Management's Discussion and Analysis & Interim Consolidated Financial Statements

As at March 31, 2021 and for the three months ended March 31, 2021 and 2020

Table of Contents

Management's Discussion and Analysis 3
Financial and Operational Highlights 5
Additional Information 24
Interim Consolidated Statements of Financial Position 25
Interim Consolidated Statements of Operations and Comprehensive Loss 26
Interim Consolidated Statements of Changes in Shareholders' Equity 27
Interim Consolidated Statements of Cash Flows 28
Notes to the Interim Consolidated Financial Statements 29

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 May 19, 2021. This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements as at March 31, 2021 and for the three months ended March 31, 2021 and 2020, and the audited interim consolidated financial statements as at and for the years ended December 31, 2020 and 2019. 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 March 31,	
($ thousands)	**2021**	**2020**
Cash flow provided by operating activities	15,893	38,837
Change in non-cash working capital	(826)	(13,810)
Adjusted EBITDA	**15,067**	**25,027**

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

($ thousands)	**As at March 31, 2021**	**As at December 31, 2020**
Total liabilities	380,706	365,177
Decommissioning obligation	(5,635)	(6,250)
Financial derivative liability	(23,381)	(10,020)
Lease liability	(1,482)	(1,617)
Total current assets	(31,923)	(20,384)
Net Debt	**318,285**	**326,906**

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, estimated average production range during 2021, methods the Company will use to monitor cash flow, 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 economic climate on PetroShale and the adverse effect on the Company's liquidity and its ability to generate income and cash flows, and its customers, the Company's derivative instruments, the terms thereof and the anticipated benefits, the term out and maturity dates of the senior credit facility, and terms of contractual obligations and other commercial commitments, 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, impact of the COVID-19 pandemic and the ability of the Company to carry on operations as contemplated in light of the COVID-19 pandemic, determinations by OPEC and other countries as to production levels, 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 impact (and the duration thereof) that the COVID-19 pandemic will have on (i) the demand for tight oil, shale gas and NGLs, (ii) our supply chain, including our ability to obtain the equipment and services we require, and (iii) our ability to produce, transport and/or sell our tight oil, shale gas and NGLs; 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 "operating netback" 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 March 31,	
	2021	**2020**
Financial *($ thousands, except share amounts)*		
Petroleum and natural gas revenue	43,405	49,110
Cash provided by operating activities	15,893	38,837
Net loss	(44,424)	(17,266)
Per share - diluted	(0.24)	(0.09)
Adjusted EBITDA [(1)]	15,067	25,027
Capital expenditures, net	2,127	23,537
Net debt [(1)]	318,285	363,089
Number of common shares outstanding:		
Weighted average – basic	188,543,702	188,937,046
Weighted average - diluted	197,304,468	191,940,212
Operating		
Number of days	90	91
Daily production: [(2)]		
Tight oil (Bbls)	6,376	10,155
Shale gas (Mcf)	11,288	12,230
Natural gas liquids (Bbls)	1,851	2,081
Barrels of oil equivalent	10,108	14,275
Average realized price:		
Tight oil ($/Bbl)	69.39	53.93
Shale gas ($/Mcf)	4.14	2.02
Natural gas liquids ($/Bbl)	25.73	7.82
Netback ($ per Boe): [(1)]		
Petroleum and natural gas revenue	47.71	37.81
Royalties	(8.74)	(7.08)
Realized loss on financial derivatives	(8.05)	0.48
Lease operating costs	(5.42)	(5.03)
Workover expense	(1.38)	(0.69)
Production taxes	(3.38)	(3.12)
Transportation expense	(2.17)	(2.39)
Operating netback [(1)]	18.57	19.98
Operating netback prior to hedging [(1)]	26.62	19.50

(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.

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 initiated a process to optimize the capital structure, reduce 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 (the Company's Executive Chairman and a director), a company of which Mr. M. Bruce Chernoff is a significant shareholder ("ChernoffCo"), 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 provided for the following:

- The Company completed 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. The Rights Offering subsequently closed on April 8, 2021.
- In lieu of participating in the Rights Offering, ChernoffCo invested $14.1 million in PetroShale via a private placement at $0.20 per common share which closed concurrently with the Rights Offering.
- First Reserve converted 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, invested $10 million in PetroShale via a private placement at $0.20 per common share closing concurrently with the Rights Offering.
- The Company raised a combined $30.0 million of equity via the Rights Offering, the ChernoffCo private placement, and the First Reserve private placement.
- The Company reached an agreement with the lenders under its credit facility whereby such lenders agreed to maintain the borrowing base at US$177.5 million and extend the term-out date of the credit facility to June 25, 2022, at which point, the facility can be extended at the option of the lenders or converted to a one-year term loan.
- As the conditions precedent to completing the Recapitalization Agreements were complete as of March 31, 2021, the Company has recognized a $27.4 million non-cash loss on modification of the preferred shares during the three-month period ended March 31, 2021.

Subsequent to completion of the Recapitalization Agreements, the Company's borrowing base was reaffirmed at US$177.5 million.

For the calendar year 2021, the Company expects to invest approximately $50.0-$60.0 million of capital, achieve annual average production between 10,500 Boepd and 11,500 Boepd during 2021, and generate free cash flow at current market commodity prices to reduce the credit facility balance and continue to optimize the Company's capital structure.

Results of Operations

Production

	Three months ended March 31,		
	2021	**2020**	**% change**
Tight oil (Bbls per day)	6,376	10,155	(37.2)
Shale gas (Mcf per day)	11,288	12,230	(7.7)
Natural gas liquids (Bbls per day)	1,851	2,081	(11.1)
Total (Boe per day)	10,108	14,275	(29.2)
Liquids percentage of total	81.4	85.7	(5.0)

Tight oil and shale gas production during the three months ended March 31, 2021 was lower than the comparable prior year period as a result of natural decline rates and temporary shut-ins following operated and non-operated well workover activity. The decrease in production for the quarter ended March 31, 2021 compared to the prior period is due primarily to reduced capital spending in the last half of 2020 and the first quarter of 2021 to preserve financial liquidity and resulting natural production declines from wells brought online in late 2019. A total of 62 gross (16.3 net) wells had first sales during 2019 with 39 gross (3.3 net) wells coming online throughout 2020. There were 19 gross (0.15 net) wells brought online in the first quarter of 2021. Production during the quarter ended March 31, 2021 was comprised of 63.1% tight oil, 18.3% natural gas liquids, and 18.6% shale gas compared to 71.1% tight oil, 14.6% natural gas liquids, and 14.3% shale gas in 2020.

Pricing

	Three months ended March 31,		
	2021	**2020**	**% change**
Average Benchmark Prices (US$)			
Crude oil – WTI (per Bbl)	57.84	46.17	25.3
Natural gas – HH spot (per Mmbtu)	4.56	1.91	138.7
Average Differential (US$)			
Crude oil (per Bbl)	(3.03)	(6.04)	(49.8)
Natural gas (per Mcf) (1)	(1.29)	(0.41)	214.6
Average Realized Prices (US$) (2)			
Tight oil (per Bbl)	54.81	40.13	36.6
Shale gas (per Mcf)	3.27	1.50	118.0
Natural gas liquids (per Bbl)	20.33	5.82	249.3
Average Realized Prices (CAD$) (2)			
Tight oil (per Bbl)	69.39	53.93	28.7
Shale gas (per Mcf)	4.14	2.02	105.0
Natural gas liquids (per Bbl)	25.73	7.82	229.0

(1) Includes conversion from Mmbtu to Mcf

(2) Excluding transportation and processing costs

As a result of the reductions in demand due to the COVID-19 pandemic and geopolitically driven supply imbalances, WTI crude oil prices began to precipitously decline in March of 2020. Through the second half of 2020, oil prices began to rebound

with substantial increases in the first quarter of 2021. The average basis differential for crude oil has substantially improved during the three months ended March 31, 2021 after widening throughout the majority of 2020.

Henry Hub benchmark natural gas prices were significantly lower in the first quarter of 2020 compared to prior periods 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 2020 and improving in the first quarter of 2021.

Revenues and Royalties

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Petroleum and natural gas revenue	43,405	49,110	(11.6)
Less: royalties	(7,953)	(9,192)	(13.5)
Petroleum and natural gas revenue, net	35,452	39,918	(11.2)
Royalties as a percentage of revenue	18.3%	18.7%	(2.1)
Per Boe amounts:			
Petroleum and natural gas revenue	47.71	37.81	26.2
Less: royalties	(8.74)	(7.08)	23.4
Petroleum and natural gas revenue, net	38.97	30.73	26.8

The decrease in revenues during the quarter ended March 31, 2021 compared to the prior year period is primarily due to decreased production, and partially offset by the increase in realized commodity prices as discussed above.

The Company's royalty rate as a percentage of revenues decreased slightly during the three-month period March 31, 2021, as compared to the prior year periods primarily due to varying royalty rates on different producing leases.

Realized and Unrealized Gain (Loss) on Financial Derivatives

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Realized gain (loss) on financial derivatives	(7,323)	625	(1,271.7)
Unrealized gain (loss) on financial derivatives	(13,521)	1,855	(817.3)
Realized gain (loss) on financial derivatives per Boe	(8.05)	0.48	(1,777.1)

The Company realized losses on its financial derivatives in the three months ended March 31, 2021 due to improving oil prices during the period and hedges that were entered into during the volatile oil markets of 2020. With improving forward oil prices, the Company incurred an unrealized loss on financial derivatives outstanding at March 31, 2021.

Operating Expense

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Lease operating costs	4,930	6,528	(24.5)
Workover expense	1,258	897	40.2
Production taxes	3,072	4,054	(24.2)
Total operating expense	9,260	11,479	(19.3)
Per Boe amounts:			
Lease operating costs	5.42	5.03	7.8
Workover expense	1.38	0.69	100.0
Production taxes	3.38	3.12	8.3
Total operating expense	10.18	8.84	15.2
Production taxes – % of revenue	8.7%	10.2%	(14.7)

Lease operating costs

Lease operating costs for the three months ended March 31, 2021 decreased over the prior year period due to reduced production volumes versus the same period in the prior year. Lease operating costs per Boe were consistent during the three-month period ended March 31, 2021 compared to the same period in 2020.

Workover expense

Workover expense by its nature can vary from period to period depending on the level of workover activity, which may not be consistent with production levels. Workover expense increased period over period in absolute and per Boe terms as the Company performed workovers on several of its operated wells.

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 slightly lower than statutory rates for the three-month period ended March 31, 2021, and lower than the previous year as a higher concentration of taxes were attributable to NGLs and shale gas in the current period. Production taxes per Boe are higher than the comparable prior year period due to improved shale gas and NGL pricing and are consistent with the changes in the Company's average realized prices as discussed in the Pricing section above.

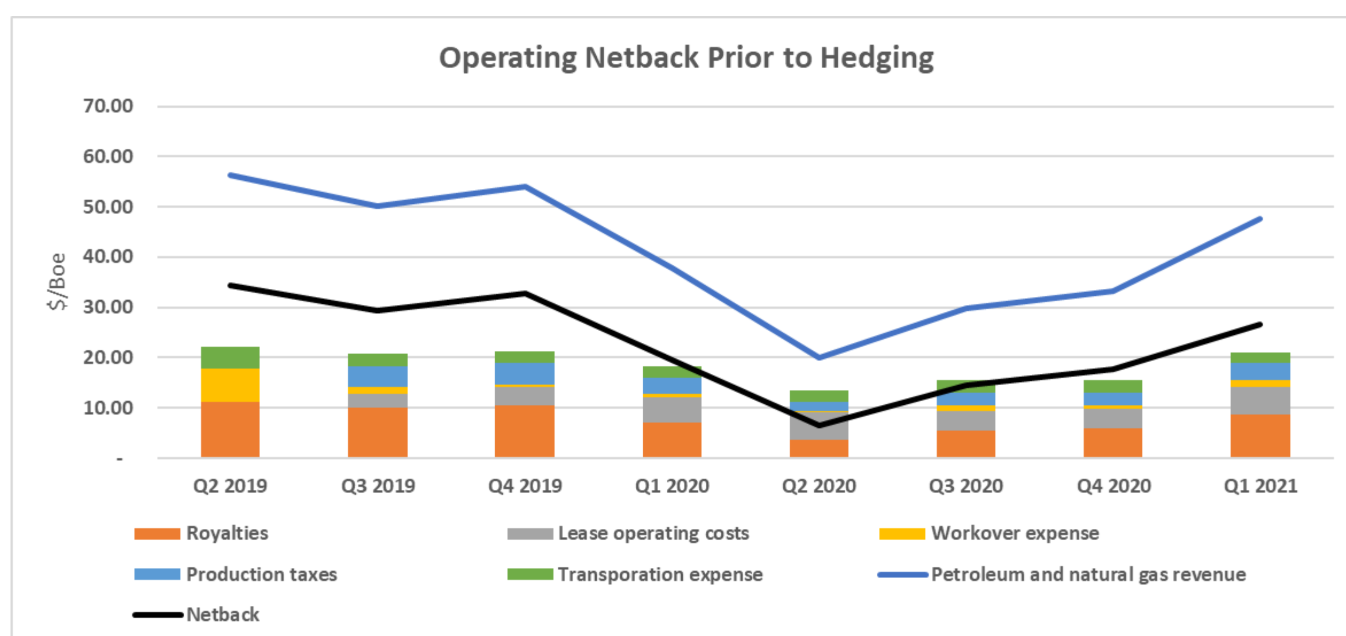
Transportation expense

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Transportation expense	1,977	3,103	(36.3)
Transportation expense per Boe	2.17	2.39	(9.2)

Transportation costs associated with the Company's petroleum production are netted against the related revenue if they are incurred following the transfer of control to the entity which has purchased the commodity. If transportation costs are incurred prior to the sale of the production, such costs are reflected separately as an expense in the consolidated statement of operations. Transportation costs were lower in the three-month period ended March 31, 2021 when compared to the same period in 2020 due to the decrease in production volumes in the first quarter of 2021. Transportation expense per Boe was consistent with the prior period.

Operating Netback

($ per Boe)	Three months ended March 31, 2021	2020	% change
Petroleum and natural gas revenue	47.71	37.81	26.2
Royalties	(8.74)	(7.08)	23.4
Realized (loss) gain on financial derivatives	(8.05)	0.48	(1,777.1)
Lease operating costs	(5.42)	(5.03)	7.8
Workover expense	(1.38)	(0.69)	100.0
Production taxes	(3.38)	(3.12)	8.3
Transportation expense	(2.17)	(2.39)	(9.2)
Operating netback	18.57	19.98	(7.1)
Operating netback prior to hedging	26.62	19.50	36.5



General and Administrative ("G&A") Expense

($ thousands except where noted)	Three months ended March 31, 2021	2020	% change
Gross G&A expense	2,084	1,405	48.3
Capitalized G&A	(122)	(249)	(51.0)
Overhead recovery	(137)	(222)	(38.3)
Net G&A expense	1,825	934	95.4
Net G&A expense per Boe	2.01	0.72	179.2

Overall, gross and net G&A for the three-month period ended March 31, 2021 increased when compared to the prior year period. The increase is due to costs associated with the Recapitalization Agreements, increased consulting expense, 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 three months ended March 31, 2021 increased versus the prior year due to the decrease in production and increase in gross G&A costs.

Depreciation and Depletion Expense

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Depreciation and depletion expense	10,961	18,706	(41.4)
Depreciation and depletion expense per Boe	12.05	14.40	(16.3)

Depreciation and depletion expense, on an absolute dollar and per Boe basis, decreased during the three-month period ended March 31, 2021 as compared to the prior period due to the reduced capital base following the impairment recorded in the first quarter of 2020 as well as reduced production volumes versus the same period in the prior year.

Impairment

	Three months ended March 31,		
($ thousands except where noted)	**2021**	**2020**	**% change**
Impairment	-	24,000	(100.0)
Impairment per Boe	-	18.48	(100.0)

The Company evaluates its developed and producing ("D&P") assets for impairment indicators that may suggest the carrying value of these assets may not be recoverable. If such impairment indicators exist, impairment 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 the 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 March 31, 2021, there were no indicators of impairment or impairment reversal.

Finance Expense

	Three months ended March 31,		
($ thousands)	**2021**	**2020**	**% change**
Preferred share dividends	3,984	2,267	75.7
Senior credit facility interest	2,635	2,205	19.5
Preferred share accretion, net	683	713	(4.2)
Decommissioning obligation accretion	21	42	(50.0)
Operating lease and other	27	11	145.5
Total finance expense	**7,350**	**5,238**	**40.3**

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 slightly higher year over year reflecting higher senior debt levels. Preferred share dividends increased year over year due to payment-in-kind of preferred share dividends in February and March 2021 and foreign currency fluctuation.

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 March 31, 2021, the Company determined that due to the uncertainty related to commodity prices, the generation of future taxable income was not probable and thus a deferred tax recovery and asset were not recorded.

Share-based Compensation

	Three months ended March 31,		
($ thousands)	**2021**	**2020**	**% change**
Gross share-based compensation	281	337	(16.6)
Capitalized share-based compensation	(22)	(54)	(59.3)
Net share-based compensation	**259**	**283**	**(8.5)**

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 pro rata, typically over a three-year period. 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 performance share bonus award 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 period ended March 31, 2021 versus the period ended March 31, 2020 due to increased capitalization of expense from restricted and performance share bonus awards/grants.

Foreign Currency Gain (Loss) and Translation Adjustment

	Three months ended March 31,	
	2021	2020
Foreign currency translation rates – US$/CAD$:		
Average period exchange rate	1.2661	1.3437
Ending period exchange rate	1.2602	1.4062

The Company's interim consolidated financial statements are reported in Canadian dollars, which is the Company's presentation currency. Transactions of the Company's US subsidiary are recorded in US dollars, its functional currency, as this is the primary economic environment in which the subsidiary operates. The assets, liabilities, and results of operations of the Company's US subsidiary are translated to Canadian dollars in the interim consolidated financial statements according to the Company's foreign currency translation policy, with any corresponding gain or loss reflected as a currency translation adjustment in other comprehensive income. The Company experienced a currency translation loss of $1.2 million for the period ended March 31, 2021 (2020 – gain of $15.8 million), due to a strengthening Canadian dollar relative to the US dollar during the period 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 forecasts reflect a significantly negative trend, 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 current and future financial capacity and liquidity before proceeding with additional wells on its operated lands.

As at March 31, 2021, the Company had a net working capital surplus of $2.7 million, excluding the current financial derivative liability of $23.0 million. Subsequent to the completion of the Recapitalization Agreements, the Senior Credit Facility balance was further reduced to approximately US$150.4 million, or US$145.3 million net of available cash. The available borrowing base was reaffirmed at US$177.5 million and the Company has no other debt obligations. The Company intends to continue to invest in capital expenditures at a reduced pace and, at current commodity prices, to generate free cash flow and continue to reduce the senior credit facility balance.

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 $15.9 million for the three months ended March 31, 2021 as compared to $38.8 million for the comparable period in the prior year. During the three-month period March 31, 2021, adjusted EBITDA declined due to decreased production and a lower netback after hedging losses. Net cashflow provided by operating activities also declined due to a $13.0 million reduced contribution from changes in non-cash working capital.

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 March 31, 2021, the Company had various oil price derivative contracts outstanding. The table below represents the weighted average price for each contract type by fiscal quarter:

Contract Type	Quarter	Volume (Bbls/d)	Swap (US$)	Sold Put (US$)	Bought Put (US$)	Sold Call (US$)
Three-way collars						
	Q1 2021	5,000	-	24.40	38.15	46.35
	Q2 2021	5,500	-	24.55	38.23	47.34
	Q3 2021	5,500	-	24.55	38.23	47.34
	Q4 2021	5,500	-	24.55	38.23	47.34
Costless collars						
	Q1 2022	2,250	-	-	46.22	60.92
	Q2 2022	2,000	-	-	46.37	59.48
	Q3 2022	500	-	-	45.00	63.15
	Q4 2022	500	-	-	45.00	63.15
Fixed swaps						
	Q1 2022	500	49.53	-	-	-
	Q2 2022	250	48.95	-	-	-

Subsequent to the end of the reporting period, the Company entered into additional derivative contracts. The table below represents the weighted average price for each contract type by fiscal quarter as at May 19, 2021:

Contract Type	Quarter	Volume (Bbls/d)	Swap (US$)	Sold Put (US$)	Bought Put (US$)	Sold Call (US$)
Three-way collars						
	Q2 2021	5,500	-	24.55	38.23	47.34
	Q3 2021	5,500	-	24.55	38.23	47.34
	Q4 2021	5,500	-	24.55	38.23	47.34
Costless collars						
	Q1 2022	2,250	-	-	46.22	60.92
	Q2 2022	2,500	-	-	47.10	60.53
	Q3 2022	1,250	-	-	48.00	62.76
	Q4 2022	1,250	-	-	48.00	62.76
Fixed swaps						
	Q1 2022	500	49.53	-	-	-
	Q2 2022	250	48.95	-	-	-

Capital Expenditures

	Three months ended March 31,		
($ thousands)	**2021**	**2020**	**% change**
Drilling and completion	2,100	23,535	(91.1)
Other, net	27	2	1,250.0
	2,127	23,537	(91.0)
Non-cash:			
Capitalized share-based compensation	22	54	163.0
Decommissioning obligation	(578)	-	-
Total capital expenditures	**1,571**	**23,591**	**(92.8)**

Capital expenditures related to D&P activity for the three months ended March 31, 2021 were funded from operating cash flows. Capital expenditures in 2021 were mainly related to operated and non-operated well workover activities as well as facilities expansion. In the current environment, the Company is cautiously investing in capital expenditures at a reduced pace to maintain and optimize production, as demonstrated by the low expenditure levels in the current period and the three months ended December 31, 2020.

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 reaffirmed at US$177.5 million as at March 31, 2021 by the lending syndicate. Subsequent to the completion of the Recapitalization Agreements, the term-out date was extended to June 25, 2022, at which point, the facility can be extended at the option of the lenders or converted to a one-year term loan. The amount of the facility is subject to a borrowing base test performed on a periodic basis based primarily on producing oil and natural gas reserves and using commodity prices estimated by the lender as well as other factors. The next scheduled borrowing base redetermination is May 31, 2022. 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 March 31, 2021. The credit facility has no financial covenants.

As at May 19, 2021, outstanding borrowings under the senior credit facility were US$149.3 million. The Company held cash of US$4.5 million for net borrowings of US$144.8 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. In April 2021, the Company utilized gross proceeds from the Rights Offering to reduce the amount drawn under the senior credit facility by approximately $28.9 million (US$22.9 million).

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 to its dividend due in February 2021 and in respect to dividends accruing to the date the preferred shares were converted to common shares as part of the Recapitalization Agreements (paid-in-kind March 2021). The Company paid cash dividends for the period of April 1 through April 8, 2021. Refer also to Notes 9 and 17 in the Company's consolidated financial statements.

Share Capital

	As at May 19, 2021	As at March 31, 2021	As at December 31, 2020
Weighted average common shares outstanding:			
Basic		188,543,702	188,240,502
Diluted		197,304,468	195,784,268
Outstanding securities:			
Common shares	520,832,038	188,556,240	188,556,240
Preferred shares, convertible	-	75,000	75,000
Stock options	550,000	550,000	550,000
Restricted share bonus awards	5,079,598	3,518,026	3,251,027
Performance share bonus awards	9,602,238	5,242,740	4,242,740

On completion of the transactions pursuant to the Recapitalization Agreements in April 2021, the preferred shares were converted to common shares and the voting rights associated with the preferred shares were cancelled.

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 the quarter ended March 31, 2020, the Company purchased and cancelled 3,851,500 shares at an average price of $0.48 per common share for a total repurchase cost of $1.9 million under the NCIB. On April 1, 2020, the Company ceased making further purchases under the NCIB and no further purchases were made in 2020 or 2021. The NCIB expired on Feb 8, 2021 and was not renewed.

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 March 31, 2021:

($ thousands)	Contractual Cash Flow	2021	2022	2023	2024	2025
Accounts payable and accrued liabilities	28,718	28,718	-	-	-	-
Lease liability	1,482	360	344	237	259	282
Senior credit facility [(1)]	241,834	7,616	10,109	224,109	-	-
Preferred share obligation [(2)]	112,154	112,154	-	-	-	-

(1) Includes future interest expense at the rate of 4.61% being the rate applicable at March 31, 2021 to the currently established maturity date of June 25, 2023.

(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. These preferred shares were subsequently converted to common shares at the option of the investor pursuant to the Recapitalization Agreements.

Off-Balance Sheet Arrangements

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

Letters of Credit

The Company has an outstanding letter of credit in favor of the energy regulator in North Dakota in the amount of US$75,000. As security, the Company has set aside an equivalent amount in cash at the financial institution that issued the letter of credit. In addition, the Company has advanced funds to other regulatory agencies of US$160,000 as security in order to operate in North Dakota.

Summary of Quarterly Results

($ thousands except where noted)	**Mar 31 2021**	**Dec 31 2020**	**Sep 30 2020**	**Jun 30 2020**	**Mar 31 2020**	**Dec 31 2019**	**Sep 30 2019**	**Jun 30 2019**
Revenues, net of royalty	35,452	30,564	26,949	19,820	39,918	48,883	42,249	24,419
Adjusted EBITDA	15,067	15,204	10,217	8,278	25,027	35,567	29,996	16,344
Cash flow – operating activities	15,893	13,326	1,491	16,336	38,837	27,677	32,275	(1,626)
Net income (loss)	(44,424)	(12,417)	(9,134)	(23,169)	(17,266)	9,609	4,982	1,733
Net income (loss) per share:								
Basic and Diluted	(0.24)	(0.07)	(0.05)	(0.12)	(0.09)	0.05	0.03	0.01

In the first quarter of 2021, revenues and cash flow from operating activities increased versus the prior quarter primarily as a result of improved pricing while Adjusted EBITDA remained relatively consistent due to the offsetting impacts of a higher operating netback and lower production.

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.

Critical Accounting Estimates

The timely preparation of the interim 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 interim consolidated financial statements and the reported amounts of revenue and expenses during the period. Actual results may differ from these estimates.

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

Reserve Estimates

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

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

Impairment

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).

COVID-19 Impacts and Oil Pipeline Egress

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 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 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 the 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$62.36/Bbl in March 2021 and forward strip pricing has been in excess of US$65/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.

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 this particular 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. A decision by the DCCOA in January 2021 allows DAPL to remain operational while the USACE prepares the EIS. In a May 3, 2021 court filing, USACE indicated that the court ordered EIS would likely be completed in March 2022 and that the agency intends to allow pipeline to continue transporting crude, unless the DC District Court rules otherwise. Both the State of North Dakota and the MHA Nation have issued recent statements and legal petitions in support of DAPL's continued operations. Energy Transfer, the owner of the DAPL, filed a motion at the end of April asking the U.S. Supreme Court to intervene in the ongoing legal battle; it remains uncertain whether the case will be taken up by the highest U.S. court. In the event the DAPL is required to shut down, 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. 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.

Interim Consolidated Statements of Financial Position

(Unaudited)

($ thousands)	Note	As at March 31, 2021	As at December 31, 2020
Assets			
Current assets			
Cash and cash equivalents		7,732	2,830
Accounts receivable	3	23,939	17,232
Prepaid expenses and deposits		252	322
Total current assets		31,923	20,384
Restricted cash	14,15	297	300
Right of use assets	4	1,386	1,529
Property, plant and equipment, net	5	466,804	480,664
Total assets		**500,410**	**502,877**
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	6	28,718	28,327
Financial derivative liability	15	22,974	10,020
Lease liability	4	467	472
Total current liabilities		52,159	38,819
Senior credit facility	7,17	218,411	221,915
Preferred share obligation	9,17	103,079	97,048
Financial derivative liability	15	407	-
Lease liability	4	1,015	1,145
Decommissioning obligation	8	5,635	6,250
Total liabilities		**380,706**	**365,177**
Shareholders' equity			
Common shares	10,17	198,932	198,925
Preferred share equity component	9,17	34,910	7,510
Contributed surplus	10	7,237	6,968
Accumulated deficit		(119,095)	(74,671)
Accumulated other comprehensive loss		(2,280)	(1,032)
Total shareholders' equity		**119,704**	**137,700**
Commitments	14		
Subsequent events	17		
Total liabilities and shareholders' equity		**500,410**	**502,877**

See accompanying notes to the interim consolidated financial statements

Interim Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

		Three months ended March 31,	
($ thousands, except per share amounts)	**Note**	**2021**	**2020**
Revenue			
Petroleum and natural gas	11	43,405	49,110
Less: Royalties		(7,953)	(9,192)
Petroleum and natural gas, net of royalties		35,452	39,918
Realized (loss) gain on financial derivatives	15	(7,323)	625
Unrealized (loss) gain on financial derivatives	15	(13,521)	1,885
Total revenue		**14,608**	**42,428**
Expenses			
Operating		9,260	11,479
Transportation	11	1,977	3,103
General and administrative		1,825	934
Depreciation and depletion	4,5	10,961	18,706
Impairment	5	-	24,000
Finance expense	13	7,350	5,238
Share-based compensation	10	259	283
Loss on modification of preferred shares	9	27,400	-
Total expenses		**59,032**	**63,743**
Loss before income taxes		(44,424)	(21,315)
Deferred income tax recovery		-	(4,049)
Net loss		**(44,424)**	**(17,266)**
Currency translation adjustment		(1,248)	15,771
Comprehensive loss		**(45,672)**	**(1,495)**
Net loss per share:			
Basic	12	(0.24)	(0.09)
Diluted	12	(0.24)	(0.09)

See accompanying notes to the interim consolidated financial statements

Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

($ thousands, except share amounts)	Voting Common Shares	Share Capital	Preferred Share Equity Component	Contributed Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
December 31, 2019	**191,185,628**	**200,630**	**7,510**	**6,191**	**(12,686)**	**(444)**	**201,201**
Purchase of common shares for cancellation	(3,851,500)	(1,857)	-	-	-	-	(1,857)
Settlement of share bonus awards	-	-	-	-	-	-	-
Share-based compensation, gross	-	-	-	337	-	-	337
Net loss	-	-	-	-	(17,266)	-	(17,266)
Other comprehensive income	-	-	-	-	-	15,771	15,771
March 31, 2020	**187,334,128**	**198,773**	**7,510**	**6,528**	**(29,952)**	**(15,771)**	**137,700**
December 31, 2020	**188,528,453**	**198,925**	**7,510**	**6,968**	**(74,671)**	**(1,032)**	**137,700**
Settlement of share bonus awards	27,787	7	-	(12)	-	-	(5)
Share-based compensation, gross	-	-	-	281	-	-	281
Net loss	-	-	-	-	(44,424)	-	(44,424)
Loss on modification of preferred shares	-	-	27,400	-	-	-	27,400
Other comprehensive loss	-	-	-	-	-	(1,248)	(1,248)
March 31, 2021	**188,556,240**	**198,932**	**34,910**	**7,237**	**(119,095)**	**(2,280)**	**119,704**

See accompanying notes to the interim consolidated financial statements

Interim Consolidated Statements of Cash Flows

(Unaudited)

		Three Months Ended March 31,	
($ thousands)	**Note**	**2021**	**2020**
Operating activities			
Net loss		(44,424)	(17,266)
Operating items not affecting cash:			
Depreciation and depletion	4,5	10,961	18,706
Impairment	5	-	24,000
Loss on modification of preferred shares	9	27,400	-
Deferred income tax recovery		-	(4,049)
Unrealized loss (gain) on financial derivatives	15	13,521	(1,885)
Share-based compensation	10	259	283
Finance expense	13	7,350	5,238
Change in non-cash working capital	16	826	13,810
Cash provided by operating activities		**15,893**	**38,837**
Investing activities			
Additions to property, plant, and equipment	5	(2,127)	(23,537)
Change in non-cash working capital	16	(4,610)	(21,368)
Cash used in investing activities		**(6,737)**	**(44,905)**
Financing Activities			
Proceeds from (repayments to) senior credit facility, net	7	(538)	29,408
Debt issuance costs	7	(828)	-
Payment of interest and preferred dividends	16	(2,759)	(4,594)
Payment of lease liabilities	4	(145)	(117)
Settlement of share bonus awards	10	(5)	-
Purchase of common shares for cancellation	10	-	(1,857)
Cash provided by (used in) financing activities		**(4,275)**	**22,840**
Change in cash and cash equivalents		4,881	16,772
Effect of foreign exchange rate changes		21	927
Cash and cash equivalents, beginning of period		**2,830**	**607**
Cash and cash equivalents, end of period		**7,732**	**18,306**

See accompanying notes to the interim consolidated financial statements

Notes to the Interim Consolidated Financial Statements
As at March 31, 2021 and for the three months ended March 31, 2021 and 2020

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.

Note 2. Basis of Presentation

Basis of Measurement and Statement of Compliance

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including International Accounting Standard 34, "Interim Financial Reporting" ("IAS 34"), and have been prepared following the same accounting policies and methods of computation as the annual consolidated financial statements for the year ended December 31, 2020. Income taxes on earnings or loss in the interim periods are accrued using the income tax rate that would be applicable to the expected total annual earnings or loss.

Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2020, which have been prepared in accordance with IFRS as issued by the IASB.

These interim consolidated financial statements were approved for issuance by the Board of Directors on May 19, 2021.

Use of Estimates, Judgments and Assumptions

The timely preparation of the interim 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 interim consolidated financial statements and the reported amounts of revenue and expenses during the period. Actual results may differ from these estimates, judgments, and assumptions.

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 have resulted 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 3. Accounts Receivable

($ thousands)	**As at March 31, 2021**	**As at December 31, 2020**
Accounts receivable – petroleum and natural gas	21,575	15,386
Accounts receivable – joint interest billing and other	2,364	1,846
Total	**23,939**	**17,232**

Note 4. Right of Use Assets and Lease Liability

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

Right of Use Assets

($ thousands)	
January 1, 2020	**445**
Additions	1,901
De-recognition	(242)
Depreciation	(502)
Effect of foreign currency rate changes	(73)
December 31, 2020	**1,529**
Depreciation	(128)
Effect of foreign currency rate changes	(15)
March 31, 2021	**1,386**

Lease Liability

($ thousands)	
January 1, 2020	**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**
Payments	(145)
Lease interest expense	25
Effect of foreign currency rate changes	(15)
March 31, 2021	**1,482**

Note 5. Property, Plant and Equipment

($ thousands)	Developed and Producing	Other	Total
December 31, 2019	**543,222**	**142**	**543,364**
Additions	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**
Additions, net	2,100	27	2,127
Capitalized share-based compensation	22	-	22
Decommissioning obligation	(578)	-	(578)
Depreciation and depletion	(10,827)	(6)	(10,833)
Effect of foreign currency rate changes	(4,598)	-	(4,598)
March 31, 2021	**466,763**	**41**	**466,804**

Depreciation, Depletion, and Future Development Costs

For the three months ended March 31, 2021 and 2020, PetroShale recorded $10.8 million and $18.6 million, respectively, of depreciation and depletion expense on its developed and producing ("D&P") assets, which reflected an estimated US$303.7 million and US$320.0 million, respectively, of future development costs associated with proved plus probable reserves.

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 depreciation and depletion 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 during that time. 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 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 have resulted 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 depreciation and depletion if the estimated recoverable amounts of the CGUs exceed their carrying amount. At March 31, 2021, 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 three months ended March 31, 2021, the Company capitalized $0.1 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 ($0.2 million and $0.1 million, respectively, for the three months ended March 31, 2020).

Note 6. Accounts Payable and Accrued Liabilities

($ thousands)	**As at March 31, 2021**	**As at December 31, 2020**
Trade payables	5,821	8,579
Accrued liabilities	7,010	8,902
Revenue payable	15,887	10,846
Total	**28,718**	**28,327**

Note 7. 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 March 31, 2021, the net amount drawn under the Senior Credit Facility was US$167.2 million representing US$174.0 million of borrowings under the Senior Credit Facility less $0.7 million of debt issuance costs and US$6.1 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.

On March 4, 2021, the Company entered into a series of agreements (the "Recapitalization Agreements") with its largest common shareholder, M. Bruce Chernoff (the Company's Executive Chairman and a director), a company of which Mr. M. Bruce Chernoff is a significant shareholder ("ChernoffCo"), the Investor, and the Company's bank lending syndicate. In association with the Recapitalization Agreements, the lenders extended the term-out date to June 25, 2022, at which point, the facility can be extended at the option of the lenders or converted to a one-year term loan. The Senior Credit Facility is secured by a fixed and floating charge debenture on substantially all the Company's assets. Subsequent to the completion of the Recapitalization Agreements, the net proceeds were applied to the Senior Credit Facility balance which further reduced to approximately US$150.4 million.

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. As part of the Recapitalization Agreements, the lenders to the Senior Credit Facility recently reaffirmed the borrowing base at US$177.5 million.

The Company was in compliance with terms of the Senior Credit Facility at March 31, 2021. For the three months ended March 31, 2021, the effective interest rate on the outstanding borrowings under the Senior Credit Facility was 4.7% (4.5% for the three months ended March 31, 2020).

Note 8. Decommissioning Obligation

($ thousands)	**Three months ended March 31, 2021**	**Year ended December 31, 2020**
Beginning of period	6,250	6,313
Obligations incurred	-	20
Change in estimated future cash flows	(578)	(52)
Accretion	21	135
Effect of foreign currency rate changes	(58)	(166)
End of period	**5,635**	**6,250**

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 $5.6 million at March 31, 2021 ($6.3 million at December 31, 2020) based on a total future undiscounted liability of $9.9 million ($9.4 million 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 March 31, 2021, a risk-free interest rate of 2.4% (1.7% at December 31, 2020) and an inflation rate of 1.7% (1.4% at December 31, 2020) were used to calculate the present value of the decommissioning obligation.

Note 9. Preferred Shares

($ thousands, except share amounts)	**Number of Shares**	**Liability Component**	**Equity Component**
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**
Paid in-kind dividends	-	6,290	-
Accretion	-	683	-
Loss on modification of preferred shares	-	-	27,400
Effect of foreign currency rate changes	-	(941)	-
March 31, 2021	**75,000**	**103,079**	**34,910**

In April 2021, the holder of the preferred shares exchanged all outstanding preferred shares into common shares. Refer to note 17.

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 had a maturity date of January 25, 2023, which could be extended at the option of the Investor by one year. The preferred shares entitled the Investor to a cumulative annual dividend of 9.0% per annum, payable quarterly. 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 2020, August 2020, November 2020, February 2021, and March 2021 in kind.

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.

Pursuant to the Recapitalization Agreements, the Company and the holder of the preferred shares 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 17. As the conditions precedent to completing the exchange were ratified at March 30, 2021, the Company recognized a $27.4 million non-cash loss on modification of preferred shares in the Consolidated Statements of Operations and Comprehensive Loss for the three-month period ended March 31, 2021. The loss is representative of the difference between the originally prescribed exchange price of $2.40 per share and the subsequently agreed upon exchange price of $0.60 per share, in respect of the number of common shares to be issues on conversion, using a common share valuation as of March 30, 2021.

Note 10. Share Capital

Common Shares

The Company's authorized share capital includes unlimited Class A preferred shares with rights and privileges to be determined by the Board of Directors prior to issuance, unlimited non-voting common shares, convertible into voting common shares on a 1 for 1 basis, and unlimited voting common shares. As at March 31, 2021, the Company had 188,556,240 voting common shares (188,528,453 at December 31, 2020), no non-voting common shares, and 45,568,949 special voting preferred shares (42,953,105 at December 31, 2020) outstanding. The special voting preferred shares were issued in conjunction with the preferred shares issued by the Subsidiary Issuer in January 2018 as well as in connection with the Company's election to pay its preferred share dividends in kind (see Note 9). The special voting preferred shares issued to the Investor entitle the Investor to the "as-exchanged" voting rights of the preferred shares but no other redemption or distribution rights and no claims on the Company's assets. The special voting preferred shares were subsequently cancelled, and the preferred shares (see Note 9) were converted to common shares as part of the Recapitalization Agreements. Refer to Note 17.

The following table reflects the Company's outstanding common shares as at March 31, 2021:

($ thousands, except share amounts)	**Shares**	**Share Capital**
December 31, 2019	**191,185,628**	**200,630**
Purchase of common shares for cancellation	(3,865,000)	(1,859)
Settlement of restricted share bonus awards	1,207,825	154
December 31, 2020	**188,528,453**	**198,925**
Settlement of restricted and performance share bonus awards	27,787	7
March 31, 2021	**188,556,240**	**198,932**

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 the quarter ended March 31, 2020, the Company purchased and cancelled 3,851,500 shares at an average price of $0.48 per common share for a total repurchase cost of $1.9 million under the NCIB. On April 1, 2020, the Company ceased making further purchases under the NCIB and no further purchases were made in 2020 or 2021. The NCIB expired on Feb 8, 2021 and was not renewed.

Stock Options

The following table presents stock option transactions for the three months ended March 31, 2021 and year ended December 31, 2020:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
December 31, 2019	**550,000**	**0.70**	**1.55**
Exercised	-	-	-
December 31, 2020	**550,000**	**0.70**	**0.55**
Exercised	-	-	-
March 31, 2021	**550,000**	**0.70**	**0.30**

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, 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**
Granted	267,000	1,000,000	1,267,000	0.21
Settled	(50,000)	-	(50,000)	(2.00)
March 31, 2021	**3,518,027**	**5,242,740**	**8,760,767**	**0.37**

Note 11. Revenue

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

	Three months ended March 31,	
($ thousands)	**2021**	**2020**
Petroleum and natural gas	43,405	49,110

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 12. Net Income (Loss) per Common Share

	Three months ended March 31,	
($ thousands, except share and per share amounts)	**2021**	**2020**
Net income (loss)	(44,424)	(17,266)
Weighted average common shares outstanding - basic	188,543,702	188,937,046
Weighted average common shares outstanding - diluted	197,304,468	191,940,212
Net loss per share - basic	(0.24)	(0.09)
Net loss per share – diluted	(0.24)	(0.09)

The Subsidiary Issuer has issued 75,000 preferred shares which had been convertible, at the Investor's option, to 45,568,949 common shares of the Company at a fixed price of $2.40 per share, subject to certain conditions. Subsequent to March 31, 2021, and in association with the Recapitalization Agreements, the preferred shares were converted to common shares. See Notes 9 and 17. For purposes of the net income (loss) per share calculation, the preferred shares and stock options are not considered dilutive as of March 31, 2021.

Note 13. Finance Expense

	Three months ended March 31,	
($ thousands)	**2021**	**2020**
Preferred share dividends	3,984	2,267
Senior credit facility interest	2,635	2,205
Preferred share accretion, net	683	713
Decommissioning obligation accretion	21	42
Operating lease and other	27	11
Total finance expense	**7,350**	**5,238**

Note 14. 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. These funds are held as restricted cash in the Interim Consolidated Statements of Financial Position.

Note 15. 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 March 31, 2021**	**As at December 31, 2020**
Fixed price swaps	504	-
Three-way Collars	22,452	10,020
Costless Collars	425	-
Total	**23,381**	**10,020**

Derivatives and Hedging Activity

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

The amount of unrealized loss recognized in the consolidated statement of operations related to the Company's derivative financial instruments was $13.5 million for the three months ended March 31, 2021 ($1.9 million unrealized gain for the three months ended March 31, 2020). As at March 31, 2021, the Company's derivative instruments consisted of the following types of instruments:

*Costless Collars / Three-way collar*s: 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 March 31, 2021, the Company had various oil price derivative contracts outstanding. The table below represents the weighted average price for each contract type by fiscal quarter:

Contract Type	Quarter	Volume (Bbls/d)	Swap (US$)	Sold Put (US$)	Bought Put (US$)	Sold Call (US$)
Three-way collars						
	Q1 2021	5,000	-	24.40	38.15	46.35
	Q2 2021	5,500	-	24.55	38.23	47.34
	Q3 2021	5,500	-	24.55	38.23	47.34
	Q4 2021	5,500	-	24.55	38.23	47.34
Costless collars						
	Q1 2022	2,250	-	-	46.22	60.92
	Q2 2022	2,000	-	-	46.37	59.48
	Q3 2022	500	-	-	45.00	63.15
	Q4 2022	500	-	-	45.00	63.15
Fixed swaps						
	Q1 2022	500	49.53	-	-	-
	Q2 2022	250	48.95	-	-	-

Subsequent to the end of the reporting period, the Company entered into additional derivative contracts. The table below represents the weighted average price for each contract type by fiscal quarter as at May 19, 2021:

Contract Type	Quarter	Volume (Bbls/d)	Swap (US$)	Sold Put (US$)	Bought Put (US$)	Sold Call (US$)
Three-way collars						
	Q2 2021	5,500	-	24.55	38.23	47.34
	Q3 2021	5,500	-	24.55	38.23	47.34
	Q4 2021	5,500	-	24.55	38.23	47.34
Costless collars						
	Q1 2022	2,250	-	-	46.22	60.92
	Q2 2022	2,500	-	-	47.10	60.53
	Q3 2022	1,250	-	-	48.00	62.76
	Q4 2022	1,250	-	-	48.00	62.76
Fixed swaps						
	Q1 2022	500	49.53	-	-	-
	Q2 2022	250	48.95	-	-	-

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 March 31, 2021, the Company had a net working capital surplus (current assets less current liabilities excluding derivatives) of $2.7 million, excluding the current financial derivative liability of $23.0 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, the preferred share obligation, lease liability, and derivative liability. 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 March 31, 2021 is approximately $28.7 million (December 31, 2020 - $28.3 million). It is the Company's general practice to pay suppliers within 60 days. In association with the Recapitalization Agreements, the Company's senior lenders reaffirmed the existing borrowing capacity and extended the term-out date to June 25, 2022, at which point, the facility can be extended at the option of the lenders or converted to a one-year term loan. In addition, as a result of the Recapitalization Agreements, the Company's preferred shares were converted to common shares of the Company. Refer to Note 17.

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 at March 31, 2021, including estimated interest and dividend payments:

($ thousands)	**Contractual Cash Flow**	**2021**	**2022**	**2023**	**2024**	**2025**
Accounts payable and accrued liabilities	28,718	28,718	-	-	-	-
Lease liability	1,482	360	344	237	259	282
Senior credit facility [1]	241,834	7,616	10,109	224,109	-	-
Preferred share obligation [2]	112,154	112,154	-	-	-	-

[1] Includes future interest expense at the rate of 4.61% being the rate applicable at March 31, 2021 to the currently established maturity date of June 25, 2023.

[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. These preferred shares were subsequently converted to common shares at the option of the investor pursuant to the Recapitalization Agreements.

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 at March 31, 2021, a 1 percent increase or decrease in the interest rate on floating rate debt would amount to an impact on income before tax of $0.6 million for the three months ended March 31, 2021.

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. 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 16. Supplemental Cash Flow Disclosures

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

	Three months ended March 31,	
(in thousands)	**2021**	**2020**
Source (use) of cash:		
Accounts receivable	(6,707)	27,264
Prepaid expenses and deposits	70	(235)
Accounts payable and accrued liabilities	(391)	(30,566)
	(6,246)	**(3,537)**
Related to operating activities	826	13,810
Related to investing activities	(4,610)	(21,368)
Accrued and unpaid dividends on preferred shares	(2,361)	(110)
Difference due to foreign exchange	(101)	4,131
	(6,246)	**(3,537)**
Interest and preferred dividends paid	(2,759)	(4,594)

Note 17. Subsequent Events

The direct implications of the Recapitalization Agreements, and the subsequently closed Rights Offering and private placements on April 8, 2021, are highlighted below:

- The Company completed 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. The Rights Offering subsequently closed on April 8, 2021.
- In lieu of participating in the Rights Offering, ChernoffCo invested $14.1 million in PetroShale via a private placement at $0.20 per common share which closed concurrently with the Rights Offering.
- First Reserve converted 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, invested $10 million in PetroShale via a private placement at $0.20 per common share closing concurrently with the Rights Offering.
- The Company raised a combined $30.0 million of equity via the Rights Offering, the ChernoffCo private placement, and the First Reserve private placement.
- The Company reached an agreement with the lenders under its credit facility whereby such lenders agreed to maintain the borrowing base at US$177.5 million and extend the term-out date of the credit facility to June 25, 2022, at which point, the facility can be extended at the option of the lenders or converted to a one-year term loan.
- As the conditions precedent to completing the Recapitalization Agreements were complete as of March 31, 2021, the Company has recognized a $27.4 million non-cash loss on modification of the preferred shares during the three-month period ended March 31, 2021.

On April 8, 2021, PetroShale paid the remaining accrued dividend due of $0.2 million in cash on its outstanding preferred shares which had accrued from April 1, 2021 to the date of conversion of preferred shares to common stock on April 8, 2021.

In April 2021, pursuant to the Company's Bonus Award Incentive Plan ("Plan"), an aggregate of 1,511,571 restricted share bonus awards and 4,359,498 performance share bonus awards were granted to certain officers and employees of PetroShale. The awards may be settled, at the Company's sole discretion, in cash and/or voting common shares of PetroShale, in accordance with the terms of the Plan.