share equity component of its outstanding preferred shares is dependent on an estimate of the rate of interest which would be incurred by the Company on a similar debt obligation without a conversion feature.

## Changes in Accounting Policies

### IFRS 3 Business Combinations

PetroShale adopted IFRS 3, *Business Combinations*, on January 1, 2020. Amendments to IFRS 3 were issued by the IASB in October 2018, that seek to clarify whether a transaction results in an asset or a business acquisition. The amendments include an election to use an optional concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets. If the concentration test is not applied, or the test is failed, then the assessment focuses on the existence of a substantive process. The adoption of IFRS 3 had no impact to the Company's financial statements.

## Business Conditions and Risks

The Company is engaged in the acquisition, exploration, development and production of crude oil and natural gas. The Company's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates, and the ability to access debt and/or equity financing at a reasonable cost, or at all. Operational risks include the performance of the Company's properties, safety and performance risks associated with drilling and well completion activities, competition for land and services, environmental factors, reservoir performance uncertainties, a complex regulatory environment, safety concerns, and reliance on the operators of a portion of the Company's properties. When acquiring land, the Company uses technical and industry knowledge to evaluate potential hydrocarbon plays in order to pay what it believes are economically sound prices that will benefit PetroShale's shareholders. The Company's focus is on areas in which the prospects are understood by management. There is risk that the Company may not realize the anticipated benefits of acquired properties or future development thereof.

The Company minimizes operational risks by hiring experienced management and engaging experienced service providers on our operated properties and by participating with well-established operators of our non-operated properties. On our non-operated properties, we have limited ability to exercise influence over, and control the risks associated with, operations of these properties. The failure of an operator of the Company's non-operated properties to adequately perform operations, an operator's breach of the applicable agreements or regulations or an operator's failure to act in ways that are in the Company's best interests could reduce production and revenues or could create a liability for the Company for the operator's failure to properly maintain wells and facilities or to adhere to applicable safety and environmental standards. With respect to properties that the Company does not operate:

- The operator could refuse to initiate exploration or development projects
- If the Company proceeded with any of those projects the operator has refused to initiate, PetroShale may not receive any funding from the operator with respect to that project and thus bear all the risk
- The operator may initiate exploration or development projects on a different schedule than the Company would prefer, possibly resulting in lease expirations
- The operator may propose greater capital expenditures, or on a different schedule than the Company anticipated, including expenditures to drill more wells or build more facilities on a project than the Company has funds for, which may mean that the Company cannot participate in those projects or participate in a substantial amount of the revenues from those projects
- The operator may not have adequate expertise or resources to perform operations efficiently

Any of these events could significantly and adversely affect anticipated exploration and development activities carried out on its properties which the Company does not operate, and the results of those activities.

PetroShale's focus is on areas and geological formations in which the prospects are understood by management. Technological tools are regularly used to increase the probability of success and reduce risk.

PetroShale relies on appropriate sources of funding to support the various stages of the Company's business strategy. There is no guarantee that external sources of financing will be available in the future, on favorable terms or at all. The various sources of funding include:

- Internally generated cash flow from operations
- New common or preferred equity, if available on acceptable terms, may be utilized to fund acquisitions, to expand capital programs when appropriate and to repay any outstanding debt
- Debt, in the form of traditional oil and gas borrowing base bank facilities, and/or subordinated debt which typically has a higher cost than bank debt.
- Disposition of non-core assets

The Company is exposed to commodity price and market risk for our principal products of crude oil, natural gas, and natural gas liquids. Commodity prices are influenced by a wide variety of factors, most of which are beyond PetroShale's control. In addition, the Company is exposed to fluctuations in the differentials between market price benchmarks and what is received in our geographic area of operation for our production. To manage this risk, the Company may enter financial derivative contracts for hedging purposes. These derivative contracts may relate to crude oil and natural gas prices, as well as foreign exchange and interest rates. The Company may also, from time to time, enter fixed physical contracts to hedge the realized prices from its production. The Company monitors the cost and associated benefit of these instruments and contracts as well as any debt levels and utilization rates on debt lines and utilizes these derivatives and contracts when warranted. Although the Company's intent in entering such derivative contracts is to manage its exposure to fluctuations in commodity prices, such contracts may limit the Company's ability to fully realize the benefits of higher market prices.

Risk of cost inflation subjects the Company to potential erosion of product netbacks and returns from well drilling and completion activities. For example, increasing costs of oil and natural gas production equipment and services can inflate operating costs and/or drilling and well completion expenditures. In addition, increasing prices for undeveloped land can inflate costs of both asset and corporate acquisitions.

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a reasonable cost and produce them in an economic and timely fashion. In periods of increased activity, these services and supplies can become difficult to obtain. The Company and the operators of its non-operated properties attempt to mitigate this risk by developing long-term relationships with suppliers and contractors.

Demand for crude oil, natural gas liquids ("NGLs") and natural gas produced by the Company exists within Canada and the United States; however, crude oil prices are affected by worldwide supply and demand fundamentals while natural gas prices are currently primarily affected by factors restricted to the North American market. Demand for natural gas liquids is influenced mainly by the demand for petrochemicals in North American and offshore markets.

PetroShale mitigates the above-mentioned risks as follows:

- PetroShale and the operators of certain of our properties attempt to explore for and produce crude oil that is high quality (light, sweet), mitigating the Company's exposure to adverse quality differentials
- Natural gas production will generally be connected to established pipeline infrastructure or other uses for the natural gas may be found
- Financial derivative instruments or fixed price physical contracts may be used where appropriate to manage commodity price volatility

The Company is exposed to operational risks in terms of engaging service suppliers and drilling contractors, the normal oilfield risks of dangerous operations and the potential for discharge of hazardous substances into the environment, arranging for marketing of the Company's oil and natural gas production, as well as financing the costs of completing wells and recovering a share of those costs from our non-operating partners. The Company has and will continue to engage appropriate resources to ensure these risks are managed to the extent possible.

PetroShale owns leases from individual mineral owners (Fee Leases), the State of North Dakota acting by and through the Board of University and School Lands (State Leases), individual native owners with approval from the Secretary of the Interior of the Bureau of Indian Affairs (Allotted or BIA Leases), and the Bureau of Land Management (Federal Leases). PetroShale adheres to the National Environmental Policy Act in its operations and is under the regulatory authority of the North Dakota Industrial Commission, the Bureau of Indian Affairs (BIA), the Bureau of Land Management and the Department of the Interior's Office of Natural Resources Revenue. The Allotted Leases are held in trust by the United States for the benefit of individual native owners and are subject to restrictions against alienation or encumbrance without approval of the Secretary of the Interior. All the Company's Allotted Leases are located within the boundaries of the Fort Berthold Indian Reservation (FBIR) which makes the Company subject to unique regulations that are not applicable to lands outside the FBIR. The Company mitigates regulatory risk by maintaining good relationships with the BIA and staying abreast of current regulations. PetroShale's ability to execute projects and realize the benefits therefrom is subject to factors beyond our control, including changes to regulations promulgated by any of the above entities.

PetroShale owns interests in certain oil and natural gas leases beneath the Missouri River in North Dakota. In late 2013, the North Dakota Supreme Court upheld that the State of North Dakota owns the mineral rights under the navigable portions of the Missouri River up to the delineated high-water mark. PetroShale had purchased interests in certain leases which were negatively impacted by the decision, although not material to PetroShale in aggregate. There is ongoing litigation as to the proper delineation of the high-water mark which could further impact PetroShale's interest in these leases, positively or negatively.

Like most companies of our size, PetroShale has a limited number of accounting and finance personnel, and therefore it is difficult to create strong segregation of duties which is normally a feature of a company's internal control structure. Management mitigates this risk through performance of analytical review procedures on operating and financial results.

## Environmental Risks

### General Risks

Oil and gas exploration and production can involve environmental risks such as litigation, physical and regulatory risks. Physical risks include the pollution of the environment, climate change and destruction of natural habitat, as well as safety risks such as personal injury. The Company works hard to identify the potential environmental impacts of its new projects in the planning stage and during operations. The Company conducts its operations with high standards in order to protect the environment, its employees and consultants, and the general public. The Company maintains current insurance coverage for comprehensive and general liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect current corporate requirements, as well as industry standards and government regulations. Without such insurance, and if the Company becomes subject to environmental liabilities, the payment of such liabilities could reduce or eliminate its available funds or could exceed the funds the Company has available and result in financial distress.

### Climate Change Risks

Our exploration and production facilities and other operations and activities emit greenhouse gasses ("GHG") which may require us to comply with US federal and/or state GHG emissions legislation. Climate change policy is evolving at regional, national, and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place to prevent climate change or mitigate our effects. The direct or indirect costs of compliance with GHG-related regulations may have a material adverse effect on our business, financial condition, results of operations and prospects. Some of our significant facilities may ultimately be subject to future regional, and/or US federal climate change regulations to manage GHG emissions. In addition, climate change has been linked to long-term shifts in climate patterns and extreme weather conditions both of which pose the risk of causing operational difficulties. The Company has undertaken several initiatives, including continuous flaring reduction initiatives, transporting oil by pipeline rather than by truck, and connecting natural gas to pipeline connections to reduce GHG emissions from its operations.

## Recent Oil Price Market Events and COVID-19 Impacts

Recent market events and conditions, including global excess oil and natural gas supply caused primarily by the diminished demand for crude oil and refined petroleum products due to the COVID-19 pandemic, have had a significant negative impact on world oil prices. Although OPEC+ has taken significant steps to address the recent demand destruction, supply cuts are gradually being removed and industrialized economic activity has not fully recovered and likely will not do so until a vaccine is widely available. Future oil price volatility is likely. In addition, our field and office operations may be negatively impacted if our key personnel become infected with the COVID-19 virus. Entities which provide services to the Company may also have their operations impacted by COVID-19 and this may result in reduced access to certain services that may negatively impact our operations. The Company has taken steps to reduce or limit such negative impacts by requesting its office personnel to work from home until further notice and to implement additional hygiene and distancing practices at our field locations.

The majority of crude oil currently sold in North Dakota is transported through the Dakota Access Pipeline (DAPL) to the US Gulf Coast. A short distance of the DAPL crosses underneath a lake in South Dakota. In July, a United States District Court Judge made a ruling that the US Army Corps of Engineers (USACE), which had provided a crossing permit under that lake to allow the DAPL to be completed in 2017, failed to perform an environmental impact study of any potential spill and ordered the DAPL to be shut down and emptied of oil. Energy Transfer, which owns the DAPL, and the USACE appealed that decision to the DC Circuit Court of Appeals (DCCOA). The DCCOA stayed the injunction against the DAPL allowing the DAPL to continue to operate if authorized to do so by the USACE. The USACE has agreed to allow DAPL to continue to operate. In the meantime, the USACE and Energy Transfer have continued their appeal to the DCCOA regarding whether the lower court incorrectly invalidated the crossing permit originally issued by the USACE. If, in the unlikely event the DAPL is required to shut down for a period of time, there is currently adequate excess rail capacity due to declining production in the basin to transport crude oil from North Dakota to markets. Transporting oil by rail is more expensive than transportation through the DAPL and may lead to an increase in realized price differentials if such an event occurs.

## Additional Information

Additional information can be obtained by contacting the Company at PetroShale Inc., Suite 3230, 421-7th Avenue SW, Calgary, Alberta T2P 4K9 or by email at info@petroshaleinc.com. Additional information is also available on www.sedar.com or www.petroshaleinc.com.

## Interim Consolidated Statements of Financial Position
(Unaudited)

| *($ thousands)* | **Note** | **As at June 30, 2020** | **As at December 31, 2019** |
|---|---|---|---|
| **Assets** | | | |
| Current assets | | | |
| Cash and cash equivalents | | 17,529 | 607 |
| Accounts receivable | 3 | 15,918 | 54,020 |
| Prepaid expenses and deposits | | 253 | 86 |
| Total current assets | | 33,700 | 54,713 |
| Restricted cash | 13 | 218 | 306 |
| Right of use assets | 4 | 614 | 445 |
| Property, plant and equipment, net | 5 | 538,128 | 543,364 |
| **Total assets** | | 572,660 | 598,828 |
| **Liabilities** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | 6 | 56,967 | 108,773 |
| Financial derivative liability | 16 | 6,642 | 261 |
| Lease liability | 4 | 309 | 453 |
| Total current liabilities | | 63,918 | 109,487 |
| Senior loan | 8 | 236,470 | 188,589 |
| Preferred share obligation | 9 | 95,861 | 87,380 |
| Financial derivative liability | 16 | 274 | - |
| Lease liability | 4 | 308 | - |
| Decommissioning obligation | 7 | 7,144 | 6,313 |
| Deferred income tax liability | | - | 5,858 |
| **Total liabilities** | | 403,975 | 397,627 |
| **Shareholders' equity** | | | |
| Common shares | 10 | 198,814 | 200,630 |
| Preferred share equity component | 9 | 7,510 | 7,510 |
| Contributed surplus | 10 | 6,566 | 6,191 |
| Deficit | | (53,121) | (12,686) |
| Accumulated other comprehensive income (loss) | | 8,916 | (444) |
| **Total shareholders' equity** | | 168,685 | 201,201 |
| Commitments | 13 | | |
| Subsequent events | 17 | | |
| **Total liabilities and shareholders' equity** | | 572,660 | 598,828 |

See accompanying notes to the interim consolidated financial statements

## Interim Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

| | | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|---|
| *($ thousands, except per share amounts)* | **Note** | **2020** | **2019** | **2020** | **2019** |
| **Revenue** | | | | | |
| Petroleum and natural gas | 11 | 24,200 | 30,476 | 73,310 | 51,802 |
| Less: Royalties | | (4,380) | (6,057) | (13,571) | (10,153) |
| Petroleum and natural gas, net of royalties | | 19,820 | 24,419 | 59,739 | 41,649 |
| Realized gain on financial derivatives | 16 | 1,650 | - | 2,275 | - |
| Unrealized loss on financial derivatives | 16 | (8,723) | - | (6,838) | - |
| **Total revenue** | | 12,747 | 24,419 | 55,176 | 41,649 |
| **Expenses** | | | | | |
| Operating | | 9,081 | 5,853 | 20,560 | 11,406 |
| Transportation | 11 | 2,966 | 1,157 | 6,069 | 2,019 |
| General and administrative | | 1,145 | 1,065 | 2,080 | 2,299 |
| Depreciation and depletion | 4,5 | 17,719 | 8,280 | 36,425 | 14,912 |
| Impairment | 5 | - | - | 24,000 | - |
| Finance | 14 | 7,018 | 4,567 | 12,256 | 8,334 |
| Share-based compensation | 10 | 89 | 283 | 372 | 753 |
| **Total expenses** | | 38,018 | 21,205 | 101,762 | 39,723 |
| Income (loss) before income taxes | | (25,271) | 3,214 | (46,586) | 1,926 |
| Deferred income tax expense (recovery) | | (2,102) | 1,481 | (6,151) | 1,189 |
| **Net income (loss)** | | (23,169) | 1,733 | (40,435) | 737 |
| Currency translation adjustment | | (6,411) | (3,602) | 9,360 | (7,658) |
| **Comprehensive loss** | | (29,580) | (1,869) | (31,075) | (6,921) |
| **Net income (loss) per share:** | | | | | |
| Basic | 12 | (0.12) | 0.01 | (0.21) | 0.00 |
| Diluted | 12 | (0.12) | 0.01 | (0.21) | 0.00 |

See accompanying notes to the interim consolidated financial statements

## Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

| *($ thousands, except share amounts)* | Voting Common Shares | Share Capital | Preferred Share Equity Component | Contributed Surplus | Deficit | Accumulated Other Comprehensive Income (Loss) | Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| **December 31, 2018** | **191,758,236** | **200,651** | **7,510** | **5,444** | **(28,013)** | **9,137** | **194,729** |
| Purchase of common shares for cancellation | (83,000) | (81) | - | - | - | - | (81) |
| Settlement of RSU's | 496,339 | 570 | - | (1,026) | - | - | (456) |
| Share-based compensation, gross | - | - | - | 976 | - | - | 976 |
| Net income | - | - | - | - | 737 | - | 737 |
| Other comprehensive loss | - | - | - | - | - | (7,658) | (7,658) |
| **June 30, 2019** | **192,171,575** | **201,140** | **7,510** | **5,394** | **(27,276)** | **1,479** | **188,247** |
| | | | | | | | |
| **December 31, 2019** | **191,185,628** | **200,630** | **7,510** | **6,191** | **(12,686)** | **(444)** | **201,201** |
| Purchase of common shares for cancellation | (3,865,000) | (1,859) | - | - | - | - | (1,859) |
| Settlement of RSU's | 301,094 | 43 | - | (74) | - | - | (31) |
| Share-based compensation, gross | - | - | - | 449 | - | - | 449 |
| Net loss | - | - | - | - | (40,435) | - | (40,435) |
| Other comprehensive income | - | - | - | - | - | 9,360 | 9,360 |
| **June 30, 2020** | **187,621,722** | **198,814** | **7,510** | **6,566** | **(53,121)** | **8,916** | **168,685** |

See accompanying notes to the interim consolidated financial statements

## Interim Consolidated Statements of Cash Flows

(Unaudited)

| | | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|---|
| *($ thousands)* | **Note** | **2020** | **2019** | **2020** | **2019** |
| **Operating activities** | | | | | |
| Net income (loss) | | (23,169) | 1,733 | (40,435) | 737 |
| Operating items not affecting cash: | | | | | |
| Depreciation and depletion | | 17,719 | 8,280 | 36,425 | 14,912 |
| Impairment | | - | - | 24,000 | - |
| Deferred income tax expense (recovery) | | (2,102) | 1,481 | (6,151) | 1,189 |
| Unrealized loss on financial derivatives | | 8,723 | - | 6,838 | - |
| Share-based compensation | | 89 | 283 | 372 | 753 |
| Finance expense | | 7,018 | 4,567 | 12,256 | 8,334 |
| Change in non-cash working capital | 15 | 8,058 | (17,970) | 21,868 | (7,341) |
| **Cash provided by (used in) operating activities** | | 16,336 | (1,626) | 55,173 | 18,584 |
| **Investing activities** | | | | | |
| Additions to property, plant, and equipment | | (6,358) | (58,068) | (29,895) | (104,157) |
| Acquisitions | | - | (3,183) | - | (3,183) |
| Change in non-cash working capital | 15 | (16,834) | 27,502 | (38,202) | 38,215 |
| **Cash used in investing activities** | | (23,192) | (33,749) | (68,097) | (69,125) |
| **Financing Activities** | | | | | |
| Proceeds from senior loan, net | | 9,860 | 50,067 | 39,268 | 65,199 |
| Payment of interest and preferred dividends | | (2,954) | (3,872) | (7,548) | (7,048) |
| Payment of lease liabilities | | (123) | (48) | (240) | (96) |
| Settlement of RSU's | | (31) | (456) | (31) | (456) |
| Purchase of common shares for cancellation | | (2) | (81) | (1,859) | (81) |
| **Cash provided by financing activities** | | 6,750 | 45,610 | 29,590 | 57,518 |
| Change in cash and cash equivalents | | (106) | 10,235 | 16,666 | 6,977 |
| Effect of foreign exchange rate changes | | (671) | (2,941) | 256 | 78 |
| **Cash and cash equivalents, beginning of period** | | 18,306 | 252 | 607 | 491 |
| **Cash and cash equivalents, end of period** | | 17,529 | 7,546 | 17,529 | 7,546 |

See accompanying notes to the interim consolidated financial statements

# Notes to the Interim Consolidated Financial Statements

**As at June 30, 2020 and for the three and six month periods ended June 30, 2020 and 2019**

## Note 1. Description of Business

PetroShale Inc. (the "Company") is an independent oil company focused on the acquisition, development, and production of oil-weighted assets in the Bakken and Three Forks formations in the Williston Basin area of North Dakota. The Company's common shares are listed on the TSX Venture Exchange under the symbol "PSH".

The Company has corporate offices located at 421 - 7th Avenue SW, Suite 3230, Calgary, Alberta T2P 4K9 and at 303 E. 17th Avenue, Suite 940, Denver, CO 80203.

## Note 2. Basis of Presentation

### Basis of Measurement and Statement of Compliance

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including International Accounting Standard 34, "Interim Financial Reporting" ("IAS 34"), and have been prepared following the same accounting policies and methods of computation as the annual consolidated financial statements for the year ended December 31, 2019 except as noted in Changes in Accounting Policies below. Income taxes on earnings or loss in the interim periods are accrued using the income tax rate that would be applicable to the expected total annual earnings or loss.

Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2019, which have been prepared in accordance with IFRS as issued by the IASB.

These interim consolidated financial statements were approved by the Chair of the Audit Committee and the Executive Chairman on August 19, 2020, having been duly authorized to do so by the Board of Directors.

### Use of Estimates, Judgments and Assumptions

The timely preparation of the condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the condensed consolidated financial statements.

In early March 2020, the World Health Organization declared the COVID-19 coronavirus outbreak to be a pandemic. Responses to the spread of COVID-19 have resulted in significant disruption to business operations and a significant increase in economic uncertainty, with more volatile commodity prices and currency exchange rates, and a marked decline in long-term interest rates. These events are resulting in a challenging economic climate in which it is difficult to reliably estimate the length or severity of these developments and their financial impact. The results of the potential economic downturn and any potential resulting direct and indirect impact to the Company has been considered in management's estimates described above at the period end; however, there could be a further prospective material impact in future periods.

### Changes in Accounting Policies

**IFRS 3 Business Combinations**

PetroShale adopted IFRS 3, *Business Combinations*, on January 1, 2020. Amendments to IFRS 3 were issued by the IASB in October 2018, that seek to clarify whether a transaction results in an asset or a business acquisition. The amendments include an election to use an optional concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets. If the concentration test is not applied, or the test is failed, then the assessment focuses on the existence of a substantive process. The adoption of IFRS 3 had no impact to the Company's financial statements.

## Note 3. Accounts Receivable

| *($ thousands)* | **As at June 30, 2020** | **As at December 31, 2019** |
|---|---|---|
| Accounts receivable – oil and gas sales | 11,389 | 32,559 |
| Accounts receivable – joint interest billing and other | 4,529 | 21,461 |
| **Total** | **15,918** | **54,020** |

## Note 4. Right of Use Assets and Lease Liability

PetroShale's right of use assets and lease liability relate to a lease for its Denver office space as well as a lease for a field compressor.

*Right of Use Assets*

| *($ thousands)* | |
|---|---|
| **December 31, 2019** | 445 |
| Additions | 636 |
| De-recognition | (242) |
| Depreciation | (240) |
| Effect of foreign currency rate changes | 15 |
| **June 30, 2020** | 614 |

*Lease Liability*

| *($ thousands)* | |
|---|---|
| **December 31, 2019** | 453 |
| Additions | 636 |
| De-recognition | (247) |
| Payments | (240) |
| Effect of foreign currency rate changes | 15 |
| **June 30, 2020** | 617 |

## Note 5. Property, Plant and Equipment

| ($ thousands) | Developed and Producing | Other | Total |
|---|---|---|---|
| **December 31, 2018** | **372,852** | **211** | **373,063** |
| Acquisitions, net | 7,007 | - | 7,007 |
| Additions | 229,512 | 184 | 229,696 |
| Capitalized share-based compensation | 404 | - | 404 |
| Decommissioning obligation | 1,693 | - | 1,693 |
| Depreciation and depletion | (46,509) | (224) | (46,733) |
| Effect of foreign currency rate changes | (21,737) | (29) | (21,766) |
| **December 31, 2019** | **543,222** | **142** | **543,364** |
| Additions | 29,893 | 2 | 29,895 |
| Capitalized share-based compensation | 77 | - | 77 |
| Decommissioning obligation | 471 | - | 471 |
| Impairment | (24,000) | - | (24,000) |
| Depreciation and depletion | (36,139) | (46) | (36,185) |
| Effect of foreign currency rate changes | 24,500 | 6 | 24,506 |
| **June 30, 2020** | **538,024** | **104** | **538,128** |

### Depreciation, Depletion, and Future Development Costs

For the six months ended June 30, 2020 and 2019, PetroShale recorded $36.2 million and $14.8 million, respectively, of depreciation and depletion expense on its developed and producing assets, which reflected an estimated US$316.3 million and US$360.0 million, respectively of future development costs associated with proved plus probable reserves.

### Impairment

During the first quarter of 2020, PetroShale recognized an impairment charge of $24.0 million on the Company's Bakken cash generating unit ("CGU"). The impairment was attributable to declines in current and forecasted crude prices as a result of the rapid and severe deterioration of economic activity related to COVID-19 (Coronavirus), combined with a price war fueled by Russia and Saudi Arabia. The recoverable amount of the Bakken CGU of $568.2 million at March 31, 2020 was estimated based on a value in use methodology using the estimated discounted cash flows from proved plus probable reserves at a discount rate of 14%.

Determining the estimated cash flows associated with the Company's proved plus probable reserves is an inherently complex process involving the exercise of professional judgment and the use of significant estimates, including future commodity prices, differentials, discount rates, production volumes, royalties, operating costs, foreign currency exchange rates and future capital expenditures. Commodity prices are based on market prices at March 31, 2020 and are benchmarked against the forward price curve and pricing forecasts prepared by external firms.

The table below summarizes the pricing forecast used in determining the future cash flows associated with the Bakken CGU:

| Year | WTI (US$/Bbl) |
|---|---|
| 2020 | $ 24.17 |
| 2021 | $ 35.45 |
| 2022 | $ 44.17 |
| 2023 | $ 48.28 |
| 2024 | $ 50.66 |
| Remainder | $ 61.81 |

A one percent change in the discount rate or a five percent change in the forward price curve over the life of the reserves would result in changes in impairment of approximately $31.2 million and $65.4 million, respectively. In future periods, the impairment can be reversed up to the original carrying value less any associated DD&A if the estimated recoverable amounts of the CGUs exceed their carrying amount. At June 30, 2020, there were no impairment or impairment reversal indicators present and therefore an impairment test was not required.

### Capitalized Overhead

During the six months ended June 30, 2020, the Company capitalized $377,000 of general and administrative costs and $77,000 of share-based compensation costs directly attributable to acquisition and development activities of certain of its personnel in relation to the Company's operated properties ($536,000 and $223,000, respectively, for the six months ended June 30, 2019).

## Note 6. Accounts Payable and Accrued Liabilities

| *($ thousands)* | **As at June 30, 2020** | **As at December 31, 2019** |
|---|---|---|
| Trade payables | 32,512 | 56,425 |
| Accrued liabilities | 11,797 | 35,677 |
| Revenue payable | 12,658 | 16,671 |
| **Total** | **56,967** | **108,773** |

## Note 7. Decommissioning Obligation

| *($ thousands)* | **Six months ended June 30, 2020** | **Year ended December 31, 2019** |
|---|---|---|
| Beginning of period | 6,313 | 4,934 |
| Obligations incurred | - | 1,956 |
| Obligations acquired | - | 275 |
| Change in estimated cash flows | 471 | (718) |
| Accretion | 85 | 133 |
| Effect of foreign currency rate changes | 275 | (267) |
| **End of period** | **7,144** | **6,313** |

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 Company has estimated the net present value of its total decommissioning provision to be $7.1 million as at June 30, 2020 ($6.3 million at December 31, 2019) based on a total future undiscounted liability of $11.4 million ($13.7 million at December 31, 2019). At June 30, 2020 management estimates that these payments are expected to be made over the next 40 years in accordance with estimates prepared by independent engineers. As at June 30, 2020 a risk-free interest rate of 1.43% (2.6% at December 31, 2019) and an inflation rate of 1.5% (2.4% at December 31, 2019) were used to calculate the present value of the decommissioning obligation.

## Note 8. Senior Loan

The Company's reserves-based revolving credit facility of US$177.5 million is comprised of a US$167.5 million syndicated facility and a US$10.0 million non-syndicated operating facility (together, the "Credit Facility"). As at June 30, 2020, the net amount drawn under the Credit Facility was US$161.3 million representing US$174.2 million of borrowings under the Credit Facility less US$12.9 million of cash on hand. Advances under the Credit Facility are available by way of direct advances, bankers' acceptances, and standby letters of credit. Direct advances bear interest at the prime rate, US base rate or LIBOR rate, as elected by the Company, plus a margin ranging from 2.0% to 5.0%, which is dependent on the Company's Senior Debt to EBITDA ratio. EBITDA, as defined in the Credit Facility agreement and used for determining the Senior Debt to EBITDA ratio, may be different from Adjusted EBITDA referred to in the Company's other disclosures, including Management's Discussion & Analysis.

The Credit Facility is available on a revolving basis until June 26, 2021, at which point, the Credit Facility can be extended at the option of the lenders, or if not extended, will convert to a term loan maturing on June 25, 2022. The Credit Facility is secured by a fixed and floating charge debenture on substantially all the Company's assets.

The Credit Facility borrowing base is subject to redetermination on a periodic basis and at least twice annually by the lenders, based primarily on producing oil and natural gas reserves, as estimated by the Company's independent third party engineer, and using commodity prices established by the lender as well as other factors. The Company's next borrowing base redetermination is scheduled to occur in the fourth quarter of 2020. A decrease in the borrowing base could result in the requirement to make a repayment to the lenders within 90 days of the borrowing base redetermination.

The Company was in compliance with all terms of the Credit Facility at June 30, 2020. For the quarter ended June 30, 2020, the effective interest rate on the outstanding borrowings under the Credit Facility was 4.3% (4.3% for the six months ended June 30, 2019).

## Note 9. Preferred Shares

| *($ thousands, except share amounts)* | **Number of Shares** | **Liability Component** | **Equity Component** |
|---|---|---|---|
| December 31, 2018 | 75,000 | 88,912 | 7,510 |
| Accretion | - | 2,568 | - |
| Effect of foreign currency rate changes | - | (4,100) | - |
| December 31, 2019 | 75,000 | 87,380 | 7,510 |
| Paid in-kind dividends | - | 3,117 | - |
| Accretion | - | 1,494 | - |
| Effect of foreign currency rate changes | - | 3,870 | - |
| **June 30, 2020** | **75,000** | **95,861** | **7,510** |

In January 2018, the Company's wholly owned subsidiary (the "Subsidiary Issuer") issued 75,000 preferred shares to First Reserve (the "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 pay-in-kind 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 paid-in-kind 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 Company elected to pay its preferred share dividend due in May 2020, in kind, and as disclosed in Note 17 has also elected to do the same in respect of its dividend due in August 2020.

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 price and minimum amount of trading liquidity in the thirty days preceding the optional redemption date.

## Note 10. Share Capital

### Common Shares

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, 2020, the Company had 187,621,722 voting common shares (191,185,628 at December 31, 2019), no non-voting common shares and 40,487,422 special voting preferred shares (39,308,176 at December 31, 2019) outstanding. The special voting preferred shares were issued in conjunction with the preferred shares issued by the Subsidiary Issuer in January 2018 as well as in connection with the Company's election to pay its preferred share dividend due in May 2020 in kind (see Note 9). 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 June 30, 2020:

| *($ thousands, except share amounts)* | **Shares** | **Share Capital** |
|---|---|---|
| December 31, 2018 | 191,758,236 | 200,651 |
| Purchase of common shares for cancellation | (1,074,615) | (596) |
| Settlement of restricted share bonus awards | 502,007 | 574 |
| December 31, 2019 | 191,185,628 | 200,630 |
| Purchase of common shares for cancellation | (3,865,000) | (1,859) |
| Settlement of restricted share bonus awards | 301,094 | 43 |
| **June 30, 2020** | **187,621,722** | **198,814** |

On February 7, 2019, the Company announced that the TSX Venture Exchange had accepted the Company's intention to commence a normal course issuer bid ("NCIB"). Pursuant to the NCIB, which was renewed in 2020, the Company is permitted to purchase up to 11,785,163 voting common shares of the Company between February 10, 2020 and February 8, 2021. During the three months ended March 31, 2020, the Company purchased and cancelled 3,865,000 shares at an average price of $0.48 per common share for a total repurchase cost of $1.9 million under the NCIB. On April 1, 2020, the Company ceased making further purchases under the NCIB until further notice. From February 7, 2019, through April 1, 2020, the Company purchased 4,939,615 shares under the NCIB at an average price of $.50/share for a total repurchase cost of $2.5 million.

### Stock Options

The following table presents stock option transactions for the six months ended June 30, 2020, and for the year ended December 31, 2019:

| | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) |
|---|---|---|---|
| December 31, 2018 | 550,000 | 0.70 | 2.55 |
| Exercised | - | - | - |
| December 31, 2019 | 550,000 | 0.70 | 1.55 |
| Exercised | - | - | - |
| **June 30, 2020** | 550,000 | 0.70 | 1.05 |

### Share Bonus Awards

The Company has granted restricted share bonus awards and performance share bonus awards (collectively, the "share bonus awards") to certain directors, officers, and employees. Share bonus awards granted according to the plan vest over three years from the date of grant and expire before the end of the third year from the date of grant. Performance share bonus awards also vest based on achievement of certain performance hurdles and are subject to a multiplier between 0 and 2 times based on relative performance. The share bonus awards may be settled by the Company, in its sole discretion, in cash and or common shares of the Company. The estimated fair value of the share bonus awards is determined based on the current market value of the Company's common shares at the dates of grant and considering anticipated forfeiture rates. For purposes of valuing performance share bonus awards, the Company assumes a multiplier of 1.0 times. A charge to income is reflected as share-based compensation expense in the interim consolidated statement of operations over the vesting period with a corresponding increase to contributed surplus.

| | Restricted Share Bonus Awards | Performance Share Bonus Awards | Total Awards | Estimated Fair Value Price ($) |
|---|---|---|---|---|
| **December 31, 2018** | 3,185,000 | - | 3,185,000 | 1.75 |
| Granted | 1,731,300 | 1,090,200 | 2,821,500 | 0.75 |
| Settled | (903,332) | - | (903,332) | (1.82) |
| Forfeited and expired | (1,600,000) | (500,000) | (2,100,000) | (0.80) |
| **December 31, 2019** | 2,412,968 | 590,200 | 3,003,168 | 1.46 |
| Granted | 33,500 | 86,500 | 120,000 | 0.10 |
| Settled | (533,333) | - | (533,333) | (1.69) |
| Forfeited and expired | (159,581) | (43,787) | (203,368) | (1.31) |
| **June 30, 2020** | **1,753,554** | **632,913** | **2,386,467** | 1.36 |

## Note 11. Revenue

The following reflects our petroleum and natural gas revenue, before royalties:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **2020** | **2019** |
| Petroleum and natural gas | 24,200 | 30,476 | 73,310 | 51,802 |

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 has several 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 interim consolidated 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 interim consolidated statement of operations.

## Note 12. Net Income (Loss) per Common Share

| | Three Months Ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *($ thousands, except share and per share amounts)* | **2020** | **2019** | **2020** | **2019** |
| Net income (loss) | (23,169) | 1,733 | (40,435) | 737 |
| | | | | |
| Weighted average common shares outstanding - basic | 187,615,253 | 192,133,374 | 188,276,150 | 191,989,090 |
| Weighted average common shares outstanding - diluted | 187,615,253 | 194,631,212 | 188,276,150 | 194,488,268 |
| | | | | |
| Net income (loss) per share - basic | (0.12) | 0.01 | (0.21) | 0.00 |
| Net income (loss) per share – diluted | (0.12) | 0.01 | (0.21) | 0.00 |

The Subsidiary Issuer has issued 75,000 preferred shares which are convertible, at the Investor's option, to 40,487,422 common shares of the Company at a fixed price of $2.40 per share, subject to certain conditions. See Notes 10 and 18. The preferred shares are not currently considered dilutive.

## Note 13. 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$160,000 as security in order to operate in North Dakota. Subsequent to the end of the period, the Company entered into a new office space lease. See Note 17.

## Note 14. Finance Expense

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *($ thousands)* | **2020** | **2019** | **2020** | **2019** |
| Preferred share dividends | 3,188 | 2,257 | 5,455 | 4,502 |
| Senior loan interest | 2,329 | 1,237 | 4,534 | 2,080 |
| Preferred share accretion | 781 | 633 | 1,494 | 1,213 |
| Decommissioning obligation accretion | 43 | 57 | 85 | 65 |
| Operating lease and other | 677 | 383 | 688 | 474 |
| **Total finance expense** | 7,018 | 4,567 | 12,256 | 8,334 |

## Note 15. Supplemental Cash Flow Disclosures

Changes in non-cash working capital is comprised of the following:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *(in thousands)* | **2020** | **2019** | **2020** | **2019** |
| Source (use) of cash: | | | | |
| Accounts receivable | 10,838 | (19,107) | 38,102 | (11,410) |
| Prepaid expenses and deposits | 68 | (339) | (167) | (473) |
| Accounts payable and accrued liabilities | (21,238) | 25,278 | (51,806) | 41,800 |
| | (10,332) | 5,832 | (13,871) | 29,917 |
| | | | | |
| Related to operating activities | 8,058 | (17,970) | 21,868 | (7,341) |
| Related to investing activities | (16,834) | 27,502 | (38,202) | 38,215 |
| Accrued and unpaid dividends on preferred shares | 123 | (2,253) | 12 | - |
| Difference due to foreign exchange | (1,679) | (1,447) | 2,451 | (957) |
| | (10,332) | 5,832 | (13,871) | 29,917 |
| | | | | |
| Interest and preferred dividends paid | (2,954) | (3,872) | (7,548) | (7,048) |
| Income taxes paid | - | - | - | - |

## Note 16. Financial Instruments and Risk Management

### Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, restricted cash, accounts payable, senior loan, preferred share obligation, financial derivative assets and liabilities, and lease liabilities. Financial derivatives are measured at fair value through profit or loss. The Company's remaining financial instruments are measured at amortized cost. The fair value of cash and cash equivalents, accounts receivable, restricted cash, accounts payable and lease liabilities approximate their carrying amount due to the highly liquid or short-term nature of these instruments. The fair value of the senior loan approximates the carrying amount due the floating rate of interest and the margin charged by the syndicate being indicative of current spreads. The preferred share obligation bears interest at a fixed rate that the Company would expect to pay for similar financing transactions and accordingly the fair value approximates the carrying value.

The following table summarizes the Company's financial instruments that are carried at fair value as a financial derivative liability on the interim consolidated statements of financial position:

| *($ thousands)* | **As at June 30, 2020** | **As at December 31, 2019** |
|---|---|---|
| Crude oil contracts: | | |
| Fixed price swap | 1,085 | - |
| Three-way Collars | 1,034 | 261 |
| Costless collars | 3,326 | - |
| Call swaption | 1,327 | - |
| Call option | 144 | - |
| **Total** | **6,916** | **261** |

## Risk Management Activities

### Commodity Price Risk

PetroShale may use financial derivative instruments such as swaps, collars, and options to mitigate the impact of commodity price volatility and enhance the predictability of cash flows for a portion of its future oil, gas, and natural gas liquids production. The Company does not enter derivative instruments for speculative purposes. While these instruments mitigate the cash flow risk associated with future decreases in commodity prices, they may also curtail benefits from future increases in commodity prices.

As at June 30, 2020, the Company's derivative instruments consisted of the following types of instruments:

*Fixed price swaps*: Under a fixed price swap, the Company receives a fixed price and pays a floating market price to the counterparty.

*Call option*: Under a sold call option, if, at the time of settlement, market prices exceed the fixed price of the call option, the Company pays the difference to the counterparty.

*Call swaption*: Call swaptions allow the counterparty, on a specific date, to extend an existing fixed price swap for a certain future period.

*Costless Collars / Three-way collars*: Costless collars consist of a fixed floor price (purchased put option) and a fixed ceiling price (sold call option). If the market price is between the floor and the ceiling, no payments are due from either party. At the time of settlement, if the market price exceeds the ceiling or falls below the floor, we receive the fixed price and pay the market price. Three-way collars combine a costless collar with a sold put option below the purchased put option in exchange for a more favorable ceiling price. Under a three-way collar, our downside protection is limited to the difference between the floor price and the strike price of the sold put option.

As at June 30, 2020, the Company had the following oil price derivative contracts outstanding:

**Q3 2020**

| Contract Type | Volume (Bbls/d) | Fixed (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Costless Collars | | | | |
| | 500 | - | 25.00 | 35.50 |
| | 500 | - | 25.00 | 37.50 |
| | 500 | - | 27.00 | 37.50 |
| | 500 | - | 29.00 | 35.00 |
| Swap | | | | |
| | 1,000 | 28.76 | - | - |
| | 1,000 | 30.70 | - | - |
| **Total** | **4,000** | **29.73** | **26.50** | **36.38** |

**Q4 2020**

| Contract Type | Volume (Bbls/d) | Fixed (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Costless Collars | | | | |
| | 500 | - | 25.00 | 35.25 |
| | 500 | - | 26.00 | 34.50 |
| | 500 | - | 27.00 | 35.00 |
| | 500 | - | 27.00 | 34.35 |
| | 500 | - | 29.00 | 36.60 |
| | 500 | - | 29.00 | 37.40 |
| | 500 | - | 30.00 | 38.25 |
| | 500 | - | 30.00 | 39.35 |
| **Total** | **4,000** | - | **36.34** | **27.88** |

**Q1 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 40.05 |
| | 500 | 25.00 | 37.50 | 43.60 |
| **Total** | **1,000** | **25.00** | **37.50** | **41.83** |

**Q2 – Q4 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 48.10 |
| **Total** | **500** | **25.00** | **37.50** | **48.10** |

**FY 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 37.50 | 46.50 |
| | 500 | 25.00 | 37.50 | 46.50 |
| | 500 | 25.00 | 37.50 | 43.90 |
| **Total** | **1,500** | **25.00** | **37.50** | **45.63** |

For the three and six months ended June 30, 2020, the Company incurred an unrealized loss of $8.7 million and $6.8 million respectively (three and six months ended June 30, 2019 – nil). For the three and six months ended June 30, 2020, the Company incurred a realized gain of $1.7 million and $2.3 million respectively (three and six months ended June 30, 2019 – nil).

### Credit and Contract Risk

Credit and contract risk represent the financial loss that PetroShale would suffer if a counterparty in a transaction fails to meet its obligations in accordance with agreed terms.

Essentially all the Company’s accounts receivable is from the production of crude oil and natural gas and joint operations receivables. Sales of crude oil and natural gas production from the Company’s operated properties are made to large industry purchasers. Joint operations receivables are from participants in the crude oil and natural gas section and collection of outstanding balances is dependent on industry factors including commodity price fluctuations, The Company has not experienced any material credit losses on the collection of accounts receivable.

The use of financial derivative instruments also exposes the Company to credit and contract risk. The Company has entered into derivative instruments only with counterparties that are also lenders in the Credit Facility and have been deemed an acceptable credit risk. As the Company’s counterparties are participants in Credit Facility, which is secured by substantially all assets of the Company, the Company is not required to post collateral.

### Interest Rate Risk

PetroShale is exposed to interest rate risk on bank credit facilities to the extent of changes in market interest rates. Based on the Company's floating rate debt position as at June 30, 2020, a 1 percent increase or decrease in the interest rate on floating rate debt would amount to an impact on income before tax of $0.8 million for the six months ended June 30, 2020.

### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meets its financial obligations as they become due. The Company’s approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its short-term and long-term financial obligations when due, under both normal and unusual conditions, without incurring unacceptable losses. As at June 30, 2020, the Company had a net working capital deficit of $23.4 million, excluding a financial derivative liability of $6.6 million, which is $18.9 million greater than the undrawn capacity of the senior credit facility of $4.5 million. The financial liabilities in the interim consolidated statement of financial position consist of accounts payable and accrued liabilities, which are all considered due within one year, and the senior loan and preferred share obligation. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities as they come due. The Company prudently manages liquidity through the rigorous forecasting of its cash flows from operating activities and its available capacity under its revolving credit facilities. The Company's accounts payable and accrued liabilities balance at June 30, 2020 is approximately $56.8 million (December 31, 2019 - $108.8 million). It is the Company's general practice to pay suppliers within 60 days. In May 2020, the Company's senior lenders confirmed the existing borrowing capacity and agreed to extend the maturity date of the credit facility to June 26, 2022. The Company's preferred shares may either be converted, at the option of the Investor, to common shares of the Company, or remain subject to redemption on January 25, 2023, which date may be extended at the option of the Investor by one year. On May 4, 2020, PetroShale elected to exercise its right to settle in kind the payment of the quarterly dividend due in May on its outstanding preferred shares. The Company also elected to settle its quarterly dividend due in August 2020 in kind. Refer to Note 17.

## Note 17. Subsequent Events

In July 2020, PetroShale entered a 65-month lease for its Denver head office space commencing August 1, 2020. The total lease commitment is estimated to be $1.3 million.

PetroShale elected to exercise its right to settle in kind the payment of the quarterly dividend due in August 2020 on its outstanding preferred shares.

In August 2020, pursuant to the Company's Bonus Award Incentive Plan ("Plan"), an aggregate of 3,080,800 restricted awards and 3,807,700 performance awards were granted to certain officers and employees of PetroShale. The awards may be settled by PetroShale, in the Company's sole discretion, in cash and/or voting common shares of PetroShale, in accordance with the terms of the Plan.

Subsequent to June 30, 2020, the Company executed the following additional financial derivative contracts:

**Q4 2020**

| Contract Type | Volume (Bbls/d) | Fixed (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Costless Collars | | | | |
| | 500 | - | 37.50 | 46.00 |
| | 500 | - | 37.50 | 46.50 |
| **Total** | **1,000** | - | **37.50** | **46.25** |

**Q2 – Q4 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 25.00 | 39.00 | 49.25 |
| **Total** | **500** | **25.00** | **39.00** | **49.25** |

**FY 2021**

| Contract Type | Volume (Bbls/d) | Sold Put (US$) | Bought Put (US$) | Sold Call (US$) |
|---|---|---|---|---|
| Three Way Collars | | | | |
| | 500 | 20.00 | 37.50 | 45.90 |
| | 500 | 25.00 | 37.50 | 47.00 |
| | 500 | 25.00 | 37.50 | 48.50 |
| | 500 | 25.00 | 39.00 | 47.00 |
| | 500 | 25.00 | 40.00 | 49.00 |
| | 500 | 25.00 | 40.00 | 49.10 |
| **Total** | **3,000** | **24.17** | **38.59** | **47.75** |