

Condensed Consolidated Interim Financial Statements of

**SOUTHERN ENERGY CORP.**

For the three and nine months ended September 30, 2020 and 2019

(unaudited)

(Canadian Dollars)

# SOUTHERN ENERGY CORP.



Condensed Consolidated Interim Statement of Financial Position (unaudited)

(\$000s of Canadian Dollars)	September 30, 2020	December 31, 2019
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 840	\$ 424
Accounts receivable	1,939	2,399
Prepaid expenses and deposits	556	371
Derivative assets (Note 8)	292	819
	3,627	4,013
Derivative assets (Note 8)	-	120
Property, plant and equipment (Note 3)	32,216	44,308
Right-of-use assets	447	735
Total assets	\$ 36,290	\$ 49,176
<b>Liabilities and Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities	2,160	2,650
Royalties payable (Note 10)	5,751	5,589
Current portion of lease liabilities	476	382
Bank debt (Note 5)	17,960	-
Derivative liabilities (Note 8)	1,033	105
	27,380	8,726
Long-term liabilities		
Derivative liabilities (Note 8)	289	14
Convertible debentures	7,015	6,648
Lease liabilities	59	381
Bank debt (Note 5)	-	18,183
Decommissioning provisions (Note 4)	5,220	5,276
Total liabilities	39,963	39,228
Shareholders' equity (Note 6)		
Share capital	35,441	35,441
Equity component of convertible debenture	665	665
Warrants	1,195	1,195
Contributed surplus	4,332	4,095
Deficit	(46,007)	(30,962)
Accumulated other comprehensive income (loss)	701	(486)
	(3,673)	9,948
Total liabilities and shareholders' equity	\$ 36,290	\$ 49,176

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

# SOUTHERN ENERGY CORP.



Condensed Consolidated Interim Statement of Loss and Comprehensive Loss (unaudited)

	Three months ended		Nine months ended	
	September 30, 2020	2019	September 30, 2020	2019
(\$000s of Canadian Dollars, except for per share amounts)				
<b>Revenues</b>				
Petroleum and natural gas revenue (Note 11)	\$ 3,537	\$ 5,145	\$ 9,412	\$13,604
Royalties	(702)	(1,052)	(1,915)	(2,762)
	<u>2,835</u>	<u>4,093</u>	<u>7,497</u>	<u>10,842</u>
<b>Expenses</b>				
Production and operating	1,453	1,875	4,455	5,036
Transportation	80	110	145	280
Depletion, depreciation and amortization (Note 3)	1,254	1,794	3,708	3,989
Impairment (Note 3)	-	-	10,400	725
Loss (gain) on derivatives (Note 8)	1,297	(461)	(296)	(853)
Gain on dispositions (Note 3)	-	-	(338)	(120)
Financing (Note 12)	641	597	1,656	1,102
General and administrative	861	1,056	2,546	3,220
Share-based compensation	46	100	237	112
Transaction costs	-	192	-	580
Loss (gain) on foreign exchange	161	(89)	29	90
	<u>5,793</u>	<u>5,174</u>	<u>22,542</u>	<u>14,161</u>
<b>Net loss from continuing operations before income tax</b>	(2,958)	(1,081)	(15,045)	(3,319)
Income tax recovery	-	-	-	(210)
<b>Net loss from continuing operations</b>	(2,958)	(1,081)	(15,045)	(3,109)
<b>Net earnings from discontinued operations</b> (Note 13)	-	-	-	23
<b>Total net loss for the period</b>	(2,958)	(1,081)	(15,045)	(3,086)
Currency translation adjustment	27	212	1,187	(242)
<b>Comprehensive loss for the period</b>	<u>\$ (2,931)</u>	<u>\$ (869)</u>	<u>\$(13,858)</u>	<u>\$ (3,328)</u>
Basic and diluted loss per share (Note 7)				
Continuing operations	\$ (0.01)	\$ (0.00)	\$ (0.07)	\$ (0.01)
Discontinued operations	0.00	0.00	0.00	0.00
<b>Total net loss per share</b>	<u>\$ (0.01)</u>	<u>\$ (0.00)</u>	<u>\$ (0.07)</u>	<u>\$ (0.01)</u>

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

# SOUTHERN ENERGY CORP.



## Condensed Consolidated Interim Statement of Changes in Shareholders' Equity (unaudited)

(\$000s of Canadian Dollars, except share amounts)	Common Shares	Shareholders' Capital	Equity Component of Convertible Debentures	Warrants	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, December 31, 2018	204,356,973	\$ 33,860	\$ -	\$ 1,195	\$ 3,883	\$(20,089)	\$ 62	\$ 18,911
Shares issued on Rights Offering	19,413,306	1,881	-	-	-	-	-	1,881
Net Loss	-	-	-	-	-	(3,086)	-	(3,086)
Other Comprehensive Loss	-	-	-	-	-	-	(242)	(242)
Convertible Debentures issued	-	-	665	-	-	-	-	665
Share-based compensation	-	-	-	-	112	-	-	112
Balance, September 30, 2019	223,770,279	\$ 35,741	\$ 665	\$ 1,195	\$ 3,995	\$(23,175)	\$ (180)	\$ 18,241
Balance, December 31, 2019	220,770,279	\$ 35,441	\$ 665	\$ 1,195	\$ 4,095	\$(30,962)	\$ (486)	\$ 9,948
Share-based compensation	-	-	-	-	237	-	-	237
Net Loss	-	-	-	-	-	(15,045)	-	(15,045)
Other Comprehensive Income	-	-	-	-	-	-	1,187	1,187
Balance, September 30, 2020	220,770,279	\$ 35,441	\$ 665	\$ 1,195	\$ 4,332	\$(46,007)	\$ 701	\$ (3,673)

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

# SOUTHERN ENERGY CORP.



Condensed Consolidated Interim Statement of Cash Flows (unaudited)

(\$000s of Canadian Dollars)	Three months ended		Nine months ended	
	September 30, 2020	2019	September 30, 2020	2019
<b>Operating activities</b>				
Total net loss for the period	\$ (2,958)	\$ (1,081)	\$ (15,045)	\$ (3,086)
Changes in non-cash items:				
Depletion, depreciation and amortization (Note 3)	1,254	1,794	3,708	4,028
Impairment (Note 3)	-	-	10,400	725
Gain on dispositions (Note 3)	-	-	(338)	(120)
Financing expense	641	597	1,656	1,108
Unrealized loss (gain) on derivatives (Note 8)	1,992	(178)	1,917	(647)
Unrealized loss (gain) on foreign exchange	161	(89)	29	90
Share-based compensation	46	100	237	112
Deferred income tax recovery	-	-	-	(210)
Decommissioning provisions liabilities settled (Note 4)	(6)	(5)	(7)	(11)
Changes in non-cash working capital	(444)	1,175	(828)	174
Net cash provided by operating activities	686	2,313	1,729	2,163
<b>Investing activities</b>				
Capital expenditures	(78)	(146)	(119)	(1,430)
Acquisitions	-	(449)	-	(21,324)
Proceeds from divestitures (Note 3)	-	-	338	504
Changes in non-cash working capital	(1)	(297)	(97)	83
Net cash (used) provided by investing activities	(79)	(892)	122	(22,167)
<b>Financing activities</b>				
Proceeds from share issuances, net	-	(11)	-	1,881
Issuance of convertible debentures, net	-	(317)	-	7,282
Repayment of bank debt (Note 5)	(599)	(595)	(599)	(461)
Payment of interest	(377)	(303)	(1,145)	(711)
Finance lease payments	(73)	(104)	(258)	(311)
Changes in non-cash working capital	274	(92)	582	11,593
Net cash (used) provided by financing activities	(775)	(1,422)	(1,420)	19,273
Net (decrease) increase in cash and cash equivalents	(168)	(1)	431	(731)
Effect of foreign exchange rate changes	(25)	16	(15)	(43)
Cash and cash equivalents, beginning of period	1,033	1,545	424	2,334
Cash and cash equivalents, end of period	\$ 840	\$ 1,560	\$ 840	\$ 1,560

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
Amounts in (\$000s of Canadian Dollars), except for per share amounts

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### **1. Reporting Entity and Nature of Operations**

Southern Energy Corp. (“Southern” or “Company”) is an oil and natural gas exploration and production company. Southern has a primary focus on developing conventional natural gas and light oil resources in the Southeast Gulf States of Mississippi and Alabama.

Southern’s head office is located in Calgary, Alberta, Canada. Southern trades on the TSX Venture Exchange (“TSXV”) under the trading symbol “SOU”. The condensed consolidated interim financial statements were authorized for issue by the Board of Directors on November 27, 2020.

### **2. Basis of Presentation and Going Concern**

#### **a) Principles of Reporting and Consolidation**

The condensed consolidated interim financial statements of Southern include the accounts of all domestic and foreign subsidiaries. Wholly-owned subsidiaries included in the Company’s accounts include Southern Energy Corp (DE), Southern Energy Operating, LLC, Southern Energy CMS, LLC, Southern Energy BWB, LLC and Southern Energy SO, LLC. Southern accounts for joint operations by recognizing the Company’s share of assets, liabilities, income and expenses. All intercompany balances and transactions have been eliminated.

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting of the International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The condensed consolidated interim financial statements use the accounting policies which the Company applied in its annual consolidated financial statements for the year ended December 31, 2019, with the exception of the changes in accounting policies described below. These condensed consolidated interim financial statements should be read in conjunction with Southern’s consolidated financial statements for the year ended December 31, 2019, which are available on SEDAR at [www.sedar.com](http://www.sedar.com). These condensed consolidated interim financial statements are presented in Canadian dollars. All financial information presented has been rounded to the nearest thousand unless otherwise indicated.

The Company’s presentation and functional currency is the Canadian dollar. The functional currency of the Company’s United States (“US”) subsidiaries is the US dollar, and its results and balance sheet items are translated to Canadian dollars for the purposes of these condensed consolidated interim financial statements, in accordance with the Company’s foreign currency translation accounting policy.

#### **b) Going Concern**

The Company prepared the condensed consolidated interim financial statements on a going concern basis, which contemplates the realization of assets and liabilities in the normal course of business as they become due. Accordingly, the condensed consolidated interim financial statements have been prepared on a historical cost basis, except certain financial instruments, which are measured at fair value.

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

At September 30, 2020, Southern had current liabilities that exceeded its current assets by \$23.8 million, including \$18.0 million of bank debt, that was classified as a current liability at September 30, 2020 and a working capital surplus of \$1.2 million, as defined by its Senior Secured Bank Credit Facility (the "Credit Facility"). See Note 5 "Bank Debt" for more information.

In March, as the COVID-19 pandemic caused significant volatility and weakness in commodity prices, Southern implemented cost saving measures by reducing corporate salaries by 20%, field salaries by 10% and eliminating all non-essential business expenditures.

With the support of the current lender, Southern entered into the Amended and Restated Credit Agreement in respect of the Credit Facility on July 20, 2020 (the "Amended Credit Agreement"). See Note 5 "Bank Debt" for more information.

On October 6, 2020, Southern entered into the first amendment to the Amended Credit Agreement (the "First Amendment"). The First Amendment postponed the next redetermination and the maturity of the non-conforming borrowing base facility (the "Non-Conforming Facility") to November 1, 2020. See Note 5 "Bank Debt" for more information.

On November 24, 2020, Southern entered into the second amendment to the Amended Credit Agreement (the "Second Amendment"). The Second Amendment included: (a) a waiver for the non compliance of the leverage ratio financial covenant as at September 30, 2020; an extension of the maturity of the Non-Conforming Facility to February 1, 2021, which is the same date as the maturity of the Conforming Facility (as defined below); and (c) redetermined the borrowing base limit at US\$13.3 million (US\$8.5 million Conforming Facility and US\$4.8 million Non-Conforming Facility) to account for debt repayments made during the year. See Note 5 "Bank Debt" for more information.

Southern continues to pay down the Credit Facility each month as per the requirements of the Amended Credit Agreement and has made the following debt repayments subsequent to September 30, 2020:

<b>Date of repayment</b>	<b>(US\$000s)</b>	<b>(\$000s)</b>
October 1, 2020	\$ 100	\$ 132
November 2, 2020	150	196
<b>Total amount repaid since September 30, 2020</b>	<b>\$ 250</b>	<b>\$ 328</b>
<b>Balance as at November 27, 2020</b>	<b>\$ 13,300</b>	<b>\$ 17,746</b>

Southern will continue to prioritize the deleveraging of the balance sheet through utilizing excess cash flow to repay the outstanding debt balance. In addition to the cost saving measures noted, Southern continues to manage liquidity by evaluating additional opportunities to reduce both operating and capital field expenditures, sale of non-core oil and natural gas assets, and looking for alternative sources of financing and the continued support of the current lender. There is no certainty that Southern will raise financing or generate sufficient cash flow to repay their debt as it comes due. This material uncertainty may cast significant doubt with respect to the ability of the Company to continue as a going concern.

These condensed consolidated interim financial statements do not reflect the adjustments and classifications of assets, liabilities, revenues and expenses which would be necessary if the Company were unable to continue as a going concern.

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
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### **c) Use of Estimates**

#### *Impact of COVID-19*

The COVID-19 outbreak was declared a pandemic by the World Health Organization on March 11, 2020. This has resulted in significant economic uncertainty and governments worldwide are enacting emergency measures to contain the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Global financial markets have experienced significant volatility and weakness as a consequence of this economic uncertainty. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the effectiveness of interventions by governments and central banks. The outbreak presents uncertainty and risk with respect to the Company, its performance, and estimates and assumptions used by management in the preparation of its financial results.

A full list of the key sources of management judgements and estimation uncertainty can be found in the Company's Annual Consolidated Financial Statements for the year ended December 31, 2019. The outbreak and current market conditions have increased the complexity of estimates and assumptions used to prepare the interim condensed consolidated financial statements, particularly related to the following key source of estimation uncertainty:

#### *Recoverable Amounts*

Determining the recoverable amount of a cash-generating unit ("CGU") requires the use of estimates and assumptions, which are subject to change as new information becomes available. The severe drop in commodity prices, due to reasons noted above, have increased the risk of measurement uncertainty in determining the recoverable amounts, especially estimating economic crude oil and natural gas reserves and estimating forward commodity prices.

### **d) Government Grants**

Government grants are recognized when the company has reasonable assurance that it has complied with the relevant conditions of the grant and that it will be received. The Company recognizes the grant against the financial statement line item that it is intended to compensate. Southern has obtained funds through the Canada Emergency Wage Subsidy ("CEWS") program and the Paycheck Protection Program ("PPP").

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
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### 3. Property, Plant and Equipment

The following table presents the reconciliation of the beginning and ending amounts of our PP&E balances including accumulated depletion, depreciation, amortization, and impairment:

	Oil and Natural Gas Assets	Other	Total
<b>Net book value as at December 31, 2019</b>	<b>\$ 44,304</b>	<b>\$ 4</b>	<b>\$ 44,308</b>
Additions	119	-	119
Depletion and depreciation	(3,419)	(1)	(3,420)
Impairment	(10,400)	-	(10,400)
Change in decommissioning obligations	(259)	-	(259)
Effect of foreign exchange rate changes	1,868	-	1,868
<b>Net book value as at September 30, 2020</b>	<b>\$ 32,213</b>	<b>\$ 3</b>	<b>\$ 32,216</b>

The calculation of depletion expense for the nine months ended September 30, 2020 included estimated future development costs of \$36.7 million (\$36.7 million at December 31, 2019) associated with the development of the Company's proved plus probable reserves.

On May 28, 2020, Southern disposed of a non-core Canadian royalty asset, with a carrying value of \$Nil, for net proceeds of \$338 thousand.

#### *Impairment*

At September 30, 2020, Southern did not identify any indicators of impairment or impairment reversal for any of its CGUs.

At March 31, 2020, Southern determined that the significant decrease in oil prices in March 2020 and Southern's market capitalization falling below the net assets of the Company were indications of impairment. Southern estimated the recoverable amount of all CGUs at March 31, 2020 and determined that the carrying value of the Central Mississippi ("CMS") and the Smackover ("SO") CGUs exceeded their recoverable amounts. A non-cash impairment charge of \$10.4 million was recorded in the condensed consolidated interim statements of loss and comprehensive loss.

The Company estimated the recoverable amounts as fair value less costs of disposal, using the net present value of the cash flows from proved developed producing oil and gas reserves of each CGU, and a 10% discount rate. The proved developed producing oil and gas reserves were based on reserves estimated by Southern's independent reserves evaluator at December 31, 2019, and revised price estimates at March 31, 2020.

**SOUTHERN ENERGY CORP.**

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

The following table details the forward pricing used in estimating the recoverable amounts of Southern's CGUs at March 31, 2020:

Period Ending	West Texas Intermediate (\$US/bbl)	Henry Hub (\$US/MMBtu)	FX (USD/CAD)
12-31-2020	30.00	2.08	0.710
12-31-2021	41.18	2.54	0.731
12-31-2022	49.88	2.79	0.751
12-31-2023	55.87	2.92	0.760
12-31-2024	57.98	2.99	0.761
12-31-2025	59.22	3.05	0.763
12-31-2026	60.39	3.11	0.763
12-31-2027	61.60	3.18	0.763
12-31-2028	62.84	3.24	0.763
12-31-2029	64.09	3.30	0.763

Thereafter, WTI and HH prices escalated 2 percent on January 1 of each year and FX rates held constant at 0.763

Changes in any of the key judgements, such as a revision in reserves, changes in forecast commodity prices, foreign exchange rates, capital or operating costs would impact the estimated recoverable amount. As at March 31, 2020, a 1% increase in the assumed discount rate would reduce the estimated recoverable amounts of the impaired CGUs by \$0.8 million while a 5% decrease change in commodity price forecasts would reduce the estimated recoverable amounts by \$2.2 million.

**4. Decommissioning Provisions**

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of legal obligations associated with the retirement of property, plant and equipment:

	<b>Total</b>
<b>Balance as at December 31, 2019</b>	<b>\$ 5,276</b>
Liabilities settled	(7)
Change in estimates	(259)
Accretion expense	66
Effect of foreign exchange rate changes	144
<b>Balance as at September 30, 2020</b>	<b>\$ 5,220</b>
<b>Long term liability</b>	<b>\$ 5,220</b>

The Company's decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The total decommissioning provision is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The total estimated, inflated undiscounted risked cash flows required to settle the provision, is approximately \$5.8 million at September 30, 2020 (\$6.2 million at December 31, 2019), which have been discounted using a risk-free interest rate of 1.3% at September 30, 2020 (1.7% to 1.9% at December 31, 2019).

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

### 5. Bank Debt

Southern had the following Credit Facility obligations outstanding as at the dates indicated:

	As at Sep 30, 2020	As at Dec 31, 2019
Current Portion Senior Secured Bank Credit Facility	\$ 18,074	\$ -
Long Term Portion Senior Secured Bank Credit Facility	-	18,183
Unamortized transaction costs	(114)	-
<b>Total Bank Debt</b>	<b>\$ 17,960</b>	<b>\$ 18,183</b>

Southern Energy Corp. (Delaware), one of the wholly-owned subsidiaries of Southern, continues to hold the existing Credit Facility. The Credit Facility is secured against the oil and gas properties of Southern. At September 30, 2020, Southern had US\$13.6 million (\$18.1 million) drawn on the Credit Facility, which has been paid down by US\$250 thousand (\$328 thousand) subsequent to quarter end, as described above in Note 2 "Going Concern". On July 20, 2020, as part of a bank redetermination, Southern entered into the Amended Credit Agreement. Details of the Amended Credit Agreement, as amended by the First Amendment and Second Amendment, include:

- Borrowing base limit set to US\$13.3 million; comprised of a US\$8.5 million conforming borrowing base facility (the "Conforming Facility") and a US\$4.8 million Non-Conforming Facility.
- Non-Conforming Facility has a coupon 50 basis points above existing Credit Facility rates.
- Beginning July 26, 2020, and continuing every month, the Non-Conforming Facility is reduced by the greater of US\$100 thousand or Bank EBITDAX less maintenance capital expenditures.
- Upon execution of the Amended Credit Facility, Southern made a principal repayment of US\$100 thousand.
- The Non-Conforming Facility and the Conforming Facility have the same maturity date of February 1, 2021.
- Amendments to the Credit Facility financial covenants, which are summarized below:

Financial covenant	Jun 30, 2020	Sep 30, 2020	Dec 31, 2020	Mar 31, 2021
Leverage ratio (Debt / Bank EBITDAX)	4.60	4.00	3.75	3.50
Interest coverage ratio (Bank EBITDAX / Cash Interest)	2.75	2.75	2.75	2.75
Current ratio (Current Assets / Current Liabilities)	0.95	1.00	1.00	1.00

Subsequent to September 30, 2020, Southern entered into the First Amendment and Second Amendment to the Amended Credit Agreement (see Note 2 "Going Concern" for more information). The November 1, 2020 bank redetermination was completed and the borrowing base has been confirmed at US\$13.3 million (US\$8.5 million Conforming Facility and US\$4.8 million Non-Conforming Facility) to account for debt repayments made during the year. As the maturity date of the Credit Facility is less than twelve months from September 30, 2020, the outstanding bank debt has been classified under current liabilities.

With the execution of the Amended Credit Agreement, interest on borrowings under the Credit Facility is determined by reference to the Eurodollar Rate, and includes a minimum rate of 1.0%, plus a margin that

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

ranges from 2.5% to 3.5%. As part of the Amended Credit Agreement, Southern will pay an additional 0.5% per annum on balances that exceed the Conforming Facility. The Second Amendment includes an additional 2.0% per annum on all outstanding borrowings until the February 1, 2021 maturity of the Amended Credit Agreement. During the nine months ended September 30, 2020, the effective interest rate, excluding commitment and other fees, was 4.5%.

The financial covenants of the Credit Facility, calculated quarterly, include covenants which relate to a maximum leverage ratio (Debt / Bank EBITDAX), minimum interest coverage ratio (Bank EBITDAX / Cash Interest) and minimum current ratio (Current Assets / Current Liabilities).

Below are the financial covenant calculations based on the Amended Credit Agreement for September 30, 2020:

Financial covenant	Limit	As at	As at
		Sep 30, 2020	Dec 31, 2019
Leverage ratio (Debt / Bank EBITDAX)	Maximum 4.00	4.53	3.32
Interest coverage ratio (Bank EBITDAX / Cash Interest)	Minimum 2.75	3.31	4.86
Current ratio (Current Assets / Current Liabilities)	Minimum 1.00	1.34	1.44

The financial covenants include financial measures defined within the Amended Credit Agreement that are not defined under IFRS. These financial measures are defined by the Amended Credit Agreement as follows:

- Debt includes only the Credit Facility drawings at the period end.
- Bank EBITDAX is defined as Earnings before Interest, Taxes, Depreciation, Depletion, Amortization, Exploration Expenses and other non-cash charges such as, Impairment, Unrealized (gain) / loss on derivatives, Stock-based compensation and Foreign exchange (gain) / loss.
- Current Assets is calculated by taking the total current assets from the consolidated statement of financial position less the current derivative asset and adding the unused portion of the available Credit Facility.
- Current Liabilities is calculated by taking the total current liabilities from the consolidated statement of financial position less the current derivative liability, the current portion of the lease liability, royalties payable balances greater than one year and the current bank debt.

Southern was not in compliance with the leverage ratio covenant of its Credit Facility for the period ended September 30, 2020, but has obtained a written waiver from its lenders for non-compliance until the next quarterly calculation.

## 6. Shareholders' Equity

### *Share capital*

The authorized share capital of the Company consists of an unlimited number of voting Common Shares and an unlimited number of preferred shares.

**SOUTHERN ENERGY CORP.**

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

The following table reflects the Company's outstanding Common Shares at September 30, 2020 and December 31, 2019:

	<b>Number of Shares</b>	<b>Share Capital</b>
<b>Balance as at December 31, 2019</b>	220,770,279	\$ 35,441
<b>Balance as at September 30, 2020</b>	<b>220,770,279</b>	<b>\$ 35,441</b>

*Warrants*

As at September 30, 2020, 19,306,667 performance-based Common Share purchase warrants ("Recap Warrants") had vested as the 20-day volume weighted average trading price ("Market Price") of the Common Shares had exceeded \$0.15.

*Stock Option Plan*

The following table reflects the Company's outstanding common stock options at September 30, 2020 and December 31, 2019:

	<b>Number of stock options</b>	<b>Weighted average exercise price</b>
Balance at December 31, 2019	19,400,000	\$ 0.10
<b>Balance at September 30, 2020</b>	<b>19,400,000</b>	<b>\$ 0.10</b>

  

	<b>Outstanding and Exercisable</b>	
<b>Exercise price</b>	<b>Number of stock options</b>	<b>Weighted average remaining life (years)</b>
\$ 0.10	19,400,000	3.7
<b>\$ 0.10</b>	<b>19,400,000</b>	<b>3.7</b>

**7. Loss Per Share**

The following table presents the Company's net loss per share:

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Net (loss) earnings from:				
Continuing operations	\$ (2,958)	\$ (1,081)	\$ (15,045)	\$ (3,109)
Discontinued operations	-	-	-	23
Net loss	<b>\$ (2,958)</b>	<b>\$ (1,081)</b>	<b>\$ (15,045)</b>	<b>\$ (3,086)</b>
Basic and diluted – weighted average number of shares	220,770,279	223,770,279	220,770,279	212,321,406
Basic and diluted loss per share from:				
Continuing operations	\$ (0.01)	\$ (0.00)	\$ (0.07)	\$ (0.01)
Discontinued operations	0.00	0.00	0.00	0.00
Net loss per share	<b>\$ (0.01)</b>	<b>\$ (0.00)</b>	<b>\$ (0.07)</b>	<b>\$ (0.01)</b>

**SOUTHERN ENERGY CORP.**

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

The calculation of diluted loss per share for the three and nine months ended September 30, 2020 and 2019 excludes the effect of all outstanding share options and warrants as they are anti-dilutive.

**8. Financial Instruments and Financial Risk Management**

***Financial Derivative Contracts***

Southern utilizes oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future oil and natural gas production. Typical derivative contracts could consist of options, in the form of price floors, collars or three-way collars and fixed-price swaps. The derivative financial instruments are recorded on the condensed consolidated interim statement of financial position as either an asset or a liability measured at fair value. Southern does not apply hedge accounting to its commodity derivative contracts; accordingly, changes in the fair value of these instruments are recognized in the condensed consolidated interim statement of loss and comprehensive loss in the period of change.

Southern had the following commodity derivative contracts in place at September 30, 2020:

Natural Gas	Volume	Pricing (US\$)
<i>Fixed Price Swap</i>		
October 1, 2020 – December 31, 2020	1,000 MMBtu/d	NYMEX – HH \$2.600/MMBtu
October 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH \$2.748/MMBtu
October 1, 2020 – December 31, 2020	2,000 MMBtu/d	NYMEX – HH \$2.575/MMBtu
October 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH \$2.253/MMBtu
January 1, 2021 – December 31, 2021	1,500 MMBtu/d	NYMEX – HH \$2.575/MMBtu
January 1, 2021 – December 31, 2021	3,600 MMBtu/d	NYMEX – HH \$2.402/MMBtu
Crude Oil	Volume	Pricing (US\$)
<i>Fixed Price Swap</i>		
October 1, 2020 – December 31, 2020	50 bbl/d	WTI \$55.25/bbl
October 1, 2020 – December 31, 2020	25 bbl/d	WTI \$56.45/bbl

On April 27, 2020, Southern entered into a buy-back swap for 75 Bbl/d of oil production. By entering into this transaction, in combination with the existing two oil swaps, Southern will realize proceeds of US\$68 thousand per month for the remainder of 2020.

**SOUTHERN ENERGY CORP.**

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

***Financial Derivative Contracts Financial Statement Recognition***

The Company's financial instruments that were accounted for at fair value as of September 30, 2020 and December 31, 2019 are presented below. The classification within the fair value hierarchy for these financial instruments is Level 2.

Comprised of:	As at Sep 30, 2020	As at Dec 31, 2019
Current derivative asset	\$ 292	\$ 819
Current derivative liability	(1,033)	(105)
Non-current derivative asset	-	120
Non-current derivative liability	(289)	(14)
<b>Net fair value of contracts, end of period</b>	<b>\$ (1,030)</b>	<b>\$ 820</b>

Below is a reconciliation of the gain on derivatives from the condensed consolidated interim statement of loss and comprehensive loss:

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Realized gain on derivatives	\$ (695)	\$ (283)	\$ (2,213)	\$ (206)
Unrealized loss (gain) on derivatives	1,992	(178)	1,917	(647)
<b>Loss (gain) on derivative instruments</b>	<b>\$ 1,297</b>	<b>\$ (461)</b>	<b>\$ (296)</b>	<b>\$ (853)</b>

***Credit Risk***

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The carrying amount of the Company's cash and cash equivalents and accounts receivable and the positive fair value of any financial derivatives represent the maximum credit exposure.

***Cash and cash equivalents***

The Company manages the credit exposure related to cash and cash equivalents by selecting financial institutions with high credit ratings and monitors all short-term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

***Accounts receivable***

Substantially all of the Company's accounts receivable are due from purchasers of the Company's petroleum and natural gas production, joint interest partners and government agencies, and are subject to normal industry credit risk.

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
Amounts in (\$000s of Canadian Dollars), except for per share amounts

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Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Management of the Company believes the risk is mitigated by the size and reputation of the companies to which they extend credit.

Southern had no provision for doubtful accounts as at September 30, 2020 or December 31, 2019. During the nine months ended September 30, 2020, four third party purchasers each marketed more than 10% of the Company's oil and natural gas revenue.

### ***Liquidity Risk***

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its current and future liquidity requirements. The financial liabilities in the statement of financial position consist of accounts payable, royalties payable, lease liabilities, financial derivative liabilities, convertible debentures and the senior secured credit facility. Strategies to manage liquidity include, having adequate sources of financing available through its Credit Facilities, estimating future cash flows generated from operations based on reasonable production and pricing assumptions, adding additional commodity derivative contracts, and reducing capital spending. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing.

### ***Market Risk***

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its asset and liabilities. The object of market risk management is to manage and control market risk exposure within acceptable parameters.

To partially mitigate exposure to commodity price risk, Southern entered into various financial derivative instruments. The instruments currently outstanding are described above. As at September 30, 2020, Southern has not entered any foreign exchange derivative contracts or fixed interest rate contracts. As at September 30, 2020, a 10% change in future commodity prices applied against these contracts would have a \$0.9 million impact on net income. At September 30, 2020, the Canadian dollar to US dollar foreign exchange rate was 1.3339 (December 31, 2019 – 1.2988).

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. The Company's interest rate risk arises from its floating rate Credit Facility. For the nine months ended September 30, 2020, the Company did not enter any interest rate derivative contracts. The impact of a 1% increase in the interest rate associated with the Credit Facility would increase net loss by approximately \$93 thousand.

## **9. Capital Risk Management**

The current challenging economic climate, due to the COVID-19 pandemic and volatile commodity prices, may lead to further adverse changes in cash flows, working capital levels and debt balances, which may also have a direct impact on the Company's operating result and financial position. These and other

## SOUTHERN ENERGY CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. While it is too early to know all of the impacts of the COVID-19 pandemic, Southern has deferred discretionary expenditures in order to ensure capital preservation.

The Company's officers are responsible for managing the Company's capital and do so through quarterly meetings and regular reviews of financial information. The Company's directors are responsible for overseeing this process. The Company considers its capital structure to include working capital.

The Company monitors its capital based on projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by or reviewed with the Company's Board of Directors. The budget results are regularly reviewed and updated as required.

In order to maintain or adjust the capital structure, the Company may issue shares, seek debt financing and adjust its capital spending to manage its current and projected capital structure. The Company's ability to raise additional debt or equity financing is impacted by external conditions, including future commodity prices and global economic conditions. The Company continually monitors business conditions including changes in economic conditions, the risk of its drilling programs, forecasted commodity prices, and potential corporate or asset acquisitions.

### 10. Royalties Payable

As at September 30, 2020, Southern had \$5.8 million (\$5.6 million at December 31, 2019) of non-interest bearing royalty payables related to unresolved title or ownership issues not expected to be settled within the operating cycle unless claimants demand repayment and provide proof of ownership. The increase was primarily due to the stronger US dollar on September 30, 2020 compared to December 31, 2019. The royalty payable account is made up of balances due to approximately 5,600 royalty holders with over 96% of the balances outstanding for greater than 120 days. The royalty holders have deficiencies with their accounts that precludes Southern from making payments. For the calculation of the Current Ratio covenant as at September 30, 2020, Southern removed \$5.4 million (December 31, 2019 - \$5.1 million) in royalty liabilities as they pertain to balances prior to September 30, 2019 (December 31, 2018).

### 11. Oil and Natural Gas Sales

The following table presents Southern's oil and natural gas sales disaggregated by revenue source:

	Three months ended		Nine months ended	
	September 30,		September 30,	
Commodity sales from production, by product	2020	2019	2020	2019
Crude oil	\$ 709	\$ 1,392	\$ 1,923	\$ 3,864
Natural gas liquids	45	91	112	374
Natural gas	2,783	3,662	7,377	9,366
<b>Total Revenue from Continuing Operations</b>	<b>\$ 3,537</b>	<b>\$ 5,145</b>	<b>\$ 9,412</b>	<b>\$ 13,604</b>

**SOUTHERN ENERGY CORP.**

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)  
 Amounts in (\$000s of Canadian Dollars), except for per share amounts

**12. Financing**

The following table presents a breakdown of Southern's financing expenses:

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Bank debt interest	\$ 196	\$ 303	\$ 641	\$ 711
Convertible debentures interest	163	163	484	193
Accretion	273	117	501	152
Interest on lease obligations	9	14	30	46
<b>Total Financing Expenses from Continuing Operations</b>	<b>\$ 641</b>	<b>\$ 597</b>	<b>\$ 1656</b>	<b>\$ 1,102</b>

**13. Discontinued Operations**

On May 2, 2019, Southern disposed of all of its Canadian oil and natural gas assets for \$0.5 million. The results of operations from the Canadian segment have been reported as a discontinued operation.

*Results of Discontinued Operations*

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
<b>Revenues</b>				
Petroleum and natural gas revenue	\$ -	\$ -	\$ -	\$ 334
Royalties	-	-	-	(54)
	-	-	-	280
<b>Expenses</b>				
Production and operating	-	-	-	42
Transportation	-	-	-	19
Exploration evaluation	-	-	-	1
Depletion, depreciation and amortization	-	-	-	39
Finance	-	-	-	6
General and administrative	-	-	-	150
	-	-	-	257
<b>Net earnings from discontinued operations</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 23</b>

*Cash Flows from Discontinued Operations*

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Cash from operating activities	\$ -	\$ (60)	\$ -	\$ 14
Cash from investing activities	-	-	-	504
Cash from financing activities	-	-	-	-
<b>Net Cash Flows</b>	<b>\$ -</b>	<b>\$ (60)</b>	<b>\$ -</b>	<b>\$ 518</b>