



Third Quarter Report

**For the three and nine months ended
September 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 November 24, 2020. This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements as at September 30, 2020 and for the three and nine months ended September 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:

<u>Term</u>	<u>Description</u>
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 September 30,		Nine months ended September 30,	
(\$ thousands)	2020	2019	2020	2019
Cash flow provided by operating activities	1,491	32,275	56,665	50,859
Change in non-cash working capital	8,726	(2,279)	(13,143)	5,062
Adjusted EBITDA	10,217	29,996	43,522	55,921

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

	As at September 30,	
(\$ thousands)	2020	2019
Total liabilities	383,216	359,603
Decommissioning obligation	(7,224)	(5,540)
Financial derivative liability	(3,502)	-
Lease liability	(1,801)	(159)
Total current assets	(20,930)	(52,039)
Net Debt	349,759	301,865

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 September 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 September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Financial (\$ thousands, except share amounts)				
Petroleum and natural gas revenue	32,928	52,887	106,238	104,689
Cash provided by (used in) operating activities	1,491	32,275	56,665	50,859
Net income (loss)	(9,134)	4,982	(49,568)	5,719
Per share - diluted	(0.05)	0.03	(0.26)	0.03
Adjusted EBITDA ⁽¹⁾	10,217	29,996	43,522	55,921
Drilling and completion capital expenditures	(2,559)	(63,798)	(32,454)	(171,138)
Net debt ⁽¹⁾			349,459	301,865
Number of common shares outstanding:				
Weighted average - basic	187,803,375	192,168,550	188,117,408	192,014,140
Weighted average - diluted	195,913,542	197,273,567	196,227,575	197,191,551
Operating				
Number of days	92	92	274	273
Daily production: ⁽²⁾				
Crude oil (Bbls)	7,983	8,427	9,180	5,504
Natural gas (Mcf)	11,471	8,974	11,567	6,127
Natural gas liquids (Bbls)	2,066	1,544	2,063	979
Barrels of oil equivalent	11,961	11,467	13,171	7,504
Average realized price:				
Crude oil (\$/Bbl)	46.61	69.90	43.85	70.43
Natural gas (\$/Mcf)	1.15	1.93	1.46	2.49
Natural gas liquids (\$/Bbl)	10.52	4.82	6.97	9.84
Netback (\$ per Boe): ⁽¹⁾				
Petroleum and natural gas revenue	29.92	50.13	29.44	51.10
Royalties	(5.43)	(10.08)	(5.42)	(10.15)
Realized loss on financial derivatives	(3.57)	-	(0.46)	-
Lease operating costs	(3.95)	(2.78)	(4.84)	(4.38)
Workover expense	(1.24)	(1.22)	(0.74)	(1.31)
Production taxes	(2.43)	(4.09)	(2.44)	(4.05)
Transportation expense	(2.42)	(2.55)	(2.42)	(2.30)
Operating netback ⁽¹⁾	10.88	29.41	13.12	28.91
Operating netback prior to hedging ⁽¹⁾	14.45	29.41	13.58	28.91
⁽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, as required, 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\$40.22/Bbl at September 30, 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, were shut-in resulting in a temporary reduction in the Company's daily production volumes. With improved pricing in the second half of the year, the majority of the non-operated shut-in wells were brought back online by the end of the third quarter of 2020.

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. These factors include 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 and third quarters, the Company took steps to minimize the impact on the Company's operating results and financial liquidity. The Company has significantly reduced discretionary capital expenditures, operating costs and general and administrative expenditures, and entered into an active hedging program for the remainder of 2020 and calendar 2021.

In November 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 second quarter of 2021. 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\$171.1 million under the senior credit facility as at September 30, 2020, net of cash of US\$2.3 million, compared to US\$161.3 million as at June 30, 2020, net of cash on hand of US\$12.9 million and has reduced accounts payable and accrued liabilities by \$16.7 million since June 30, 2020. For the remainder of calendar year 2020, the Company expects to spend approximately \$500,000 of capital and generate free cash flow.

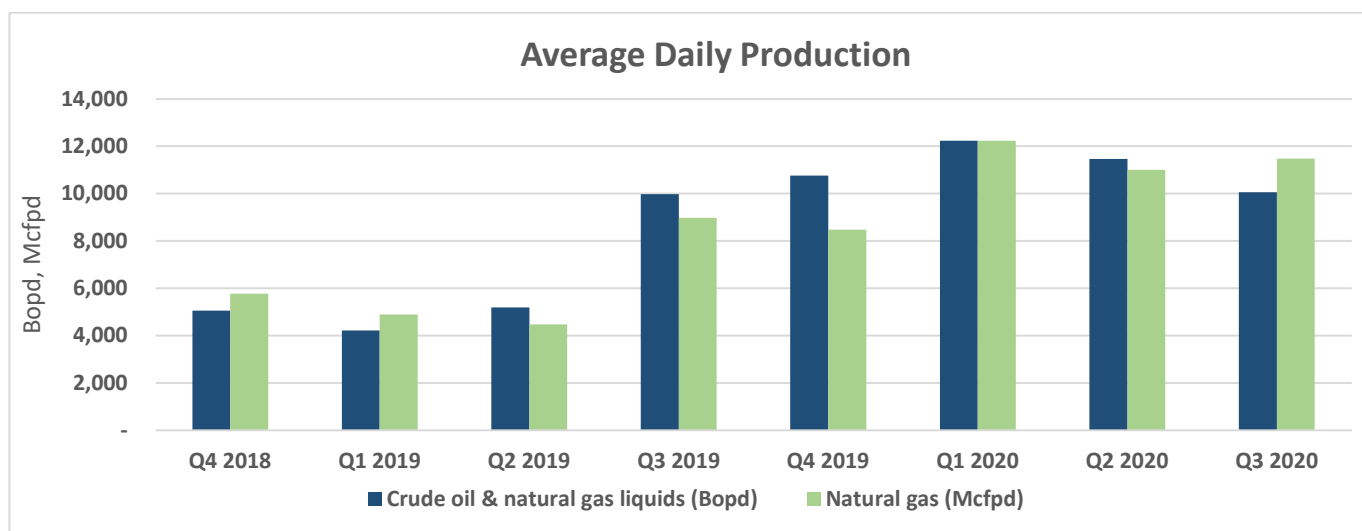


Results of Operations

Production

	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% change
Crude oil (Bbls per day)	7,983	8,427	(5.3)	9,180	5,504	66.8
Natural gas (Mcf per day)	11,471	8,974	27.8	11,567	6,127	88.8
Natural gas liquids (Bbls per day)	2,066	1,544	33.8	2,063	979	110.7
Total (Boe per day)	11,961	11,467	4.3	13,171	7,504	75.5
Liquids percentage of total	84.0	87.0	(3.4)	85.4	(86.4)	(1.2)

The increase in production for both the three-month and nine-month periods ended September 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 wells from early in the second quarter until the end of the third quarter of 2020. A total of 62 gross (16.3 net) wells had first sales during 2019 with an additional 21 gross (2.9 net) coming online in the first quarter of 2020. During the third quarter of 2020, the Company participated in 3 gross (0.01 net) wells that commenced production in the quarter. Production during the nine months ended September 30, 2020 was comprised of 69.7% crude oil, 15.7% natural gas liquids, and 14.6% natural gas compared to 73.4% crude oil, 13.0% natural gas liquids and 13.6% natural gas in the corresponding period.



Pricing

	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% change
Average Benchmark Prices (US\$)						
Crude oil – WTI (per Bbl)	40.93	56.43	(27.5)	38.32	57.05	(32.8)
Natural gas – HH spot (per Mmbtu)	2.00	2.38	(16.0)	1.87	2.62	(28.6)
Average Differential (US\$)						
Crude oil (per Bbl)	(5.94)	(3.55)	67.3	(5.92)	(3.77)	57.0
Natural gas (per Mcf) ⁽¹⁾	(1.13)	(0.92)	22.8	(0.79)	(0.74)	6.8
Average Realized Prices (US\$) ⁽²⁾						
Crude oil (per Bbl)	34.99	52.88	(33.8)	32.40	53.28	(39.2)
Natural gas (per Mcf)	0.87	1.46	(40.4)	1.08	1.88	(42.6)
Natural gas liquids (per Bbl)	7.89	3.65	116.2	5.15	7.40	(30.4)
Average Realized Prices (CAD\$) ⁽²⁾						
Crude oil (per Bbl)	46.61	69.90	(33.3)	43.85	70.43	(37.7)
Natural gas (per Mcf)	1.15	1.93	(40.4)	1.46	2.49	(41.4)
Natural gas liquids (per Bbl)	10.52	4.82	118.3	6.97	9.84	(29.2)

⁽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 and have recovered significantly in the third quarter but remain well below levels in comparative periods. 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 nine-month periods ended September 30, 2020 compared to the prior year periods but have increased in the fourth quarter of 2020. 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 September 30,			Nine months ended September 30,		
(\$ thousands except where noted)	2020	2019	% change	2020	2019	% change
Petroleum and natural gas revenue	32,928	52,887	(37.7)	106,238	104,689	1.5
Less: royalties	(5,979)	(10,638)	(43.8)	(19,551)	(20,791)	(6.0)
Petroleum and natural gas revenue, net	26,949	42,249	(36.2)	86,687	83,898	3.3
Royalties as a percentage of revenue	18.2%	20.1%	(9.7)	18.4%	19.9%	(7.3)
Per Boe amounts:						
Petroleum and natural gas revenue	29.92	50.13	(40.3)	29.44	51.10	(42.4)
Less: royalties	(5.43)	(10.08)	(46.1)	(5.42)	(10.15)	(46.6)
Petroleum and natural gas revenue, net	24.49	40.05	(38.8)	24.02	40.95	(41.3)



The decrease in revenues during the quarter ended September 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 nine-month periods ended September 30, 2020, compared to the prior year periods.

Realized and Unrealized Gain (Loss) on Financial Derivatives

(\$ thousands except where noted)	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% change
Realized loss on financial derivatives	(3,933)	-	(100.0)	(1,657)	-	(100.0)
Unrealized gain (loss) on financial derivatives	3,301	-	100.0	(3,537)	-	(100.0)
Realized loss on financial derivatives per Boe	(3.57)	-	(100.0)	(0.46)	-	(100.0)

The Company realized losses on its financial derivatives in the three and nine months ended September 30, 2020 due to improving oil prices during the period. During the nine months ended September 30, 2020, the Company entered into additional commodity price hedges to protect its operating cash flows for the remainder of the year and 2021. The Company incurred an unrealized loss on those derivatives for the nine-month period ended September 30, 2020 but with future strip prices improving later in the period, the Company recognized an unrealized gain in the three-month period ending September 30, 2020.

Operating Expense

(\$ thousands except where noted)	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% change
Lease operating costs	4,346	2,932	48.2	17,459	8,964	94.8
Workover expense	1,365	1,288	6.0	2,681	2,685	(0.1)
Production taxes	2,675	4,314	(38.0)	8,806	8,291	6.2
Total operating expense	8,386	8,534	(1.7)	28,946	19,940	45.2
Per Boe amounts:						
Lease operating costs	3.95	2.78	42.1	4.84	4.38	10.5
Workover expense	1.24	1.22	1.6	0.74	1.31	(43.5)
Production taxes	2.43	4.09	(40.6)	2.44	4.05	(39.8)
Total operating expense	7.62	8.09	(5.8)	8.02	9.74	(17.7)
Production taxes - % of revenue	9.9%	10.2%	(2.8)	10.2%	9.9%	2.8

Lease operating costs

Lease operating costs for the three-month and nine-month periods ended September 30, 2020, increased over the prior year periods due primarily to increased operated and non-operated well count. Lease operating costs per Boe were consistent during the nine-month period ended September 30, 2020. During the three-month period ended September 30, 2020, lease operating costs were higher as compared to the same period in 2019 but decreased versus prior quarters in 2020.

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. However, workover expense was relatively consistent period over period in absolute and Boe terms.

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 nine months ended September 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.

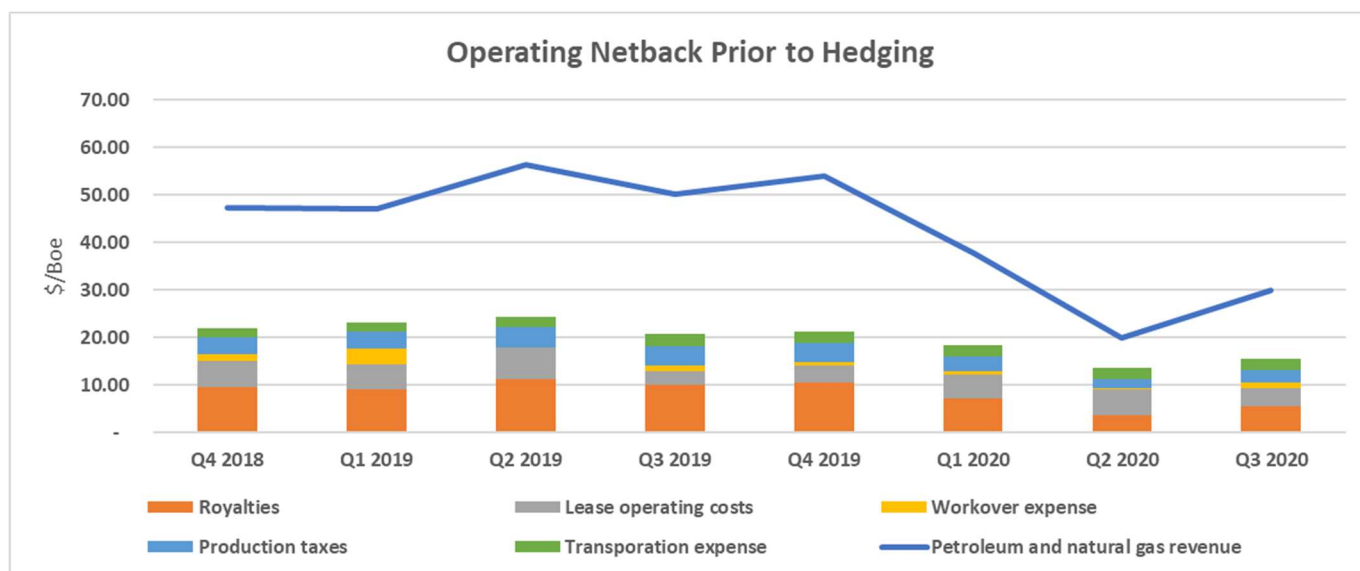
Transportation expense

	Three months ended September 30,			Nine months ended September 30,		
<i>(\$ thousands except where noted)</i>	2020	2019	% change	2020	2019	% change
Transportation expense	2,665	2,686	(0.8)	8,734	4,705	85.6
Transportation expense per Boe	2.42	2.55	(5.1)	2.42	2.30	5.2

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 were consistent in the three-month period ended September 30, 2020 versus the same period in 2019 while transportation costs increased in the nine-month period ended September 30, 2020 as compared to the same period in the year prior. Production volumes were lower in the first half of 2019 as compared to the same period in 2020 and subsequently increased significantly in the third quarter of 2019. 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 September 30,			Nine months ended September 30,		
<i>(\$ per Boe)</i>	2020	2019	% change	2020	2019	% change
Operating netback:						
Petroleum and natural gas revenue	29.92	50.13	(40.3)	29.44	51.10	(42.4)
Royalties	(5.43)	(10.08)	(46.1)	(5.42)	(10.15)	(46.6)
Realized gain on financial derivatives	(3.57)	-	100.0	(0.46)	-	100.0
Lease operating costs	(3.95)	(2.78)	42.1	(4.84)	(4.38)	10.5
Workover expense	(1.24)	(1.22)	1.6	(0.74)	(1.31)	(43.5)
Production taxes	(2.43)	(4.09)	(40.6)	(2.44)	(4.05)	(39.8)
Transportation expense	(2.42)	(2.55)	(5.1)	(2.42)	(2.30)	5.2
Operating netback	10.88	29.41	(63.0)	13.12	28.91	(54.6)
Operating netback prior to hedging	14.45	29.41	(50.9)	13.58	28.91	(53.0)



General and Administrative (“G&A”) Expense

(\$ thousands except where noted)	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% Change
Gross G&A expense	2,003	1,604	24.9	4,856	4,869	(0.3)
Capitalized G&A	(129)	(266)	(51.5)	(506)	(803)	(37.1)
Overhead recovery	(145)	(305)	(52.5)	(541)	(734)	(26.3)
Net G&A expense	1,729	1,033	67.4	3,809	3,332	14.3
Net G&A expense per Boe	1.57	0.98	60.5	1.06	1.63	(35.1)

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

Depreciation and Depletion Expense

(\$ thousands except where noted)	Three months ended September 30,			Nine months ended September 30,		
	2020	2019	% change	2020	2019	% change
Depreciation and depletion expense	15,774	16,260	(3.0)	52,198	31,172	67.5
Depreciation and depletion expense per Boe	14.34	15.41	(7.0)	14.46	15.22	(4.9)

Depreciation and depletion expense decreased during the three-month period ended September 30, 2020 as compared to the prior year period due to a reduced capital base following the impairment recording in the first quarter of 2020. Depreciation and depletion expense increased during the nine-month period as a result of higher production volumes and significant increases to the capital base incurred during 2019 and the first part of 2020.

Impairment

	Three months ended September 30,			Nine months ended September 30,		
(\$ thousands except where noted)	2020	2019	% change	2020	2019	% change
Impairment	-	-	-	24,000	-	100.0
Impairment per Boe	-	-	-	6.65	-	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 \$568.2 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 September 30, 2020, there were no impairment or impairment reversal indicators present.

Finance Expense

	Three months ended September 30,			Nine months ended September 30,		
(\$ thousands)	2020	2019	% change	2020	2019	% change
Preferred shares dividends	3,157	2,228	41.7	8,612	6,730	28.0
Senior loan interest	2,811	1,859	51.2	7,393	4,404	67.8
Preferred share accretion, net	575	677	(15.1)	2,069	1,890	9.5
Decommissioning obligation accretion	25	34	(27.4)	110	100	10.2
Operating lease and other	33	4	975.3	673	12	5,508.3
Total finance expense	6,601	4,802	37.5	18,857	13,136	43.5

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. Preferred shares dividends increased year over year as the Company elected to pay the dividends in-kind beginning in the second quarter of 2020. This resulted in accruing dividends at 12% rather than the 9% rate which applies to cash dividend payments.

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 September 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 \$6.2 million for the nine months ended September 30, 2020 (three months ended September 30, 2020 – nil), compared to an expense of \$4.7 million and \$3.5 million during the comparable prior year periods.

Share-based Compensation

	Three months ended September 30,			Nine months ended September 30,		
(\$ thousands)	2020	2019	% change	2020	2019	% change
Gross share-based compensation	318	540	(41.1)	767	1,516	(49.4)
Capitalized share-based compensation	(22)	(113)	(80.5)	(99)	(336)	(70.4)
Net share-based compensation	296	427	(30.6)	668	1,180	(43.4)

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.

Net share-based compensation expense is lower year over year for the three months and nine months ended September 30, 2020 due to declining measurement prices of restricted and performance share awards/grants.

Foreign Currency Gain (Loss) and Translation Adjustment

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Foreign currency translation rates – US\$/CAD\$:				
Average period exchange rate	1.3323	1.3204	1.3537	1.3204
Ending period exchange rate	1.3383	1.3241	1.3383	1.3241

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 \$6.9 million for the nine months ended September 30, 2020 (2019 – loss of \$5.6 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.



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 September 30, 2020, the Company had a net working capital deficit of \$19.9 million, excluding the current financial derivative liability of \$2.7 million, which is \$14.5 million greater than the undrawn capacity of the senior credit facility of \$5.4 million. Accounts payable and accrued liabilities consist of amounts relating to capital spending, field operating activities and general and administrative expenses and have decreased by \$68.4 million in the nine-month period ended September 30, 2020. The Company intends to continue to limit capital expenditures and, depending on oil prices, generate free cash flow to continue to reduce the working capital deficit and or the Senior Loan balance.

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. The situation is dynamic and the ultimate duration and magnitude of the COVID-19 related 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.

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, which generate adjusted EBITDA, as well as the impact of changes in non-cash working capital. Net cash flow provided by operating activities was \$56.7 million for the nine months ended September 30, 2020 as compared to \$50.9 million for the prior year period. During the ninth-month period ended September 30, 2020, adjusted EBITDA declined due to the impact of significantly lower oil prices which was offset by a positive contribution from changes to non-cash working capital associated with operating activities.

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. The Company will, from time to time, enter into various derivative instruments to mitigate a portion of its exposure to adverse market changes. These derivative instruments allow the Company to predict with greater certainty the total revenue it will receive, provide stability of cash flows for capital spending planning purposes, and protect acquisition economics.



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

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
	500	-	37.50	46.00
	500	-	37.50	46.50
Total	5,000	-	29.80	38.32

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
	500	25.00	39.00	49.25
Total	1,000	25.00	38.25	48.68

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
	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	4,500	24.44	38.22	47.04



Capital Expenditures

	Three months ended September 30,			Nine months ended September 30,		
(\$ thousands)	2020	2019	% change	2020	2019	% change
Drilling and completion	2,430	63,295	(96.2)	31,948	167,383	(80.9)
Acquisitions	-	484	(100.0)	-	3,667	(100.0)
Dispositions	(23)	-	(100.0)	(23)	-	(100.0)
Other, net	129	19	578.9	506	88	475.4
	2,536	63,798	(96.0)	32,431	171,138	(81.1)
Non-cash:						
Capitalized share-based compensation	22	113	(80.5)	99	336	(70.5)
Decommissioning obligation	156	-	100.0	627	378	65.9
Total capital expenditures	2,714	63,911	(95.8)	33,157	171,852	(80.7)

Capital expenditures for the three and nine months ended September 30, 2020 were funded from borrowings under the Company's senior loan facility and operating cash flows. 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 continuing to minimize discretionary capital expenditures, as demonstrated by the low expenditure level in the third quarter.

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 September 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 covenants under the senior loan as at September 30, 2020. The credit facility has no financial covenants.

As at November 24, 2020, outstanding borrowings under the senior loan were US\$173.4 million. The Company held cash of US\$2.3 million for net borrowings of US\$171.1 million. The Company's lenders recently confirmed the amount of the existing borrowing base capacity under the Senior Loan facility at US\$177.5 million. The Company's next borrowing base redetermination is scheduled to occur during the second quarter of 2021.

Preferred Shares

The Company elected to pay its preferred share dividends due in May and August 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 November 2020. See Note 17 to the Company's interim consolidated financial statements.



Share Capital

	As at November 24, 2020	As at September 30, 2020	As at December 31, 2019
Weighted average common shares outstanding:			
Basic		187,803,375	191,920,373
Diluted		195,913,542	194,395,182
Outstanding securities:			
Common shares	188,357,215	188,357,215	191,185,628
Preferred shares, convertible	75,000	75,000	75,000
Stock options	550,000	550,000	550,000
Restricted share bonus awards	3,372,693	3,850,307	2,412,968
Performance share bonus awards	3,282,740	4,259,860	590,200

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 September 30, 2020:

(\$ thousands)	Contractual Cash Flow	2020	2021	2022	2023	2024	2025
Accounts payable and accrued liabilities	40,399	40,399	-	-	-	-	-
Lease liability	1,801	101	509	365	252	275	299
Senior loan ⁽¹⁾	249,222	2,487	9,865	236,870	-	-	-
Preferred share obligation ⁽²⁾	130,444	4,792	9,584	9,584	106,484	-	-

⁽¹⁾ Includes future interest expense at the rate of 4.25% being the rate applicable at September 30, 2020 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 by the Company 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)	Sep 30 2020	Jun 30 2020	Mar 31 2020	Dec 31 2019	Sep 30 2019	Jun 30 2019	Mar 31 2019	Dec 31 2018
Revenues, net of royalty	26,949	19,820	39,918	48,883	42,249	24,419	17,230	20,899
Adjusted EBITDA	10,217	8,278	25,027	35,566	29,996	16,344	9,581	11,684
Cash flow – operating activities	1,491	16,336	38,837	27,677	32,275	(1,626)	20,210	19,810
Net income (loss)	(9,134)	(23,169)	(17,266)	9,608	4,982	1,733	(996)	7,892
Net income (loss) per share:								
Basic and Diluted	(0.05)	(0.12)	(0.09)	0.05	0.03	0.01	-	0.04

During the third quarter of 2020, revenues increased versus the previous quarter due the stabilization of oil prices. As a result, Adjusted EBITDA improved and the net loss decreased versus the prior quarter. Cash flow declined due to changes in non-cash working capital.

Revenues declined in the second quarter of 2020 versus the first quarter 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 \$24.0 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 third quarter of 2018 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 third 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 third quarter of 2019 compared to a net loss in the first quarter of 2019. Cash flow from operations decreased in the third 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.

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 statement (EIS) 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, and concurrently began public scoping for the EIS in September. A decision by the DCCOA is expected in December 2020 or January 2021. If, in the unlikely event the DAPL is required to shut down for a period of time, management believes there is currently adequate excess rail capacity due to declining production in the basin to transport crude oil from North Dakota to markets to handle any oil displaced by a DAPL shutdown. 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 September 30, 2020	As at December 31, 2019
Assets			
Current assets			
Cash and cash equivalents		3,089	607
Accounts receivable	3	17,465	54,020
Prepaid expenses and deposits		376	86
Total current assets		20,930	54,713
Restricted cash	13	315	306
Right of use assets	4	1,743	445
Property, plant and equipment, net	5	517,516	543,364
Total assets		540,504	598,828
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	6	40,399	108,773
Financial derivative liability	16	2,674	261
Lease liability	4	464	453
Total current liabilities		43,537	109,487
Senior loan	8	232,113	188,589
Preferred share obligation	9	98,177	87,380
Financial derivative liability	16	828	-
Lease liability	4	1,337	-
Decommissioning obligation	7	7,224	6,313
Deferred income tax liability		-	5,858
Total liabilities		383,216	397,627
Shareholders' equity			
Common shares	10	198,906	200,630
Preferred share equity component	9	7,510	7,510
Contributed surplus	10	6,721	6,191
Deficit		(62,254)	(12,686)
Accumulated other comprehensive income (loss)		6,405	(444)
Total shareholders' equity		157,288	201,201
Commitments	13		
Subsequent events	17		
Total liabilities and shareholders' equity		540,504	598,828

See accompanying notes to the interim consolidated financial statements



Interim Consolidated Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

		Three months ended September 30,		Nine months ended September 30,	
(\$ thousands, except per share amounts)	Note	2020	2019	2020	2019
Revenue					
Petroleum and natural gas	11	32,928	52,887	106,238	104,689
Less: Royalties		(5,979)	(10,638)	(19,551)	(20,791)
Petroleum and natural gas, net of royalties		26,949	42,249	86,687	83,898
Realized loss on financial derivatives	16	(3,933)	-	(1,657)	-
Unrealized gain (loss) on financial derivatives	16	3,301	-	(3,537)	-
Total revenue		26,317	42,249	81,493	83,898
Expenses					
Operating		8,386	8,534	28,946	19,940
Transportation	11	2,665	2,686	8,734	4,705
General and administrative		1,729	1,033	3,809	3,332
Depreciation and depletion	4,5	15,774	16,260	52,198	31,172
Impairment	5	-	-	24,000	-
Finance	14	6,601	4,802	18,857	13,136
Share-based compensation	10	296	427	668	1,180
Total expenses		35,451	33,742	137,212	73,465
Income (loss) before income taxes		(9,134)	8,507	(55,719)	10,433
Deferred income tax expense (recovery)		-	3,525	(6,151)	4,714
Net income (loss)		(9,134)	4,982	(49,568)	5,719
Currency translation adjustment		(2,552)	2,104	6,849	(5,554)
Comprehensive income (loss)		(11,686)	7,086	(42,719)	165
Net income (loss) per share:					
Basic	12	(0.05)	0.03	(0.26)	0.03
Diluted	12	(0.05)	0.03	(0.26)	0.03

See accompanying notes to the interim consolidated financial statements



Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

<i>(\$ thousands, except share amounts)</i>	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	(90,000)	(86)	-	-	-	-	(86)
Settlement of RSU's	502,007	574	-	(1,031)	-	-	(457)
Share-based compensation, gross	-	-	-	1,515	-	-	1,515
Net income	-	-	-	-	5,719	-	5,719
Other comprehensive loss	-	-	-	-	-	(5,554)	(5,554)
September 30, 2019	192,170,243	201,139	7,510	5,928	(22,294)	3,583	195,866
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	1,036,587	135	-	(237)	-	-	(102)
Share-based compensation, gross	-	-	-	767	-	-	767
Net loss	-	-	-	-	(49,568)	-	(49,568)
Other comprehensive income	-	-	-	-	-	6,849	6,849
September 30, 2020	188,357,215	198,906	7,510	6,721	(62,254)	6,405	157,288

See accompanying notes to the interim consolidated financial statements



Interim Consolidated Statements of Cash Flows

(Unaudited)

		Three months ended September 30,		Nine months ended September 30,	
(\$ thousands)	Note	2020	2019	2020	2019
Operating activities					
Net income (loss)		(9,134)	4,982	(49,568)	5,719
Operating items not affecting cash:					
Depreciation and depletion		15,774	16,260	52,198	31,172
Impairment		-	-	24,000	-
Gain on sale of other assets		(19)	-	(19)	-
Deferred income tax expense (recovery)		-	3,525	(6,151)	4,714
Unrealized (gain) loss on financial derivatives		(3,301)	-	3,537	-
Share-based compensation		296	427	668	1,180
Finance expense		6,601	4,802	18,857	13,136
Change in non-cash working capital	15	(8,726)	2,279	13,143	(5,062)
Cash provided by operating activities		1,491	32,275	56,665	50,859
Investing activities					
Additions to property, plant, and equipment		(2,559)	(63,314)	(32,454)	(167,471)
Acquisitions		-	(484)	-	(3,667)
Proceeds from sale of other assets		23	-	23	-
Change in non-cash working capital	15	(9,178)	(6)	(47,380)	38,209
Cash used in investing activities		(11,714)	(63,804)	(79,811)	(132,929)
Financing Activities					
Proceeds from (repayments to) senior loan, net		(1,698)	31,113	37,570	96,312
Payment of interest and preferred dividends		(2,945)	(4,086)	(10,493)	(11,134)
Payment of lease liabilities		(113)	(48)	(353)	(144)
Settlement of RSU's		(71)	(1)	(102)	(457)
Purchase of common shares for cancellation		-	(5)	(1,859)	(86)
Cash provided by (used in) financing activities		(4,827)	26,973	24,763	84,491
Change in cash and cash equivalents		(15,050)	(4,556)	1,617	2,421
Effect of foreign exchange rate changes		610	(1,734)	865	(1,656)
Cash and cash equivalents, beginning of period		17,529	7,546	607	(491)
Cash and cash equivalents, end of period		3,089	1,256	3,089	1,256

See accompanying notes to the interim consolidated financial statements



Notes to the Interim Consolidated Financial Statements

As at September 30, 2020 and for the three- and nine-month periods ended September 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 "PSH" ticker symbol.

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 November 24, 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

<i>(\$ thousands)</i>	As at September 30, 2020	As at December 31, 2019
Accounts receivable – oil and gas sales	15,381	32,559
Accounts receivable – joint interest billing and other	2,084	21,461
Total	17,465	54,020

Note 4. Right of Use Assets and Lease Liability

The Company'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

<i>(\$ thousands)</i>	
December 31, 2019	445
Additions	1,891
De-recognition	(242)
Depreciation	(369)
Effect of foreign currency rate changes	18
September 30, 2020	1,743

Lease Liability

<i>(\$ thousands)</i>	
December 31, 2019	453
Additions	1,891
De-recognition	(247)
Payments	(353)
Lease interest expense	38
Effect of foreign currency rate changes	19
September 30, 2020	1,801



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, net	32,454	(88)	32,366
Capitalized share-based compensation	99	-	99
Decommissioning obligation	627	-	627
Impairment	(24,000)	-	(24,000)
Depreciation and depletion	(51,719)	(26)	(51,745)
Effect of foreign currency rate changes	16,801	4	16,805
September 30, 2020	517,484	32	517,516

Depreciation, Depletion, and Future Development Costs

For the nine months ended September 30, 2020 and 2019, PetroShale recorded \$51.7 million and \$31.2 million, respectively, of depreciation and depletion expense on its developed and producing assets, which reflected an estimated US\$315.4 million and US\$335.0 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 September 30, 2020, there were no impairment or impairment reversal indicators present and therefore an impairment test was not required.

Capitalized Overhead

During the nine months ended September 30, 2020, the Company capitalized \$506,000 of general and administrative costs and \$99,000 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 (\$803,000 and \$336,000, respectively, for the nine months ended September 30, 2019).

Note 6. Accounts Payable and Accrued Liabilities

<i>(\$ thousands)</i>	As at September 30, 2020	As at December 31, 2019
Trade payables	16,298	56,425
Accrued liabilities	11,400	35,677
Revenue payable	12,701	16,671
Total	40,399	108,773

Note 7. Decommissioning Obligation

<i>(\$ thousands)</i>	Nine months ended September 30, 2020	Year ended December 31, 2019
Beginning of period	6,313	4,934
Obligations incurred	-	1,956
Obligations acquired	-	275
Change in estimated future cash flows	627	(718)
Accretion	110	133
Effect of foreign currency rate changes	174	(267)
End of period	7,224	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 \$7.2 million as at September 30, 2020 (\$6.3 million at December 31, 2019) based on a total future undiscounted liability of \$10.5 million (\$13.7 million at December 31, 2019). At September 30, 2020 management estimates that these payments are expected to be made over the next 42 years in accordance with estimates prepared by independent engineers. As at September 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, consistent with the prior quarter.

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 September 30, 2020, the net amount drawn under the Credit Facility was US\$171.1 million representing US\$173.4 million of borrowings under the Credit



Facility less US\$2.3 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 recently completed a borrowing base redetermination on November 18, 2020 which reaffirmed the borrowing base at US\$177.5 million. The next borrowing base redetermination is scheduled to occur in the second quarter of 2021. 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 September 30, 2020. For the quarter ended September 30, 2020, the effective interest rate on the outstanding borrowings under the Credit Facility was 4.4% (4.3% for the nine months ended September 30, 2020).

Note 9. Preferred Shares

<i>(\$ thousands, except share amounts)</i>	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	-	6,113	-
Accretion	-	2,069	-
Effect of foreign currency rate changes	-	2,615	-
September 30, 2020	75,000	98,177	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 preferred share agreement allowed the Company to 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. In September 2020, the preferred share agreement was modified to remove the limitation on the number of payment in kind elections in any twelve-month period. 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 dividends due in May and August 2020, in kind, and as disclosed in Note 17, has also elected to do the same in respect of its dividend due in November 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 September 30, 2020, the Company had 188,357,215 voting common shares (191,185,628 at December 31, 2019), no non-voting common shares and 41,702,044 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 dividends 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 September 30, 2020:

<i>(\$ thousands, except share amounts)</i>	Shares	Share Capital
December 31, 2018	191,758,236	200,651
Purchase of common shares for cancellation	(1,074,615)	(595)
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 and performance share bonus awards	1,036,587	135
September 30, 2020	188,357,215	198,906

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 nine months ended September 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	-	-	-
September 30, 2020	550,000	0.70	0.80

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	3,364,300	3,894,200	7,258,500	0.16
Settled	(1,732,380)	(96,603)	(1,828,983)	(0.63)
Forfeited and expired	(194,581)	(127,937)	(322,518)	(1.00)
September 30, 2020	3,850,307	4,259,860	8,110,167	0.50

Note 11. Revenue

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

	Three months ended September 30,		Nine months ended September 30,	
(\$ thousands)	2020	2019	2020	2019
Petroleum and natural gas	32,928	52,887	106,238	104,689



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 September 30,		Nine months ended September 30,	
<i>(\$ thousands, except share and per share amounts)</i>	2020	2019	2020	2019
Net income (loss)	(9,134)	4,982	(49,568)	5,719
Weighted average common shares outstanding - basic	187,803,375	192,168,550	188,117,408	192,014,140
Weighted average common shares outstanding - diluted	195,913,542	197,273,567	196,227,575	197,191,551
Net income (loss) per share - basic	(0.05)	0.03	(0.26)	0.03
Net income (loss) per share – diluted	(0.05)	0.03	(0.26)	0.03

The Subsidiary Issuer has issued 75,000 preferred shares which are convertible, at the Investor's option, to 41,702,044 common shares of the Company at a fixed price of \$2.40 per share, subject to certain conditions. See Notes 9 and 17. 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. In August 2020, the Company entered into a new office space lease.

Note 14. Finance Expense

	Three months ended September 30,		Nine months ended September 30,	
<i>(\$ thousands)</i>	2020	2019	2020	2019
Preferred share dividends	3,157	2,228	8,612	6,730
Senior loan interest	2,811	1,859	7,393	4,404
Preferred share accretion, net	575	677	2,069	1,890
Decommissioning obligation accretion	25	34	110	100
Operating lease and other	33	4	673	12
Total finance expense	6,601	4,802	18,857	13,136

Note 15. Supplemental Cash Flow Disclosures

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

	Three months ended September 30,		Nine months ended September 30,	
<i>(in thousands)</i>	2020	2019	2020	2019
Source (use) of cash:				
Accounts receivable	(1,547)	(12,004)	36,555	(23,414)
Prepaid expenses and deposits	(123)	(6)	(290)	(479)
Accounts payable and accrued liabilities	(16,568)	13,216	(68,374)	55,016
	(18,238)	1,206	(32,109)	31,123
Related to operating activities	(8,726)	2,279	13,143	(5,062)
Related to investing activities	(9,178)	(6)	(47,380)	38,209
Accrued and unpaid dividends on preferred shares	87	-	99	-
Difference due to foreign exchange	(421)	(1,067)	2,029	(2,024)
	(18,238)	1,206	(32,109)	31,123
Interest and preferred dividends paid	(2,945)	(4,086)	(10,493)	(11,134)

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:

<i>(\$ thousands)</i>	As at September 30, 2020	As at December 31, 2019
Three-way Collars	1,131	261
Costless collars	2,371	-
Total	3,502	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 September 30, 2020, the Company's derivative instruments consisted of the following types of instruments:

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 September 30, 2020, the Company had the following oil price derivative contracts outstanding:

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
	500	-	37.50	46.00
	500	-	37.50	46.50
Total	5,000	-	29.80	38.32

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
	500	25.00	39.00	49.25
Total	1,000	25.00	38.25	48.68

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
	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	4,500	24.44	38.22	47.04

For the three and nine months ended September 30, 2020, the Company incurred an unrealized gain of \$3.3 million and an unrealized loss of \$3.5 million respectively (three and nine months ended September 30, 2019 – nil). For the three and nine months ended September 30, 2020, the Company recognized a realized loss of \$3.9 million and \$1.7 million respectively (three and nine months ended September 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 September 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 \$1.7 million for the nine months ended September 30, 2020.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet 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 September 30, 2020, the Company had a net working capital deficit of \$19.9 million, excluding a financial derivative liability of \$2.7 million, which is \$14.5 million greater than the undrawn capacity of the senior credit facility of \$5.4 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 by 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 September 30, 2020 is approximately \$40.4 million (December 31, 2019 - \$108.8 million). It is the Company's general practice to pay suppliers within 60 days. On November 18, 2020, the Company's senior lenders reaffirmed the existing borrowing capacity and maintained the previously established maturity date of 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. PetroShale elected to exercise its right to settle in kind the payment of the quarterly dividends due in May 2020 and August 2020 on its outstanding preferred shares. The Company also elected to settle in kind the payment of quarterly dividends due in November 2020. Refer to Note 17.

Note 17. Subsequent Events

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

On November 18, 2020, the Company's senior lenders agreed to reaffirm the amount of the existing borrowing capacity of US\$177.5 million.

