PetroShale

Calgary • Denver

Management's Discussion and Analysis & Consolidated Financial Statements

As at December 31, 2020 and 2019 and for the three-month periods and for the years then ended

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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 March 22, 2021. This MD&A should be read in conjunction with the Company's audited consolidated financial statements as at December 31, 2020 and 2019 and for the years then ended. The reader should be aware that the operating results discussed below may not be indicative of future performance.

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

Frequently Used Terms:

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

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"). 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 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 assets.

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 December 31,		**Year ended December 31,**	
($ thousands)	**2020**	**2019**	**2020**	**2019**
Cash flow provided by operating activities	13,326	27,677	69,991	78,536
Change in non-cash working capital	1,878	7,889	(11,265)	12,951
Adjusted EBITDA	**15,204**	**35,566**	**58,726**	**91,487**

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

	As at December 31,	
($ thousands)	**2020**	**2019**
Total liabilities	365,177	397,627
Decommissioning obligation	(6,250)	(6,313)
Financial derivative liability	(10,020)	(261)
Deferred income tax liability	-	(5,858)
Lease liability	(1,617)	(453)
Total current assets	(20,384)	(54,713)
Net Debt	**326,906**	**330,029**

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, the Company's plans, focus and strategy, capital expenditures for 2021 and the Company's ability to generate cash flow from operations in 2021, intention to continue to limit capital expenditures and continue to reduce the working capital deficit and/or the senior credit facility balance; the potential impacts of the current challenging economic climate on PetroShale and its customers, timing of capital expenditures and methods of financing capital expenditures and the ability to fund financial liabilities, crude oil price volatility, the completion of the transactions contemplated by the Recapitalization Agreement and the amendments to the credit facility and the potential benefits and effects of the transactions contemplated by the Recapitalization Agreement on the Company, the potential minimum and maximum gross proceeds of the Private Placement and Rights Offering, the results to be derived from the commodity price hedges; the Company's derivative instruments, the terms thereof and the anticipated benefits, the term out and maturity dates of the senior credit facility, reserve estimates, future lease operating, workover and transportation costs, expectation that there is currently adequate excess rail capacity, the result of transport by rail on the realized price differentials 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.

Oil and Gas Advisories

This document contains metrics commonly used in the oil and natural gas industry, such as "recycle ratio," "finding and development costs" and "finding, development and acquisition costs." Each of these metrics are determined by PetroShale as specifically set forth in this document. These terms do not have standardized meanings or standardized methods of calculation and therefore may not be comparable to similar measures presented by other companies, and therefore should not be used to make such comparisons. Such metrics have been included to provide readers with additional information to evaluate the Company's performance however, such metrics should not be unduly relied upon for investment or other purposes. Management uses these metrics for its own performance measurements and to provide readers with measures to compare PetroShale's performance over time.

Financial and Operational Highlights

	Three months ended December 31,		Year ended December 31,	
	2020	**2019**	**2020**	**2019**
Financial *($ thousands, except share amounts)*				
Petroleum and natural gas revenue	37,268	60,569	143,506	165,258
Cash provided by operating activities	13,326	27,677	69,991	78,536
Net income (loss)	(12,417)	9,608	(61,985)	15,327
Per share - diluted	(0.07)	0.05	(0.33)	0.08
Adjusted EBITDA (1)	15,204	35,566	58,726	91,487
Capital expenditures, net	2,743	65,587	35,174	236,703
Net debt (1)			326,906	330,029
Number of common shares outstanding:				
Weighted average - basic	188,459,513	191,681,135	188,240,502	191,920,373
Weighted average - diluted	196,003,279	194,684,301	195,784,268	194,395,182
Operating				
Number of days	92	92	366	365
Daily production: (2)				
Tight oil (Bbls)	7,814	9,613	8,836	6,538
Shale gas (Mcf)	12,772	8,470	11,870	6,716
Natural gas liquids (Bbls)	2,262	1,148	2,113	1,023
Barrels of oil equivalent	12,205	12,173	12,928	8,680
Average realized price:				
Tight oil ($/Bbl)	52.30	68.98	45.73	69.89
Shale gas ($/Mcf)	2.52	2.35	1.75	2.45
Natural gas liquids ($/Bbl)	12.67	12.71	8.50	10.65
Netback ($ per Boe): (1)				
Petroleum and natural gas revenue	33.19	54.08	30.33	52.16
Royalties	(5.97)	(10.43)	(5.55)	(10.25)
Realized loss on financial derivatives	(2.73)	-	(1.00)	-
Lease operating costs	(3.78)	(3.78)	(4.59)	(4.16)
Workover expense	(0.78)	(0.52)	(0.75)	(1.03)
Production taxes	(2.53)	(4.21)	(2.46)	(4.10)
Transportation expense	(2.44)	(2.35)	(2.42)	(2.32)
Operating netback (1)	14.96	32.79	13.56	30.30
Operating netback prior to hedging (1)	17.69	32.79	14.56	30.30

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

Management's Discussion and Analysis

Description of Business

PetroShale Inc. ("PetroShale" or 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.

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.

COVID-19, Commodity Prices, and Impact on Operations

In March 2020, a pandemic was declared by the World Health Organization due to the COVID-19 virus outbreak. Responses to the spread of COVID-19 have resulted in a significant disruption to business operations and a significant increase in economic uncertainty. As a result, crude oil prices drastically declined due to a reduction in oil demand associated with the pandemic, combined with oversupply issues and disputes amongst major oil producing countries. Other economic impacts of the virus have included volatility in oil and gas asset prices, marked fluctuation in currency exchange rates, and a decline in long-term interest rates. More recently, economic activity has improved, commodity prices have increased, vaccines have been approved and a phased rollout has commenced throughout most developed countries.

During the year ended December 31, 2020, 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 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 global oversupply of crude oil. The excess supply of crude oil and demand imbalance resulted in the WTI crude oil price, the benchmark price for most of the Company's crude production, declining from US$57.53/Bbl in January 2020 to US$17.08/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$47.17/Bbl in December 2020 and in excess of US$60/Bbl recently. Despite recent re-balancing of supply and demand for crude, uncertainties exist around the pace of increase in future economic activity, future actions of OPEC+, and the potential lifting of sanctions against Iran (a major oil producer), among other factors. As a result, crude oil prices could continue to be volatile and it is uncertain when business operations, including those the Company participates in, will return to conditions that existed prior to COVID-19.

PetroShale's top priority has been to maintain a safe working environment for all employees and business partners. The Company implemented preventative measures and developed corporate and field response plans to minimize risk of COVID-19 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. The Company also took steps during 2020 to minimize the impact of COVID-19 on operating results and financial liquidity. Such measures included a significant reduction in discretionary capital expenditures, maintaining low operating costs and general and administrative expenditures, as well as the development of an active hedging program.

Recent Developments

As a result of the volatile economic environment and severe downturn in crude oil and natural gas prices in early 2020, as well as the unprecedented impact of the COVID-19 pandemic, the Company evaluated strategic alternatives to reduce our debt, increase financial flexibility, and position PetroShale for long-term success. On March 4, 2021, the Company entered into a series of agreements (the "Recapitalization Agreements") with its largest common shareholder (Mr. M. Bruce Chernoff, our Executive Chairman and a director) and FR XIII PetroShale Holdings L.P. ("First Reserve" or the "Investor"), the sole owner of the Company's wholly owned subsidiary's preferred shares and reached an agreement in principle in respect of the Company's credit facility with the Company's bank lending syndicate, collectively, to fundamentally improve PetroShale's capital structure.

The Recapitalization Agreements provide for the following:

- The Company has commenced a rights offering (the "Rights Offering") with its current shareholders by issuing to holders of the outstanding common shares of record at the close of business on March 11, 2021 rights to subscribe for additional common shares at $0.20 per share.
- In order to provide shareholders the maximum ability to participate in the Rights Offering, each of First Reserve and Mr. Chernoff (and his affiliated entities) have waived all rights of participation in the Rights Offering.
- In lieu of participating in the Rights Offering, Chernoffco has agreed to invest a minimum of $12.9 million and up to $20 million in PetroShale via a private placement at $0.20 per common share to close concurrently with the Rights Offering (the "Chernoffco Private Placement").
- First Reserve has agreed to convert the entirety of its existing preferred shares to common shares at a conversion price of $0.60 per share and, in lieu of participating in the Rights Offering, to invest $10 million in PetroShale via a private place at $0.20 per common share to close concurrently with the Rights Offering (collective with the Chernoffco Private Placement, the "Private Placements").
- The Company has reached an agreement in principle with the lenders under its credit facility whereby such lenders have agreed, subject to the satisfaction of certain conditions, including the concurrent completion of the Recapitalization Agreements, to maintain the borrowing base at US$177.5 million and extend the maturity date of the credit facility to June 2023 subject to certain criteria.

Depending on participation of minority common shareholders in the Rights Offering, the Company will raise a minimum of $30.0 million, and up to $60.6 million, of equity for the Company.

The Company's existing borrowing base capacity under the senior credit facility was reaffirmed by the Company's lending syndicate at US$177.5 million in November 2020. Subject to completion of the Recapitalization Agreements, the Company's borrowing base will be maintained at US$177.5 million.

For the calendar year 2021, the Company expects to invest approximately $50.0-$60.0 million of capital, maintain production between 10,500 Boepd and 11,500 Boepd on average during 2021, and generate free cash flow at current market commodity prices.

Oil and Gas Lease Development

During the year ended December 31, 2020, the Company did not drill or complete any operated wells. The Company participated in 39 gross (3.3 net) non-operated wells which commenced production in in the Antelope, Sanish, South Berthold, and South Nesson areas of the Williston Basin (7 gross and 0.02 net wells for the quarter ended December 31, 2020). As a result of the Company's caution approach to operations in 2020, net capital expenditures totaled approximately $2.1 million and $35.2 million for the three months and year ended December 31, 2020, respectively. The Company has 56 gross (5.7 net) wells that have been drilled and awaiting completion or being completed at December 31, 2020.

Petroleum Reserves Update

The Company obtained an updated reserve report, prepared by its independent engineers, Netherland, Sewell & Associates, as at December 31, 2020. As reflected in the table below, proved reserves remained relatively consistent while probable reserves increased over the prior year, reflecting a successful capital program during 2020. Proved developed producing reserves were flat versus the prior year reserve report at 25.5 Mmboe (US$271.3 million PV10) while total proved reserves decreased marginally by 0.6 Mmboe to 56.9 Mmboe (US$476.0 million PV10) primarily due to the Company's reduced capital program in 2020. Probable reserves increased by 2.5 Mmboe versus the prior year. Overall, total proved plus probable reserves increased by 1.8 Mmboe or 2.6% to 72.3 Mmboe (US$616.4 million PV10) net of production. Finding and development ("F&D") costs and finding, development and acquisition ("FD&A") costs were $3.69 per Boe and $3.52 per Boe, respectively, based on total proved reserves. This resulted in recycle ratios of 3.9 for F&D and 4.1 for FD&A based on total proved reserves and the Company's operating netback per Boe, prior to hedging, for the year ended December 31, 2020.

Gross Company Interest Reserves

	As at December 31,		As at December 31,	
	2020	2019	2020	2019
	Mboe	Mboe	PV10 (US$MM)(1)	PV10 (US$MM)(1)
Proved developed producing	25,506	25,442	271.3	398.5
Total proved	56,861	57,451	476.0	752.9
Probable	15,450	13,016	140.4	169.9
Total proved plus probable (2P)	72,311	70,467	616.4	922.7
Liquids percentage of total proved plus probable	86%	76%		

(1) The PV10 values reported in the table above were calculated by Netherland, Sewell and Associates using forecast pricing at the respective dates in accordance with NI 51-101.

Results of Operations

Production

	Three months ended December 31,			Year ended December 31,		
	2020	2019	% change	2020	2019	% change
Tight oil (Bbls per day)	7,814	9,613	(18.7)	8,836	6,538	35.1
Shale gas (Mcf per day)	12,772	8,470	50.8	11,870	6,716	76.7
Natural gas liquids (Bbls per day)	2,262	1,148	97.0	2,113	1,023	106.8
Total (Boe per day)	12,205	12,173	0.3	12,928	8,680	48.9
Liquids percentage of total	82.6	88.4	(6.6)	84.7	87.1	(2.8)

The increase in production for the year ended December 31, 2020 compared to the prior period is due to new wells that were brought online during mid to late 2019, slightly offset by natural declines and the impact of shutting in a number of non-operated 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 39 gross (3.3 net) wells coming online throughout 2020. Production during the year ended December 31, 2020 was comprised of 68.4% tight oil, 16.3% natural gas liquids, and 15.3% shale gas compared to 75.3% tight oil, 11.8% natural gas liquids, and 12.9% shale gas in 2019. Tight oil production during the three months ended December 31, 2020 was lower than the comparable prior year period as a result of temporary shut-ins following operated and non-operated well workover activity. Shale gas and NGL production increased in the fourth quarter of 2020 versus the fourth quarter of 2019 with reduced flaring activity of operated and non-operated wells.

Pricing

	Three months ended December 31,			Year ended December 31,		
	2020	2019	% change	2020	2019	% change
Average Benchmark Prices (US$)						
Crude oil – WTI (per Bbl)	42.59	56.96	(25.2)	39.38	56.74	(30.6)
Natural gas – HH spot (per Mmbtu)	2.53	2.41	5.0	2.04	2.56	(20.3)
Average Differential (US$)						
Crude oil (per Bbl)	(2.44)	(4.70)	(48.1)	(5.27)	(4.07)	29.5
Natural gas (per Mcf) (1)	(0.60)	(0.63)	(4.8)	(0.74)	(0.71)	4.2
Average Realized Prices (US$) (2)						
Tight oil (per Bbl)	40.15	52.26	(23.2)	34.11	52.67	(35.2)
Shale gas (per Mcf)	1.93	1.78	8.4	1.30	1.85	(29.7)
Natural gas liquids (per Bbl)	9.72	9.63	0.9	6.34	8.03	(21.0)
Average Realized Prices (CAD$) (2)						
Tight oil (per Bbl)	52.30	68.98	(24.2)	45.73	69.89	(34.6)
Shale gas (per Mcf)	2.52	2.35	7.2	1.75	2.45	(28.6)
Natural gas liquids (per Bbl)	12.67	12.71	(0.3)	8.50	10.65	(20.2)

(1) Includes conversion from Mmbtu to Mcf

(2) Excluding transportation and processing costs

As a result of the reductions in demand due to COVID-19 and geopolitically driven supply imbalances, WTI crude oil prices began to decline in March of 2020 and remained volatile throughout the year. Though prices recovered significantly by the end of the year, average commodity prices for the year were well below levels in the comparative periods. The average basis differential for crude oil also widened during the majority of 2020 compared to prior periods as a result of supply imbalance, demand reduction, and market volatility before narrowing in the fourth quarter of 2020 and first quarter of 2021.

Henry Hub benchmark natural gas prices were significantly lower throughout most of 2020 compared to the prior year but improved significantly in the fourth quarter of 2020 and first quarter of 2021. Realized natural gas prices in the Williston Basin remain discounted to Henry Hub benchmark prices reflecting the shortage of takeaway and processing capacity in the area. NGL prices reflected the movement in oil prices, with lower prices on average during the year and improving in the fourth quarter.

Revenues and Royalties

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Petroleum and natural gas revenue	37,268	60,569	(38.5)	143,506	165,258	(13.2)
Less: royalties	(6,704)	(11,686)	(42.6)	(26,255)	(32,477)	(19.2)
Petroleum and natural gas revenue, net	30,564	48,883	(37.5)	117,251	132,781	(11.7)
Royalties as a percentage of revenue	18.0%	19.3%	(6.8)	18.3%	19.7%	(6.9)
Per Boe amounts:						
Petroleum and natural gas revenue	33.19	54.08	(38.6)	30.33	52.16	(41.6)
Less: royalties	(5.97)	(10.43)	(42.8)	(5.55)	(10.25)	(45.9)
Petroleum and natural gas revenue, net	27.22	43.65	(37.6)	24.78	41.66	(40.5)

The decrease in revenues during the quarter and year ended December 31, 2020 compared to the prior year periods is primarily due to the substantial decline in crude oil prices as discussed above.

The Company's royalty rate as a percentage of revenues decreased slightly during the three-month period and year ended December 31, 2020, as compared to the prior year periods primarily due to varying royalty rates on different producing leases and partially to COVID-19 relief provided by the Office of Natural Resources Revenue (ONRR) on federal properties in the third and fourth quarters of 2020.

Realized and Unrealized Loss on Financial Derivatives

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Realized loss on financial derivatives	(3,070)	-	(100.0)	(4,727)	-	(100.0)
Unrealized loss on financial derivatives	(6,849)	(266)	2,474.8	(10,386)	(266)	3,804.5
Realized loss on financial derivatives per Boe	(2.73)	-	(100.0)	(1.00)	-	(100.0)

The Company realized losses on its financial derivatives in the three months and year ended December 31, 2020 due to improving oil prices during the period. During the year ended December 31, 2020, the Company entered into additional commodity price hedges to protect its operating cash flows through 2021. With improving oil prices, the Company incurred an unrealized loss on those derivatives for the three-months and year ended December 31, 2020.

Operating Expense

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Lease operating costs	4,244	4,234	0.3	21,703	13,198	64.4
Workover expense	871	581	49.7	3,552	3,266	8.8
Production taxes	2,844	4,710	(39.6)	11,650	13,001	(10.4)
Total operating expense	7,959	9,525	(16.4)	36,905	29,465	25.3
Per Boe amounts:						
Lease operating costs	3.78	3.78	-	4.59	4.16	10.3
Workover expense	0.78	0.52	50.0	0.75	1.03	(27.2)
Production taxes	2.53	4.21	(39.9)	2.46	4.10	(40.0)
Total operating expense	7.09	8.51	(16.7)	7.80	9.29	(16.0)
Production taxes – % of revenue	9.3%	9.6%	(3.4)	9.9%	9.8%	1.5

Lease operating costs

Lease operating costs for the year ended December 31, 2020, increased over the prior year period due primarily to increased operated and non-operated well count and production volumes throughout the full fiscal year. Absolute lease operating costs and costs per Boe were consistent during the three-month period ended December 31, 2020 compared to the same period in 2019.

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 per 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-months and year ended December 31, 2020. The fluctuations in production taxes per Boe are consistent with the changes in the Company's average realized prices as discussed in the Pricing section above.

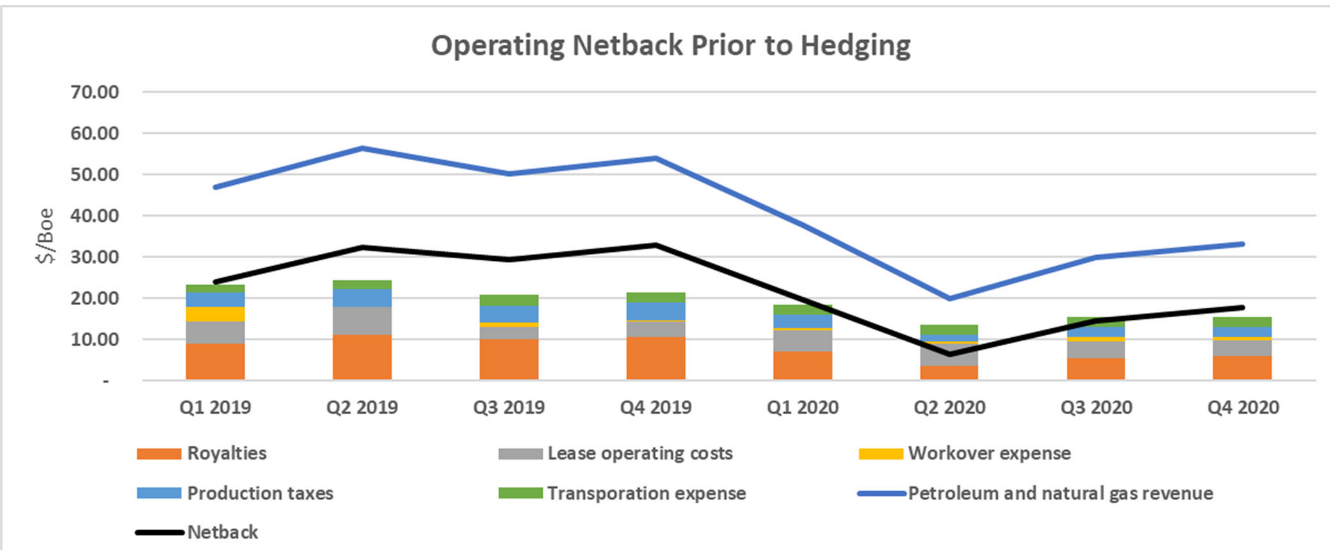
Transportation expense

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Transportation expense	2,739	2,635	3.9	11,473	7,340	56.3
Transportation expense per Boe	2.44	2.35	3.8	2.42	2.32	4.3

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 consolidated statement of operations. Transportation costs were consistent in the three-month period ended December 31, 2020 versus the same period in 2019 while transportation costs increased in the year ended December 31, 2020 as compared to the same period in the prior year due primarily due to an increase in production volume.

Operating Netback

	Three months ended December 31,			Year ended December 31,		
($ per Boe)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Operating netback:						
Petroleum and natural gas revenue	33.19	54.08	(38.6)	30.33	52.16	(41.6)
Royalties	(5.97)	(10.43)	(42.8)	(5.55)	(10.25)	(45.9)
Realized gain on financial derivatives	(2.73)	-	100.0	(1.00)	-	100.0
Lease operating costs	(3.78)	(3.78)	-	(4.59)	(4.16)	10.3
Workover expense	(0.78)	(0.52)	50.0	(0.75)	(1.03)	(27.2)
Production taxes	(2.53)	(4.21)	(39.9)	(2.46)	(4.10)	(40.0)
Transportation expense	(2.44)	(2.35)	3.8	(2.42)	(2.32)	4.3
Operating netback	14.96	32.79	(54.4)	13.56	30.30	(54.9)
Operating netback prior to hedging	17.69	32.79	(46.1)	14.56	30.30	(51.6)



General and Administrative ("G&A") Expense

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Gross G&A expense	1,830	2,217	(17.5)	6,686	7,086	(5.6)
Capitalized G&A	(104)	(247)	(57.9)	(610)	(1,050)	(41.9)
Overhead recovery	(134)	(813)	(83.5)	(675)	(1,547)	(56.4)
Net G&A expense	1,592	1,157	37.6	5,401	4,489	20.3
Net G&A expense per Boe	1.42	1.03	37.9	1.14	1.42	(19.7)

Overall, gross G&A for the three-month period and year ended December 31, 2020 decreased when compared to the prior year periods. However, net G&A for the three-month period and year ended December 31, 2020 increased over the prior periods primarily due to lower overhead recoveries and reduced capitalized G&A as a result of reduced capital activity as discussed elsewhere in this MD&A. Net G&A per Boe for the year ended December 31, 2020 decreased versus the prior year due to the significant increase in production without a commensurate increase in net G&A expense.

Depreciation and Depletion Expense

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Depreciation and depletion expense	13,930	15,814	(11.9)	66,128	46,986	40.7
Depreciation and depletion expense per Boe	12.41	14.12	(12.1)	13.98	14.83	(5.8)

Depreciation and depletion expense, on an absolute dollar and per Boe basis, decreased during the three-month period ended December 31, 2020 as compared to the prior period due to the reduced capital base following the impairment recorded in the first quarter of 2020. Depreciation and depletion expense increased for the year ended December 31, 2020 as a result of higher production volumes and significant increases to the capital base on increased capital activity during late 2019 and the first part of 2020.

Impairment

	Three months ended December 31,			Year ended December 31,		
($ thousands except where noted)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Impairment	-	-	-	24,000	-	100.0
Impairment per Boe	-	-	-	5.07	-	100.0

The Company evaluates its developed and producing ("D&P") assets for impairment indicators that suggest the carrying value these assets may not be recoverable. If such impairment indicators exist, any impairment necessary is determined by comparing the carrying amount of D&P assets to the greater of the assets value in use 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 D&P assets.

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, and future capital expenditures.

During the quarter ended March 31, 2020, the significant decline in oil prices 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. Based on results of this impairment test, the Company recognized an impairment charge of $24.0 million for the three months ending March 31, 2020 on the Company's D&P assets. The recoverable amount 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 discounted at a rate of 14% per annum.

At December 31, 2020, there were no impairment or impairment reversal indicators present.

Finance Expense

	Three months ended December 31,			Year ended December 31,		
($ thousands)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Preferred share dividends	3,180	2,227	42.8	11,792	8,957	31.7
Senior credit facility interest	2,680	2,282	17.4	10,081	6,687	50.8
Preferred share accretion, net	675	678	(0.4)	2,744	2,568	6.9
Decommissioning obligation accretion	25	33	(24.2)	135	133	1.5
Operating lease and other	28	14	100.0	693	25	2,672.0
Total finance expense	**6,588**	**5,234**	**25.9**	**25,445**	**18,370**	**38.5**

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 share 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% per annum rather than the 9% rate which applies to cash dividend payments.

Deferred Income Tax Expense (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 December 31, 2020, the Company determined that due to the challenging economic climate, the generation of future taxable income was not probable and thus a deferred tax asset was not recorded. The Company recorded a deferred income tax recovery of $6.2 million for the year ended December 31, 2020 compared to an expense of $9.2 million for the year ended December 31, 2019.

Share-based Compensation

	Three months ended December 31,			Year ended December 31,		
($ thousands)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Gross share-based compensation	281	265	6.0	1,049	1,779	(41.0)
Capitalized share-based compensation	(27)	(70)	(61.4)	(127)	(404)	(68.6)
Net share-based compensation	**254**	**195**	**30.3**	**922**	**1,375**	**(32.9)**

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 2.0 times based on the Company's performance against specified key performance indicators. 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 in the consolidated statement of financial position.

Net share-based compensation expense is lower for the year ended December 31, 2020 versus the year ended December 31, 2019 due to declining measurement prices of restricted and performance share awards/grants.

Foreign Currency Gain (Loss) and Translation Adjustment

	Three months ended December 31,		Year ended December 31,	
	2020	**2019**	**2020**	**2019**
Foreign currency translation rates – US$/CAD$:				
Average period exchange rate	1.3027	1.3198	1.3408	1.3268
Ending period exchange rate	1.2725	1.2990	1.2725	1.2990

The Company's 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 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 loss of $0.6 million for the year ended December 31, 2020 (2019 – loss of $9.6 million), due to a strengthening Canadian dollar relative to the US dollar from December 31, 2019 and the fact that the carrying value of the Company's US dollar-denominated assets exceeds the value of 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 credit facility.

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 manages 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 the operators of its non-operated properties, by reducing its drilling and completion activity on its operated properties and by entering into commodity price hedge contracts. The Company considers its financial capacity and liquidity before proceeding with additional wells on its operated lands.

As at December 31, 2020, the Company had a net working capital deficit of $8.4 million, excluding the current financial derivative liability of $10.0 million. The net working capital deficit at December 31, 2020 is $4.4 million greater than the undrawn capacity of the senior credit facility of $4.0 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 $80.4 million during the year ended December 31, 2020 ($12.1 million decrease versus September 30, 2020). The Company intends to continue to limit capital expenditures and, at current commodity prices, generate free cash flow to continue to reduce the working capital deficit and the senior credit facility 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, royalty rates, 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 $70.0 million for the year ended December 31, 2020 as compared to $78.5 million for the prior year. During the year ended December 31, 2020, adjusted EBITDA declined due to the impact of significantly lower commodity prices (primarily oil) which was offset by increased production and a positive contribution from changes to non-cash working capital associated with operating activities.

Financial Derivatives and Hedging Activities

The Company's results of operations and cash flows provided by operating activities are impacted by changes in market prices for crude 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 in commodity prices. These derivative instruments allow the Company to predict with greater certainty the total revenue it will receive, provide stability to the Company's operating cash flows for capital spending planning purposes, and protect acquisition economics.

As at December 31, 2020, the Company had the following oil price derivative contracts outstanding:

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**

Subsequent to December 31, 2020, the Company has entered into the following financial derivatives (refer to Note 21 in the consolidated financial statements):

Q1 2022

Contract Type	Volume (Bbls/d)	Fixed (US$)	Bought Put (US$)	Sold Call (US$)
Costless collars				
	250	-	40.00	58.05
	750	-	45.00	59.25
	250	-	45.00	60.00
	500	-	48.90	60.00
	250	-	53.18	60.00
Swap				
	500	49.53	-	-
Total	**2,500**	**49.53**	**46.37**	**59.48**

Q2 2022

Contract Type	Volume (Bbls/d)	Fixed (US$)	Bought Put (US$)	Sold Call (US$)
Costless collars				
	250	-	40.00	58.05
	750	-	45.00	59.25
	250	-	45.00	60.00
	500	-	48.90	60.00
	250	-	53.18	60.00
Swap				
	250	48.95	-	-
Total	**2,250**	**48.95**	**46.37**	**59.48**

Q3 – Q4 2022

Contract Type	Volume (Bbls/d)	Fixed (US$)	Bought Put (US$)	Sold Call (US$)
Costless collars				
	500	-	45.00	63.15
Total	**500**	**-**	**45.00**	**63.15**

Capital Expenditures

	Three months ended December 31,			**Year ended December 31,**		
($ thousands)	**2020**	**2019**	**% change**	**2020**	**2019**	**% change**
Drilling and completion	2,743	62,151	(95.6)	35,175	229,512	(84.7)
Acquisitions	-	3,340	(100.0)	-	7,007	(100.0)
Other, net	-	96	(100.0)	(1)	184	(87.5)
	2,743	65,587	(95.8)	35,174	236,703	(85.1)
Non-cash:						
Capitalized share-based compensation	27	70	(61.4)	127	404	(68.6)
Decommissioning obligation	(659)	1,039	(163.4)	(32)	1,693	(101.9)
Total capital expenditures	**2,111**	**66,696**	**(96.8)**	**35,269**	**238,800**	**(85.2)**

Capital expenditures related to D&P activity for the three months and year ended December 31, 2020 were funded from borrowings under the Company's senior credit facility and operating cash flows. Capital expenditures in 2020 were mainly related to completion activities on 3.3 net non-operated wells as well as operated and non-operated well workover activities. In the current environment, the Company is focusing on discretionary capital expenditures to maintain and optimize production, rather than growing production, as demonstrated by the low expenditure level in the latter half of the year.

Senior Credit Facility

The Company maintains a senior revolving credit facility which is referred to as the senior credit facility in the consolidated statement of financial position. The capacity of this facility was US$177.5 million as at December 31, 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 credit facility as at December 31, 2020. The credit facility has no financial covenants.

As at March 22, 2021, outstanding borrowings under the senior credit facility were US$174.0 million. The Company held cash of US$9.9 million for net borrowings of US$164.1 million. In November 2020, the Company's lenders confirmed the amount of the existing borrowing base capacity under the Senior Credit Facility at US$177.5 million. Coincident with the March 4, 2021 announcement of the Recapitalization Agreements, the Company's borrowing base was re-affirmed at US$177.5 million, subject to completion of the Recapitalization Agreements. Depending on the amount of gross proceeds from the Rights Offering, the Company expects the amount drawn under the senior credit facility will be reduced between $30.0 million and $60.6 million (US$23.6 million to US$47.6 million at December 31, 2020 exchange rates) following completion of the Recapitalization Agreements, resulting in significant undrawn capacity under the senior credit facility.

Preferred Shares

The Company elected to pay its preferred share dividends due in May, August, and November of 2020 in-kind as a means of preserving liquidity. The Company also elected to do the same in respect of its dividend due in February 2021 and in respect of dividends accruing to the date the preferred shares are converted to common shares as part of the Recapitalization Agreements. Refer also to Notes 11 and 21 in the Company's consolidated financial statements.

Share Capital

	As at March 22, 2021	As at December 31, 2020	As at December 31, 2019
Weighted average common shares outstanding:			
Basic		188,240,502	191,920,373
Diluted		195,784,268	194,395,182
Outstanding securities:			
Common shares	188,556,240	188,528,453	191,185,628
Preferred shares, convertible	75,000	75,000	75,000
Stock options	550,000	550,000	550,000
Restricted share bonus awards	3,251,027	3,301,027	2,412,968
Performance share bonus awards	4,242,740	4,242,740	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. The preferred shares will be converted to common shares and the voting rights associated with the preferred shares will be cancelled on completion of the transactions pursuant to the Recapitalization Agreements.

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 was permitted to purchase up to 11,785,163 voting common shares of the Company between February 10, 2020 and February 8, 2021. During 2020, the Company purchased and cancelled 3,865,000 common shares at an average price of $0.48 per common share for a total repurchase cost of $1.9 million under the NCIB. In 2019, the Company purchased 1,074,615 common shares under the NCIB at an average price of $.55 per common share for a total repurchase cost of $0.6 million. No further purchases were made in 2021 and the NCIB expired on Feb 8, 2021.

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 December 31, 2020:

($ thousands)	**Contractual Cash Flow**	**2021**	**2022**	**2023**	**2024**	**2025**
Accounts payable and accrued liabilities	28,327	28,327	-	-	-	-
Lease liability	1,617	472	359	239	262	285
Senior credit facility [(1)]	237,215	10,323	226,892	-	-	-
Preferred share obligation [(2)]	123,059	9,386	9,386	104,287	-	-

(1) Includes future interest expense at the rate of 4.66% being the rate applicable at December 31, 2020 to the current maturity date of June 25, 2022.

(2) The amount differs from that presented on the 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 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 assuming it is paid in cash at the coupon rate. These preferred shares may be converted to common shares at the option of the Investor. Refer to Note 21 of the Consolidated Financial Statements.

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.

Selected Financial Data

	As at December 31,		
($ thousands except per share amounts)	**2020**	**2019**	**2018**
Petroleum and natural gas, net of royalties	117,251	132,781	97,699
Total assets	502,877	598,828	404,022
Total non-current liabilities	326,358	288,140	165,244
Cash provided by operating activities	69,991	78,536	69,512
Net income (loss)	(61,985)	15,327	27,056
Net income (loss) per share:			
Basic	(0.33)	0.08	0.16
Diluted	(0.33)	0.08	0.16

Summary of Quarterly Results

($ thousands except where noted)	**Dec 31 2020**	**Sep 30 2020**	**Jun 30 2020**	**Mar 31 2020**	**Dec 31 2019**	**Sep 30 2019**	**Jun 30 2019**	**Mar 31 2019**
Revenues, net of royalty	30,564	26,949	19,820	39,918	48,883	42,249	24,419	17,230
Adjusted EBITDA	15,204	10,217	8,278	25,027	35,566	29,996	16,344	9,581
Cash flow – operating activities	13,326	1,491	16,336	38,837	27,677	32,275	(1,626)	20,210
Net income (loss)	(12,417)	(9,134)	(23,169)	(17,266)	9,608	4,982	1,733	(996)
Net income (loss) per share:								
Basic and Diluted	(0.07)	(0.05)	(0.12)	(0.09)	0.05	0.03	0.01	-

Revenues, adjusted EBITDA, and cash flow from operating activities increased during the fourth quarter of 2020 versus the prior quarter primarily as a result of improved pricing.

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 contributed to a reduction in Adjusted EBITDA and cash flows and also resulted in 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 non-cash 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 2019 due to a 93.4% increase in production, partially offset by lower realized commodity prices. The same factors led to significant increases in adjusted EBITDA, cash flow from operating activities and net income.

Revenue in the second quarter of 2019 increased compared to the first quarter due to an 19.6% increase in production volumes and higher realized oil prices.

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 outbreak to be a pandemic. Responses to the spread of COVID-19 have resulted in significant disruption to business operations, a significant increase in economic uncertainty, increased volatility in 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 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

Each quarter, management reviews indicators of impairment (and indicators of impairment reversal as applicable) 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 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 discount rates used 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 bonus 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.

Business Conditions and Risks

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, other 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 where 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 due to 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 capital 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 proceed on a different schedule than the Company anticipated, including expenditures to drill more wells or build more facilities 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, and the resulting activities, 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 which 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 tight oil, shale 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. When considering if derivative contracts are warranted, 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. 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 crude 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, 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 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 local 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 tight oil and shale 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 tight oil and shale 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. If the Company becomes subject to environmental liabilities without such insurance, 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 crude oil by pipeline rather than by truck, and connecting natural gas to pipeline connections to reduce GHG emissions from its operations. Climate change and related regulation and public response to such items may negatively impact demand for oil, natural gas and NGLs in the future, and could reduce market prices for our commodities. Management intends to continue its financial and physical hedging activities and reducing its debt to alleviate the impact of a possible reduction to future commodity prices.

Additional Risk Information

Additional information regarding risks including, but not limited to, business risks is available in the Company's Annual Information Form, a copy of which may be accessed through SEDAR website (www.sedar.com).

Recent Oil Price Market Events and COVID-19 Impacts

Market events and conditions, including global excess oil and 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 around the globe. 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 2020, 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 constructed in 2017, failed to prepare an environmental impact statement (EIS) for the easement. The United States District Court Judge ordered the DAPL to be shut down and emptied of oil while the USACE prepared the necessary environmental analysis. Energy Transfer, which owns the DAPL, and the USACE appealed that decision to the DC Circuit Court of Appeals (DCCOA). The DCCOA reversed the order to suspend operations and empty the pipeline but upheld the vacatur of the easement under Lake Oahe. The DCCOA has agreed to allow DAPL to continue to operate and concurrently began public scoping for the EIS in September 2020. A decision by the DCCOA in January 2021 allows DAPL to remain operational during an approximate 13-month period while USACE prepares the EIS. In February 2021, a federal judge with the D.C. District Court had asked the USACE to outline its plans related to DAPL's continued operation given the vacatur of the easement, but subsequently granted the Biden Administration's request to delay the scheduled hearing by two months to brief the new administration on the legal case; the new hearing is scheduled for April 9, 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, and alternative pipeline capacity to transport the reduced levels of oil currently produced from the basin in the event DAPL is shutdown. Transporting crude oil by rail is more expensive than transportation through the DAPL and may lead to a decrease in realized crude oil prices 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.

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PetroShale Inc.

Opinion

We have audited the consolidated financial statements of PetroShale Inc. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2020 and December 31, 2019
- the consolidated statements of operations and comprehensive income (loss) for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2020 and December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "*Auditors' Responsibilities for the Audit of the Financial Statements*" section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. Other information comprises the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

The engagement partner on the audit resulting in this auditors' report is Murray Suey.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
March 22, 2021

Consolidated Statements of Financial Position

($ thousands)	Note	As at December 31, 2020	As at December 31, 2019
Assets			
Current assets			
Cash and cash equivalents		2,830	607
Accounts receivable	5	17,232	54,020
Prepaid expenses and deposits		322	86
Total current assets		20,384	54,713
Restricted cash	19	300	306
Right of use assets	6	1,529	445
Property, plant and equipment, net	7	480,664	543,364
Total assets		**502,877**	**598,828**
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	8	28,327	108,773
Financial derivative liability	19	10,020	261
Lease liability	6	472	453
Total current liabilities		38,819	109,487
Senior credit facility	9	221,915	188,589
Preferred share obligation	11	97,048	87,380
Lease liability	6	1,145	-
Decommissioning obligation	10	6,250	6,313
Deferred income tax liability	16	-	5,858
Total liabilities		**365,177**	**397,627**
Shareholders' equity			
Common shares	12	198,925	200,630
Preferred share equity component	11	7,510	7,510
Contributed surplus	12	6,968	6,191
Accumulated deficit		(74,671)	(12,686)
Accumulated other comprehensive loss		(1,032)	(444)
Total shareholders' equity		**137,700**	**201,201**
Commitments	17		
Subsequent events	21		
Total liabilities and shareholders' equity		**502,877**	**598,828**

See accompanying notes to the consolidated financial statements

Consolidated Statements of Operations and Comprehensive Income (Loss)

		Year ended December 31,	
($ thousands, except per share amounts)	**Note**	**2020**	**2019**
Revenue			
Petroleum and natural gas	13	143,506	165,258
Less: Royalties		(26,255)	(32,477)
Petroleum and natural gas, net of royalties		117,251	132,781
Realized loss on financial derivatives	19	(4,727)	-
Unrealized loss on financial derivatives	19	(10,386)	(266)
Total revenue		**102,138**	**132,515**
Expenses			
Operating		36,905	29,465
Transportation	13	11,473	7,340
General and administrative		5,401	4,489
Depreciation and depletion	6,7	66,128	46,986
Impairment	7	24,000	-
Finance expense	15	25,445	18,370
Share-based compensation	12	922	1,375
Total expenses		**170,274**	**108,025**
Income (loss) before income taxes		(68,136)	24,490
Deferred income tax expense (recovery)	16	(6,151)	9,163
Net income (loss)		**(61,985)**	**15,327**
Currency translation adjustment		(588)	(9,581)
Comprehensive income (loss)		**(62,573)**	**5,746**
Net income (loss) per share:			
Basic	14	(0.33)	0.08
Diluted	14	(0.33)	0.08

See accompanying notes to the consolidated financial statements

Consolidated Statements of Changes in Shareholders' Equity

($ thousands, except share amounts)	Voting Common Shares	Share Capital	Preferred Share Equity Component	Contributed Surplus	Accumulated 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	(1,074,615)	(596)	-	-	-	-	(596)
Settlement of share bonus awards	502,007	575	-	(1,032)	-	-	(457)
Share-based compensation, gross	-	-	-	1,779	-	-	1,779
Net income	-	-	-	-	15,327	-	15,327
Other comprehensive loss	-	-	-	-	-	(9,581)	(9,581)
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 share bonus awards	1,207,825	154	-	(272)	-	-	(118)
Share-based compensation, gross	-	-	-	1,049	-	-	1,049
Net loss	-	-	-	-	(61,985)	-	(61,985)
Other comprehensive loss	-	-	-	-	-	(588)	(588)
December 31, 2020	**188,528,453**	**198,925**	**7,510**	**6,968**	**(74,671)**	**(1,032)**	**137,700**

See accompanying notes to the consolidated financial statements

Consolidated Statements of Cash Flows

		Year ended December 31,	
($ thousands)	**Note**	**2020**	**2019**
Operating activities			
Net income (loss)		(61,985)	15,327
Operating items not affecting cash:			
Depreciation and depletion	6,7	66,128	46,986
Impairment	7	24,000	-
Gain on sale of other assets		(19)	-
Deferred income tax expense (recovery)	16	(6,151)	9,163
Unrealized loss on financial derivatives	19	10,386	266
Share-based compensation	12	922	1,375
Finance expense	15	25,445	18,370
Change in non-cash working capital	20	11,265	(12,951)
Cash provided by operating activities		**69,991**	**78,536**
Investing activities			
Additions to property, plant, and equipment	7	(35,197)	(229,696)
Acquisitions	7	-	(7,007)
Proceeds from sale of other assets		23	-
Change in non-cash working capital	20	(56,256)	51,402
Cash used in investing activities		**(91,430)**	**(185,301)**
Financing Activities			
Proceeds from senior credit facility, net	9	39,520	123,286
Payment of interest and preferred dividends	11	(14,031)	(15,340)
Payment of lease liabilities	6	(479)	(245)
Settlement of share bonus awards	12	(118)	(457)
Purchase of common shares for cancellation	12	(1,859)	(383)
Cash provided by financing activities		**23,033**	**106,861**
Change in cash and cash equivalents		1,594	96
Effect of foreign exchange rate changes		629	20
Cash and cash equivalents, beginning of year		**607**	**491**
Cash and cash equivalents, end of year		**2,830**	**607**

See accompanying notes to the consolidated financial statements

Notes to the Consolidated Financial Statements
As at December 31, 2020 and 2019 and for the years then ended

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. 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.

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 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 reflected in these financial statements and as described herein; however, there could be a further prospective material impact in future periods.

Note 2. Basis of Presentation

Basis of Measurement and Statement of Compliance

These 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 financial statements. The Company's accounting policies have been applied consistently for all periods presented in these consolidated financial statements.

These consolidated financial statements were approved by the Chair of the Audit Committee and the Executive Chairman on March 22, 2021 having been duly authorized to do so by the Board of Directors.

Principles of Consolidation

The consolidated financial statements include the accounts of PetroShale Inc. and its wholly owned subsidiary, PetroShale (US), Inc. The Company's accounts reflect the proportionate share of the assets, liabilities, revenues, expenses, and cash flows from the Company's oil and gas activities that are conducted jointly with third parties. In preparing the consolidated financial statements, all intercompany transactions have been eliminated.

Functional and Presentation Currency

The Company's 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, 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 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.

Transactions of the US subsidiary that are denominated in a currency other than the US dollar are translated to the US dollar using the following method: monetary assets and liabilities are translated at the exchange rate in effect at the date of the consolidated statement of financial position; non-monetary assets and liabilities are translated at the exchange rate on the date such assets or liabilities are assumed; and revenues and expenses are translated at the average rate for the period. Realized gains and losses resulting therefrom are reflected in the consolidated statement of operations as foreign exchange gain or loss.

Use of Estimates, Judgments and Assumptions

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, judgments, and assumptions.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the consolidated financial statements. These underlying assumptions are based on historical experience and other factors that management believes to be reasonable under the circumstances, and are subject to change as new events occur, as more industry experience is acquired, as additional information is obtained, and as the Company's operating environment changes.

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

Identification of cash generating units

The Company's assets are aggregated into cash generating units for the purpose of calculating impairment. The aggregation of assets into a cash generating unit ("CGU" or "CGUs") is based on an assessment of the unit's ability to generate independent cash inflows. The determination of individual CGUs is based on management's judgment regarding shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Impairment of property, plant and equipment

Judgments are required to assess when impairment, or impairment reversal, indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of tight oil and shale gas reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of undeveloped land and other relevant assumptions.

Deferred income taxes

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key Sources of Estimation Uncertainty

The following are key estimates and the assumptions made by management affecting the measurement of balances and transactions in the consolidated financial statements:

Reserve estimates

The estimation of recoverable quantities of proved and probable tight oil and shale 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, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion and depreciation of property, plant and equipment.

Decommissioning obligation

The Company estimates the decommissioning obligations for oil and 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 bonus 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.

Note 3. Summary of Significant Accounting Policies

Business Combinations

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued, and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of an acquisition over the fair value of the identifiable assets acquired net of liabilities assumed is recorded as goodwill. If the cost of an acquisition is less than the fair value of the net assets of the business acquired, the difference is recognized in the consolidated statement of operations and comprehensive income.

Revenue Recognition

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

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

Cash and Cash Equivalents

The Company considers investments in all highly liquid instruments with original maturities of three months or less at the date of purchase to be cash equivalents. The Company maintains cash in accounts that may not be federally insured beyond certain limits; however, the Company has not experienced any losses in such accounts and believes there is no exposure to any significant credit risk.

Leased Assets

At inception of a contract, the Company assesses whether a contract is, or contains a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company recognizes a right-of-use asset and a lease obligation at the lease commencement date. The right-of-use asset is initially measured based on the initial amount of the lease obligation adjusted for any lease payments made at or before the commencement date. The assets are depreciated over the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of future economic benefits.

The lease obligation is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Lease components are included in the present value calculation of lease payments, with non-lease components expensed as incurred. Variable lease payments that do not depend on an index or rate are not included in the measurement of the lease obligation. The lease obligation is subsequently measured at amortized cost using the effective interest rate method.

Property, Plant and Equipment ("PP&E")

The Company has two categories of PP&E: Developed and Producing assets ("D&P assets) and Other PP&E assets. D&P assets include capital costs (i) related to drilling projects where the drilling location is already determined to hold proved and probable reserves, (ii) incurred to improve an already technically feasible and commercially viable well, and (iii) related to facilities and equipment projects. Other PP&E includes furniture, fixtures, leasehold improvements, software, and office equipment. For presentation purposes, both D&P assets and Other PP&E are included in the PP&E category on the consolidated statement of financial position.

Recognition and measurement

PP&E is measured at cost less accumulated depreciation and depletion and accumulated impairment losses. For the purposes of determining depreciation and depletion, when significant parts of PP&E have different useful lives, they are accounted for separately so that depreciation and depletion rates appropriately reflect useful lives.

Gains and losses on disposal of PP&E, including property swaps and farm-outs of oil and gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the PP&E sold, and are recognized on a net basis in profit or loss.

The net carrying value of D&P assets is depleted using the unit-of-production method by calculating the ratio of production in the period to the related proved and probable reserves. Proved and probable reserves are expressed on a barrels of oil equivalent ("Boe") basis where natural gas volumes are converted to Boe using a ratio of 6,000 cubic feet of natural gas to one barrel of oil. The net carrying value to be depleted includes an estimate of future development costs required to bring any related non-producing or undeveloped reserves into production, which may include the costs of drilling and completing wells. These estimates are reviewed at least annually by independent engineers in conjunction with their evaluation of the Company's proved and probable reserves.

Depreciation for substantially all other property, plant and equipment is provided using the straight-line method based on the estimated useful lives of assets less any estimated residual value. The useful lives of assets are estimated based upon the period the asset is expected to be available for use by the Company. Residual values are based upon the estimated amount that would be obtained on disposal; net of any costs associated with the disposal. Other property, plant and equipment held under finance leases are depreciated over the shorter of the lease term and the estimated useful life of the asset.

Depreciation and depletion rates for all capitalized costs associated with the Company's activities are reviewed at least annually, or when events or conditions occur that impact capitalized costs, reserves, and estimated service lives.

Capitalized overhead

The Company capitalizes to D&P assets certain directly attributable general and administrative costs, including share-based compensation, associated with employees and consultants involved in acquiring licenses or other approvals and drilling, completion, and construction activities on the Company's operated lands.

Impairment

For the purposes of impairment testing, assets are grouped into the smallest group of assets that generate independent cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

Impairment testing of PP&E is performed as facts and circumstances suggest by comparing the carrying amount of D&P assets to their recoverable amount. The recoverable amount is the greater of (i) the assets' value in use, and (ii) its fair value less selling costs. In assessing value in use for D&P assets, the estimated future cash flows from the production of proved and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognized in prior periods are assessed at each reporting date to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the PP&E carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the consolidated statement of operations and comprehensive income.

Subsequent costs

Subsequent costs are capital costs incurred to improve an existing D&P asset (such as a well) that is technically feasible and commercially viable. These costs are capitalized as D&P assets only if they increase the future economic benefits of the asset. All other expenditures are expensed in the consolidated statement of operations and comprehensive income as incurred. These improvement costs include costs of further developing proved and probable reserves or enhancing production. The costs of routine maintenance of D&P assets are recognized in the consolidated statement of operations and comprehensive income as incurred. The carrying value of any replaced or sold component is derecognized.

Decommissioning Obligation

An obligation is recognized if, as a result of a past event, the Company has a future legal or constructive obligation resulting from the retirement and reclamation of tangible long-lived assets and this obligation can be reliably estimated. The obligation is measured at the present value of management's best estimate of the expected expenditures required to settle this obligation and is recorded in the period the related assets are put into use with a corresponding increase to the carrying amount of the related assets. This increase in capitalized costs is depleted and depreciated on a basis consistent with the underlying assets.

Subsequent changes in the estimated fair value of the obligation are capitalized and depleted over the remaining useful life of the underlying asset.

The obligation is carried in the consolidated statement of financial position at its discounted present value and is accreted over time for the change in its present value. The obligation is discounted at a rate that reflects a current market assessment of the time value of money and the risks specific to the obligation. Accretion of the obligation is included in finance expense in the consolidated statement of operations.

Income Taxes

Current income taxes are measured at the amount expected to be payable on taxable income for the period, using tax rates enacted or substantively enacted at the end of the reporting period.

The Company follows the asset and liability method of accounting for deferred income taxes. Under this method, deferred income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of statement of financial position items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Share-based Compensation

The Company uses the fair value method to recognize the cost associated with stock options granted to employees, directors, and other service providers. The fair value of the stock options granted is measured using the Black-Scholes option pricing model. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Under the fair value method, the Company recognizes estimated compensation expense related to stock options over the vesting period of the options granted, with the related credit being charged to contributed surplus. Fair value is measured at the grant date and each vesting tranche is recognized using the graded vesting method over the period during which the options vest. At each reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. Upon exercise of any stock options, amounts previously credited to contributed surplus are reversed and credited to share capital.

Share-based awards to employees, directors and other service providers are measured at the market share price as at the date of grant. A forfeiture rate is estimated on the grant date and the related compensation expense is recognized over the vesting period of the share bonus awards, using the graded vesting method, with the related credit being charged to contributed surplus.

Earnings Per Share

Basic earnings per common share are calculated by dividing the net earnings for the period by the weighted average number of common shares outstanding in each respective period. Diluted earnings per common share reflect the maximum possible dilution from other securities, if dilutive.

Financial Instruments

Non-derivative financial instruments
These comprise cash and cash equivalents including bank overdrafts, accounts receivable, accounts payable and loans and borrowings. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

- Cash and cash equivalents in the consolidated statement of financial position comprise cash at banks and on hand and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents defined above, net of outstanding bank overdrafts. These balances are reflected at cost.

- Other non-derivative financial instruments, such as loans and borrowings, accounts receivable and accounts payable, are measured at amortized cost using the effective interest method, less any impairment losses.

Derivative financial instruments

The Company may enter into certain financial derivative contracts in order to manage its exposure to market risks from fluctuations in commodity prices, interest rates and foreign exchange rates. These instruments are not used for trading or speculative purposes. The Company will not designate its financial derivative contracts as effective accounting hedges, and thus will not apply hedge accounting, even though the Company considers all commodities contracts to be economic hedges. As a result, all financial derivative contracts will be classified as fair value through profit or loss and recorded in the consolidated statement of financial position at fair value with changes in fair value recognized in net income. Related transaction costs such as trading commissions will be recognized in the consolidated statement of operations when incurred.

Forward physical delivery and sales contracts of crude oil and natural gas products are entered into in the normal course of business and therefore not recorded at fair value in the consolidated statement of financial position. These physical delivery contracts are not considered to be derivative financial instruments or hedges. Settlements on these physical delivery contracts are recognized in petroleum and natural gas revenue in the consolidated statement of operations.

Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and stock options are recognized as a reduction from equity, net of any tax effects.

Preferred Share Compound Financial Instrument

Preferred shares which include both an equity conversion feature and a redemption obligation on the part of the Company are considered a compound financial instrument for accounting purposes. Such an instrument requires the Company to value each of the liability and equity residual components of the instrument and present them separately on the consolidated statement of financial position. The Company determines the fair value of the liability component by discounting contractual dividend and redemption payments over the term of the preferred shares at the rate of interest that would apply to a similar financial instrument without a conversion option. The liability component is presented as “preferred share obligation” under non-current liabilities on the consolidated statement of financial position and the equity residual component is presented as “preferred share equity component” under shareholders’ equity on the consolidated statement of financial position. Related transaction and issuance costs reduce the carrying amounts of each of the liability and equity residual components on a pro rata basis. The liability component is accreted to the redemption amount of the preferred shares over the term of the preferred shares to maturity, with the related accretion expense included in finance expense on the consolidated statement of operations.

Comprehensive Income

Comprehensive income consists of net earnings and other comprehensive income (loss) (“OCI”). OCI is comprised of the change in the fair value of any derivative instruments accounted for as effective hedges and, the exchange gains and losses arising from the translation of foreign operations with a functional currency that is not Canadian dollars. Amounts included in OCI are shown net of tax. Accumulated OCI is presented in the consolidated statement of financial position under shareholders’ equity.

Changes to 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 consolidated financial statements.

Note 4. Determinations of Fair Value

Several of the Company's accounting policies require a determination of fair value for certain assets and liabilities. Fair value for measurement or disclosure purposes is determined on the following basis.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques include the market, income, and cost approaches. The market approach uses information generated by market transactions involving identical or comparable assets or liabilities; the income approach converts estimated future amounts to a present value; and the cost approach is based on the amount that currently would be required to replace an asset.

The Company is required to classify its financial instruments within a hierarchy that prioritizes the inputs to fair market value. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in an active market for identical assets or liabilities

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly

Level 3 – Inputs that are not based on observable market data

Property, plant and equipment

The fair value of property, plant and equipment recognized in a business combination is based on market value. The market value of PP&E is the estimated amount for which PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted with knowledge and prudence and without compulsion. The market value of crude oil and natural gas interests included in PP&E is estimated with reference to the discounted future cash flows expected to be derived from crude oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

Cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities

The fair value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, and senior loan are estimated as the present value of related future cash flows, discounted at the market rate of interest at the reporting date. As at December 31, 2020 and 2019, the fair value of cash and cash equivalents, accounts receivable and accounts payable approximated their carrying value due to their short-term maturity.

Derivatives

The Company does not engage in the use of any derivative instruments for speculative purposes. If the Company enters into any contracts for the future delivery of non-financial assets, these are done in accordance with its expected sale requirements. As such, these contracts are not considered to be derivative instruments and have not been recorded at fair value in the consolidated financial statements. As the Company delivers petroleum products in accordance with the terms of these contracts, any associated revenue will be recorded as petroleum and natural gas revenue. The fair value of financial forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the consolidated statement of financial position date, using the remaining underlying amounts and a risk-free interest rate. The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices, and interest rates. The Company classifies its derivative financial instruments as Level 2 in the fair value hierarchy.

Share-based compensation

The fair value of share-based awards is measured using current market value at the related grant date. Measurement inputs include current market value of the Company's shares with consideration of an expected forfeiture rate.

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility of the underlying share price (based on historical experience), weighted average expected life of the option (based on historical experience and general option holder behavior), expected dividends, forfeiture rate and the risk-free interest rate (based on government bonds).

Senior credit facility and preferred share obligation

The fair value of the Senior Credit Facility approximates the carrying value as it bears a floating rate of interest and the margin charged by the lenders is indicative of current credit spreads. The preferred share obligation includes a quarterly dividend obligation at a fixed rate that the Company would expect to pay for similar financing transactions and accordingly the fair value approximates the carrying value.

Note 5. Accounts Receivable

($ thousands)	**As at December 31, 2020**	**As at December 31, 2019**
Accounts receivable – petroleum and natural gas	15,386	32,559
Accounts receivable – joint interest billing and other	1,846	21,461
Total	**17,232**	**54,020**

Note 6. 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

($ thousands)	
January 1, 2019	**298**
Additions	415
Depreciation	(253)
Effect of foreign currency rate changes	(15)
December 31, 2019	**445**
Additions	1,901
De-recognition	(242)
Depreciation	(502)
Effect of foreign currency rate changes	(73)
December 31, 2020	**1,529**

Lease Liability

($ thousands)	
January 1, 2019	298
Additions	415
Payments	(245)
Effect of foreign currency rate changes	(15)
December 31, 2019	**453**
Additions	1,901
De-recognition	(247)
Payments	(479)
Lease interest expense	65
Effect of foreign currency rate changes	(76)
December 31, 2020	**1,617**

Note 7. 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	35,175	(1)	35,174
Capitalized share-based compensation	127	-	127
Decommissioning obligation	(32)	-	(32)
Impairment	(24,000)	-	(24,000)
Depreciation and depletion	(65,504)	(122)	(65,626)
Effect of foreign currency rate changes	(8,344)	1	(8,343)
December 31, 2020	**480,644**	**20**	**480,664**

Depreciation, Depletion, and Future Development Costs

For the years ended December 31, 2020 and 2019, PetroShale recorded $65.5 million and $46.5 million, respectively, of depreciation and depletion expense on its developed and producing assets, which reflected an estimated US$304.8 million and US$332.9 million, respectively, of future development costs associated with proved plus probable reserves.

Non-Producing Property Acquisitions

During the year ended December 31, 2019, the Company purchased oil and gas leases in its focus areas in North Dakota. These acquisitions represent increased working interests in drilling units with associated proved undeveloped and probable reserves. The consideration for these leases for the years ended December 31, 2019 was approximately $7.3 million. There were no assumptions of liabilities associated with these purchases.

Impairment

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, and future capital expenditures. In future periods, previous impairments may be reversed up to the original carrying value less any associated DD&A if the estimated recoverable amounts of the D&P assets exceed their carrying amount.

During the first quarter of 2020, PetroShale recognized an impairment charge of $24.0 million on the Company's D&P assets. 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, combined with a price war fueled by Russia and Saudi Arabia. The recoverable amount 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 discounted at a rate of 14% per annum. Commodity prices were 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 Company's D&P assets in connection with the impairment determination in the first quarter of 2020:

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 December 31, 2020, the Company evaluated its D&P assets for indicators of impairment or impairment reversal of previously recognized impairment and determined that none were present and therefore the measurement of impairment loss or reversal was not deemed necessary.

Capitalized Overhead

During the year ended December 31, 2020, the Company capitalized $0.6 million of general and administrative costs and $0.1 million 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 ($1.1 million and $0.4 million, respectively, for the year ended December 31, 2019).

Note 8. Accounts Payable and Accrued Liabilities

($ thousands)	As at December 31, 2020	As at December 31, 2019
Trade payables	8,579	56,425
Accrued liabilities	8,902	35,677
Revenue payable	10,846	16,671
Total	**28,327**	**108,773**

Note 9. Senior Credit Facility

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 "Senior Credit Facility"). As at December 31, 2020, the net amount drawn under the Senior Credit Facility was US$172.1 million representing US$174.4 million of borrowings under the Senior Credit Facility less US$2.3 million of cash on hand. Advances under the Senior 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 Senior 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 Senior Credit Facility is available on a revolving basis until June 26, 2021, at which point, the Senior 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 Senior Credit Facility is secured by a fixed and floating charge debenture on substantially all the Company's assets.

The Senior Credit Facility borrowing base is subject to redetermination on a periodic basis and at least twice annually by the lenders, based primarily on producing tight oil and shale 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. As part of the Recapitalization Agreements, the lenders to the Senior Credit Facility recently affirmed the borrowing base at US$177.5 million and extended the facility to June 25, 2022, at which point the facility can be extended, at the option of the lenders or, if not extended, it will convert to a term loan maturing on June 24, 2023. Refer to Note 21.

The Company was in compliance with terms of the Senior Credit Facility at December 31, 2020. For the year ended December 31, 2020, the effective interest rate on the outstanding borrowings under the Senior Credit Facility was 4.5% (4.5% for the year ended December 31, 2019).

Note 10. Decommissioning Obligation

($ thousands)	**Year ended December 31, 2020**	**Year ended December 31, 2019**
Beginning of year	6,313	4,934
Obligations incurred	20	1,956
Obligations acquired	-	275
Change in estimated future cash flows	(52)	(718)
Accretion	135	133
Effect of foreign currency rate changes	(166)	(267)
End of year	**6,250**	**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 $6.3 million as at December 31, 2020 ($6.3 million at December 31, 2019) based on a total future undiscounted liability of $9.4 million ($13.7 million at December 31, 2019). At December 31, 2020 management estimates that these payments are expected to be made over the next 40 years in accordance with estimates prepared by independent engineers. As at December 31, 2020, a risk-free interest rate of 1.7% (2.6% at December 31, 2019) and an inflation rate of 1.4% (2.4% at December 31, 2019) were used to calculate the present value of the decommissioning obligation.

Note 11. Preferred Shares

($ thousands, except share amounts)	Number of Shares	Liability Component	Equity Component
December 31, 2018	**75,000**	**88,912**	**7,510**
Accretion	-	2,568	-
Effect of foreign currency rate changes	-	(4,100)	-
December 31, 2019	**75,000**	**87,380**	**7,510**
Paid in-kind dividends	-	8,850	-
Accretion	-	2,744	-
Effect of foreign currency rate changes	-	(1,926)	-
December 31, 2020	**75,000**	**97,048**	**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 paid-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, August, and November 2020, in kind, and as disclosed in Note 21, has also elected to do the same in respect of its dividend due in February 2021 and the dividend which accrues to March 31, 2021 as part of the Recapitalization Agreements.

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. As part of the Recapitalization Agreements, the Company and the holder of the preferred shares have agreed to revise the exchange price from $2.40 per share to $0.60 per share and to exchange all of the preferred shares to common shares at the amended exchange price. Refer to Note 21.

Note 12. 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 December 31, 2020, the Company had 188,528,453 voting common shares (191,185,628 at December 31, 2019), no non-voting common shares and 42,953,105 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 11). 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 special voting preferred shares will be cancelled, and the preferred shares (see Note 11) will be converted to common shares as part of the Recapitalization Agreements. Refer to Note 21.

The following table reflects the Company's outstanding common shares as at December 31, 2020:

($ thousands, except share amounts)	Shares	Share Capital
December 31, 2018	**191,758,236**	**200,651**
Purchase of common shares for cancellation	(1,074,615)	(596)
Settlement of restricted share bonus awards	502,007	575
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	1,207,825	154
December 31, 2020	**188,528,453**	**198,925**

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 was permitted to purchase up to 11,785,163 voting common shares of the Company between February 10, 2020 and February 8, 2021. During 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. In 2019, the Company purchased 1,074,615 shares under the NCIB at an average price of $.55/share for a total repurchase cost of $0.6 million. No further purchases were made in 2021 and the NCIB expired Feb 8, 2021.

Stock Options

The following table presents stock option transactions for the year ended December 31, 2020 and 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	-	-	-
December 31, 2020	**550,000**	**0.70**	**0.55**

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 2.0 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.

	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	3,604,300	4,854,200	8,458,500	0.15
Settled	(2,044,047)	(96,603)	(2,140,650)	(0.80)
Forfeited and expired	(672,194)	(1,105,057)	(1,777,251)	(0.48)
December 31, 2020	**3,301,027**	**4,242,740**	**7,543,767**	**0.41**

Note 13. Revenue

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

	Year ended December 31,	
($ thousands)	**2020**	**2019**
Petroleum and natural gas	143,506	165,258

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 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 consolidated statement of operations.

Note 14. Net Income (Loss) per Common Share

	Year ended December 31,	
($ thousands, except share and per share amounts)	**2020**	**2019**
Net income (loss)	(61,985)	15,327
Weighted average common shares outstanding - basic	188,240,502	191,920,373
Weighted average common shares outstanding - diluted	195,784,268	194,395,182
Net income (loss) per share - basic	(0.33)	0.08
Net income (loss) per share – diluted	(0.33)	0.08

The Subsidiary Issuer has issued 75,000 preferred shares which are convertible, at the Investor's option, to 42,953,105 common shares of the Company at a fixed price of $2.40 per share, subject to certain conditions. See Notes 11 and 21. The preferred shares and stock options are not currently considered dilutive.

Note 15. Finance Expense

	Year ended December 31,	
($ thousands)	**2020**	**2019**
Preferred share dividends	11,792	8,957
Senior credit facility interest	10,081	6,687
Preferred share accretion, net	2,744	2,568
Decommissioning obligation accretion	135	133
Operating lease and other	693	25
Total finance expense	**25,445**	**18,370**

Note 16. Income Taxes

The components of income tax expense (recovery) are as follows:

	Year ended December 31,	
($ thousands)	**2020**	**2019**
Current tax expense/(recovery)	-	-
Canada	-	-
United States	-	-
Total current tax expense/(recovery)	-	-
Deferred tax expense/(recovery)		
Canada	-	-
United States	(6,151)	9,163
Total deferred tax expense/(recovery)	(6,151)	9,163
Total income tax expense/(recovery)	**(6,151)**	**9,163**

The provision for income taxes recorded in the consolidated financial statements varies from the amount that would be computed by applying the Canadian statutory rate of 24.00% as a result of the following reconciling differences:

	Year ended December 31,	
($ thousands)	**2020**	**2019**
Income/(loss) before taxes		
Canada	(1,765)	(2,065)
United States	(66,371)	26,555
Total income/(loss) before taxes	(68,136)	24,490
Canadian statutory rate	24.00%	26.50%
Expected income tax	(16,353)	6,490
Impact on income taxes resulting from:		
Foreign and statutory rate differences	(729)	(371)
Non-deductible expenses	3,079	2,778
Impact of rate change and other	11	391
Change in valuation allowance	7,841	(125)
Income tax expense/(recovery)	**(6,151)**	**9,163**

The following tables provide details of the deferred income tax asset (liability):

($ thousands)	**December 31, 2019**	**Recognized in Earnings**	**Recognized in Equity**	**December 31, 2020**
Deferred income tax liabilities				
Property, plant and equipment	(25,944)	4,961	(871)	(21,854)
Preferred shares	(2,531)	749	(86)	(1,868)
Deferred income tax assets				
Net operating losses	19,736	3,322	664	23,722
Stock compensation	663	(663)	-	-
Accrued bonuses	450	(450)	-	-
Decommissioning obligation	1,585	(1,585)	-	-
Other	183	(183)	-	-
Total deferred income tax liability	**(5,858)**	**6,151**	**(293)**	**-**

($ thousands)	**December 31, 2018**	**Recognized in Earnings**	**Recognized in Equity**	**December 31, 2019**
Deferred income tax liabilities				
Property, plant and equipment	(16,786)	(9,158)	-	(25,944)
Preferred shares	(2,531)	-	-	(2,531)
Deferred income tax assets				
Net operating losses	20,777	(1,041)	-	19,736
Stock compensation	274	389	-	663
Accrued bonuses	323	127	-	450
Decommissioning obligation	1,244	341	-	1,585
Other	5	178	-	183
Total deferred income tax liability	**3,306**	**(9,165)**	**-**	**(5,858)**

Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

($ thousands)	**As at December 31, 2020**	**As at December 31, 2019**
Property, plant and equipment	449	478
Debt issuance costs	2,305	3,895
Stock compensation	554	-
Accrued bonus	1,227	-
Decommissioning obligation	6,251	-
Non-capital losses	20,749	11,464
Capital losses	1,478	1,478
Other	11,650	-
	44,663	**17,315**

The Company has a non-capital loss balance of $13.9 million for Canadian tax purposes which expires between 2031 and 2040. The Company has a non-capital loss balance of $102.0 million for US tax purposes, $77.7 million of which will expire between 2031 and 2037 and $24.3 million which do not expire.

Note 17. 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 18. Related Party Transactions

Key management personnel include the Chief Executive Officer (CEO) of the Company, the former Interim CEO (who resigned in August 2020), the Chief Financial Officer (CFO), the former CFO (who resigned in November 2020), and the directors and other officers of the Company.

	Years Ended December 31,	
($ thousands)	**2020**	**2019**
Salaries and other short-term benefits	1,676	2,649
Share-based compensation	208	1,295
Total compensation	**1,884**	**3,944**

Note 19. Financial Instruments and Risk Management

Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, restricted cash, accounts payable, senior credit facility, 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 credit facility approximates the carrying amount due the floating rate of interest and the margin charged by the lending 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 consolidated statements of financial position:

($ thousands)	**As at December 31, 2020**	**As at December 31, 2019**
Three-way Collars	10,020	261
Total	**10,020**	**261**

Derivatives and Hedging Activity

The Company may use swaps, collars, and options to reduce the effect of commodity price changes on a portion of its future tight oil, shale gas, and natural gas liquids production or to manage its exposure to interest and foreign exchange rate fluctuations. The objective of the Company's use of derivative financial instruments is to achieve more predictable cash flows. In an environment of volatile oil and gas prices, commodity price derivatives are used to manage the Company's exposure to commodity price risk. While the use of these derivative instruments limits the downside risk of adverse price movements, such use may also limit the Company's ability to benefit from favorable price movements. The Company may, from time to time, add incremental derivatives to hedge additional production, restructure existing derivative contracts or enter into new transactions to modify the terms of current contracts in order to realize the current value of the Company's existing positions. The Company does not enter into derivative contracts for speculative purposes.

The Company's commodity derivative financial instruments are measured at fair value and are included in the statements of financial position as financial derivative assets or liabilities. Unrealized gains and losses are recorded based on the changes in the fair values of the derivative instruments. Both the unrealized and realized gains and losses resulting from the contract settlement of derivatives are recorded in the statement of operations.

The use of derivatives involves the risk that the counterparty to such instruments will be unable to meet the financial terms of such contracts. The amount of unrealized loss recognized in the consolidated statement of operations related to the Company's derivative financial instruments was $10.4 million for the year ended December 31, 2020 ($0.3 million unrealized loss for the year ended December 31, 2019). As at December 31, 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.

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

As at December 31, 2020, the Company had the following oil price derivative contracts outstanding:

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**

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.

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 tight oil and shale gas and joint operations receivables. Sales of tight oil and shale gas production from the Company's operated properties are made to large industry purchasers. Joint operations receivables are from participants in the tight oil and shale 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.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meets its financial obligations as they become due. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its short-term and long-term financial obligations when due, under both normal and unusual conditions, without incurring unacceptable losses. As at December 31, 2020, the Company had a net working capital deficit of $8.4 million, excluding a financial derivative liability of $10.0 million, which is $4.4 million greater than the undrawn capacity of the senior credit facility of $4.0 million. The financial liabilities in the consolidated statement of financial position consist of accounts payable and accrued liabilities, which are all considered due within one year, and the senior credit facility 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 December 31, 2020 is approximately $28.3 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, August 2020, and November 2020 on its outstanding preferred shares. The Company also elected to settle in kind the payment of quarterly dividends due in February 2021. Refer to Note 21.

The following are the contractual maturities of the Company's debt and preferred share obligations and anticipated timing of settlements of its other financial liabilities as at December 31, 2020, including estimated interest and dividend payments:

($ thousands)	**Contractual Cash Flow**	**2021**	**2022**	**2023**	**2024**	**2025**
Accounts payable and accrued liabilities	28,327	28,327	-	-	-	-
Lease liability	1,617	472	359	239	262	285
Senior credit facility [(1)]	237,215	10,323	226,892	-	-	-
Preferred share obligation [(2)]	123,059	9,386	9,386	104,287	-	-

(1) Includes future interest expense at the rate of 4.66% being the rate applicable at December 31, 2020 to the current maturity date of June 25, 2022.

(2) The amount differs from that presented on the 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 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 assuming it is paid in cash at the coupon rate. These preferred shares may be converted to common shares at the option of the investor. Refer to Note 21 of the Consolidated Financial Statements.

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 December 31, 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 $2.2 million for the year ended December 31, 2020.

Capital Management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital expenditure program, which includes expenditures on oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including: current economic conditions; the risk characteristics of the Company's petroleum and natural gas assets; the depth of its investment opportunities; current and forecasted net debt levels; current and forecasted commodity prices; and other factors that influence realized commodity prices and funds flow from operations such as quality and basis differential, royalties, operation costs and transportation and processing costs. The Company considers its capital structure to include working capital, any debt, preferred shares, and shareholders' equity. The Company monitors capital based on current funds flow from operations compared to forecasted capital and operating requirements.

In order to maintain or adjust the capital structure, the Company will consider: its forecasted funds flow from operations while attempting to finance an acceptable capital expenditure program which may in the future include acquisition opportunities; the current level of credit available from its lenders; the level of credit that may become available from its lenders as a result of petroleum and natural gas reserve growth; the availability of other sources of debt with different characteristics than bank debt; the sale of assets; limiting the size of the capital expenditure program and new equity if available on favorable terms. The Company's share capital is not subject to external restrictions. Access to any bank credit facility is determined by the lenders and is generally based upon the lenders' borrowing base models which are based upon the Company's petroleum and natural gas reserves.

Note 20. Supplemental Cash Flow Disclosures

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

	Year ended December 31,	
(in thousands)	**2020**	**2019**
Source (use) of cash:		
Accounts receivable	36,788	(27,343)
Prepaid expenses and deposits	(236)	94
Accounts payable and accrued liabilities	(80,446)	64,725
	(43,894)	**37,476**
Related to operating activities	11,265	(12,951)
Related to investing activities	(56,256)	51,402
Accrued and unpaid dividends on preferred shares	(44)	328
Accrued purchase of common shares	-	213
Difference due to foreign exchange	1,141	(1,516)
	(43,894)	**37,476**
Interest and preferred dividends paid	(14,031)	15,340

Note 21. Subsequent Events

PetroShale elected to exercise its right to settle in kind the payment of the quarterly dividend due in February 2021 on its outstanding preferred shares.

In the first quarter of 2021, the Company executed multiple costless collar and swap derivative contracts hedging the Company's oil production in 2022. The first half of 2022 swaps average 375 barrels of oil per day ("Bopd") at a weighted average price of US$49.34. The first half of 2022 costless collars average 2,000 Bopd at a weighted average floor price of US$46.37 and weighted average ceiling price of US$59.48. The second half of 2022 costless collars average 500 Bopd at a weighted average floor price of US$45.00 and weighted average ceiling price of US$63.15.

On March 4, 2021, the Company entered into a series of agreements (the "Recapitalization Agreements") with its largest common shareholder (M. Bruce Chernoff, our Executive Chairman and a director), the Investor, and the Company's bank lending syndicate.

The Recapitalization Agreements provide for the following:

- The Company has commenced a rights offering (the "Rights Offering") with its current shareholders by issuing to holders of the outstanding common shares of record at the close of business on March 11, 2021 (the "Record Date") one right for each common share held (each, a "Right") to subscribe for one common share for each Right, at $0.20 per share.
- Mr. Chernoff, through an entity of which he is a significant shareholder ("Chernoffco") has agreed to invest a minimum of $12.9 million through a private placement and backstop the proceeds from the Rights Offering to ensure that the Company will receive at least $20 million from his private placement and the Rights Offering, at $0.20 per share.
- First Reserve has agreed to convert the entirety of its existing preferred shares to common shares at a conversion price of $0.60 per share and invest $10 million in PetroShale via a private placement at $0.20 per share in conjunction with the Rights Offering.

- The Company has reached an agreement in principle with the lenders under its credit facility whereby such lenders have agreed, subject to the satisfaction of certain conditions, including the concurrent completion of the Recapitalization Agreements, to maintain the borrowing base at US$177.5 million and extend the maturity date of the credit facility to June 2023 subject to certain criteria.

Depending on participation of existing common shareholders, the Recapitalization Agreements and Rights Offering will raise a minimum of $30.0 million, and up to $60.6 million, of additional equity for the Company. Net proceeds from the equity offerings will be initially applied to reduce amounts drawn on the Senior Credit Facility.