## MANAGEMENT'S REPORT

To the Shareholders of Hemisphere Energy Corporation:

Management is responsible for the preparation of the financial statements and the consistent presentation of all other financial information that is publicly disclosed. The financial statements have been prepared in accordance with the accounting policies detailed in the notes to the financial statements and in accordance with IFRS and include estimates and assumptions based on management's best judgment. Management maintains a system of internal controls to provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced in a timely manner.

**The accompanying unaudited interim condensed financial statements have not been reviewed by the Company's auditors.**

The Audit Committee, consisting of independent members of the Board of Directors, has reviewed the financial statements with management. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Vancouver, British Columbia
November 13, 2019

| | |
|---|---|
| (signed) *"Don Simmons"* | (signed) *"Dorlyn Evancic"* |
| Don Simmons, President & CEO | Dorlyn Evancic, Chief Financial Officer |

## CONDENSED STATEMENTS OF FINANCIAL POSITION

*(Expressed in Canadian dollars)*
*(Unaudited)*

| | Note | | September 30, 2019 | | December 31, 2018 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current assets** | | | | | |
| Cash and cash equivalents | | **$** | **1,086,358** | $ | 1,780,658 |
| Accounts receivable | | | **3,369,206** | | 287,169 |
| Prepaid expenses | | | **180,578** | | 190,762 |
| Fair value of financial instruments | 3(c) | | **-** | | 636,801 |
| | | | **4,636,142** | | 2,895,390 |
| **Non-current assets** | | | | | |
| Reclamation deposits | 8 | | **115,535** | | 115,535 |
| Fair value of financial instruments | 3(c) | | **32,919** | | 219,175 |
| Exploration and evaluation assets | 6 | | **3,683,513** | | 3,195,215 |
| Property and equipment | 7 | | **58,732,790** | | 52,226,110 |
| Deferred charges | 11 | | **366,563** | | 546,063 |
| **Total assets** | | **$** | **67,567,462** | $ | 59,197,488 |
| **Liabilities** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable and accrued liabilities | | **$** | **6,045,689** | $ | 2,246,175 |
| Current portion of lease liability | 9 | | **98,835** | | - |
| | | | **6,144,524** | | 2,246,175 |
| **Non-current liabilities** | | | | | |
| Term loan | 11 | | **31,754,130** | | 33,323,584 |
| Lease liability | 9 | | **297,660** | | - |
| Decommissioning obligations | 8 | | **8,582,667** | | 7,756,866 |
| | | | **46,778,981** | | 43,326,625 |
| **Shareholders' Equity** | | | | | |
| Share capital | 12 | | **54,684,141** | | 54,724,441 |
| Contributed surplus | | | **1,165,761** | | 1,014,623 |
| Warrant reserve | 12(c) | | **1,043,136** | | 1,043,136 |
| Deficit | | | **(36,104,557)** | | (40,911,337) |
| Total shareholders' equity | | | **20,788,481** | | 15,870,863 |
| **Total liabilities and shareholders' equity** | | **$** | **67,567,462** | $ | 59,197,488 |

| | |
|---|---|
| Commitments | Note 13 |
| Subsequent event | Notes 11 and 12(a) |

*The accompanying notes are an integral part of these unaudited interim condensed financial statements.*

## CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

*(Expressed in Canadian dollars)*
*(Unaudited)*

| | Note | Three Months Ended September 30 **2019** | Three Months Ended September 30 2018 | Nine Months Ended September 30 **2019** | Nine Months Ended September 30 2018 |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Oil and natural gas revenue | 5 | **$ 8,207,658** | $ 5,856,762 | **$ 22,039,005** | $ 14,869,598 |
| Royalties | | **(1,111,091)** | (1,186,777) | **(2,887,747)** | (2,696,740) |
| | | **7,096,567** | 4,669,985 | **19,151,258** | 12,172,858 |
| Realized loss on financial instruments | | **(307,899)** | (760,580) | **(1,238,262)** | (2,273,464) |
| Unrealized gain (loss) on financial instruments | 3(c) | **875,506** | (721,244) | **(823,057)** | (3,313,880) |
| **Net revenue** | | **7,664,174** | 3,188,161 | **17,089,939** | 6,585,514 |
| | | | | | |
| **Expenses** | | | | | |
| Production and operating | | **1,889,862** | 1,430,769 | **5,312,525** | 4,135,825 |
| Exploration and evaluation | 6 | **15,441** | 10,533 | **52,929** | 36,074 |
| Depletion and depreciation | 7 | **1,645,527** | 1,298,482 | **4,159,831** | 3,190,562 |
| General and administrative | | **483,070** | 377,101 | **1,191,170** | 1,273,612 |
| Share-based payments | 12(b) | **-** | 56,854 | **117,079** | 174,952 |
| | | **4,033,900** | 3,173,739 | **10,833,534** | 8,811,025 |
| **Results from operating activities** | | **3,630,274** | 14,422 | **6,256,405** | (2,225,510) |
| Finance expense | 10 | **(1,057,107)** | (869,522) | **(3,146,433)** | (2,267,376) |
| Foreign exchange gain (loss) | | **281,448** | 618,756 | **1,668,000** | (386,014) |
| **Net income (loss) and comprehensive income (loss) for the period** | | **$ 2,854,615** | $ (236,344) | **$ 4,777,972** | $ (4,878,900) |
| Net income (loss) per share | | | | | |
| Basic and diluted | 12(d) | **$ 0.03** | $ (0.00) | **$ 0.05** | $ (0.05) |

*The accompanying notes are an integral part of these unaudited interim condensed financial statements.*

## CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

*(Expressed in Canadian dollars)*
*(Unaudited)*

| | Note | Number common shares | | Share Capital | | Contributed Surplus | | Warrant Reserve | | Deficit | | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2017** | | **89,793,302** | **$** | **54,724,441** | **$** | **649,775** | **$** | 1,043,136 | **$** | **(36,057,768)** | **$** | **20,359,584** |
| Share-based payments | 12(b) | - | | - | | 364,848 | | - | | - | | 364,848 |
| Net loss for the period | | - | | - | | - | | - | | (4,853,569) | | (4,853,569) |
| **Balance, December 31, 2018** | | **89,793,302** | **$** | **54,724,441** | **$** | **1,014,623** | **$** | **1,043,136** | **$** | **(40,911,337)** | **$** | **15,870,863** |
| | | | | | | | | | | | | |
| **Balance, December 31, 2018** | | **89,793,302** | **$** | **54,724,441** | **$** | **1,014,623** | **$** | **1,043,136** | **$** | **(40,911,337)** | **$** | **15,870,863** |
| Stock Option Exercise | | 90,000 | | 7,200 | | - | | - | | - | | 7,200 |
| Share-based payments | | - | | - | | 179,945 | | - | | - | | 179,945 |
| Cancelation of Stock Options | | - | | - | | (28,807) | | - | | 28,807 | | - |
| Shares repurchased under NCIB | | (475,000) | | (47,500) | | - | | - | | - | | (47,500) |
| Net income for the period | | - | | - | | - | | - | | 4,777,973 | | 14,777,973 |
| **Balance, September 30, 2019** | | **89,408,302** | **$** | **54,684,141** | **$** | **1,165,761** | **$** | **1,043,136** | **$** | **(36,104,557)** | **$** | 20,788,481 |

*Comparison with nine months ended September 30, 2018:*

| | Note | Number common shares | | Share Capital | | Contributed Surplus | | Warrant Reserve | | Deficit | | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2017** | | **89,793,302** | **$** | **54,724,441** | **$** | **649,775** | **$** | **1,043,136** | **$** | **(36,057,768)** | **$** | **20,359,584** |
| Share-based payments | 12(b) | - | | - | | 276,565 | | - | | - | | 276,565 |
| Net loss for the period | | - | | - | | - | | - | | (4,878,900) | | (4,878,900) |
| **Balance, September 30, 2018** | | **89,793,302** | **$** | **54,724,441** | **$** | **926,340** | **$** | **1,043,136** | **$** | **(40,936,608)** | **$** | **15,757,249** |

*The accompanying notes are an integral part of these unaudited interim condensed financial statements.*

## CONDENSED STATEMENTS OF CASH FLOWS

*(Expressed in Canadian dollars)*
*(Unaudited)*

| | Three Months Ended September 30 2019 | Three Months Ended September 30 2018 | Nine Months Ended September 30 2019 | Nine Months Ended September 30 2018 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net income (loss) for the period | **$ 2,854,615** | $ (236,344) | **$ 4,777,972** | $ (4,878,900) |
| Items not affecting cash: | | | | |
| Accretion of debt issuance costs | **86,908** | 51,625 | **199,972** | 148,815 |
| Accretion of decommissioning costs | **37,233** | 34,587 | **111,699** | 103,759 |
| Amortization of deferred charges | **64,216** | 76,129 | **179,499** | 225,094 |
| Lease interest | **11,039** | - | **34,518** | - |
| Depletion and depreciation | **1,645,527** | 1,298,482 | **4,159,831** | 3,190,562 |
| Exploration and evaluation expense | **15,441** | 10,533 | **52,929** | 36,074 |
| Share-based payments | **-** | 56,855 | **117,079** | 174,952 |
| Unrealized loss (gain) on financial instruments | **(875,506)** | 721,244 | **823,057** | 3,313,880 |
| Unrealized loss (gain) on foreign exchange | **(280,800)** | (624,642) | **(1,703,000)** | 424,044 |
| Funds flow from operations | **3,558,673** | 1,387,469 | **8,753,556** | 2,738,280 |
| Changes in non-cash working capital | **245,234** | 805,358 | **(1,786,742)** | (739,285) |
| **Cash provided by operating activities** | **3,803,907** | **2,192,827** | **6,966,814** | 1,998,995 |
| **Investing activities** | | | | |
| Property and equipment expenditures | **(954,121)** | (8,219,366) | **(1,859,162)** | (11,508,888) |
| Exploration and evaluation expenditures | **(5,432,256)** | (965,726) | **(8,119,456)** | (3,079,144) |
| Changes in non-cash working capital | **1,917,121** | 1,716,824 | **2,514,405** | 3,008,897 |
| **Cash used in investing activities** | **(4,469,255)** | (7,468,268) | **(7,464,213)** | (11,579,135) |
| **Financing activities** | | | | |
| Shares issued for stock options | - | - | **7,200** | - |
| Shares repurchased under NCIB | **(47,500)** | - | **(47,500)** | - |
| Proceeds from term loan, net of costs | **(66,425)** | 4,928,635 | **(66,425)** | 8,573,645 |
| Lease payments | **(30,059)** | - | **(90,177)** | - |
| **Cash provided by (used in) financing Activities** | **(143,984)** | 4,928,635 | **(196,902)** | 8,573,645 |
| Net change in cash | **(809,331)** | (346,806) | **(694,300)** | (1,006,494) |
| Cash, beginning of period | **1,895,689** | 713,303 | **1,780,658** | 1,372,991 |
| **Cash , end of period** | **$ 1,086,358** | $ 366,497 | **$ 1,086,358** | $ 366,495 |

Supplemental cash flow information (Note 14)

*The accompanying notes are an integral part of these unaudited interim condensed financial statements.*

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS
For the three and nine months ended September 30, 2019 and 2018
*(Expressed in Canadian Dollars)*
*(Unaudited)*

### 1. Nature and Continuance of Operations

Hemisphere Energy Corporation (the "Company") was incorporated under the laws of British Columbia on March 6, 1978. The Company's principal business is the acquisition, exploration, development and production of petroleum and natural gas interests in Canada. It is a publicly traded company listed on the TSX Venture Exchange under the symbol "HME". The Company's head office is located at Suite 501, 905 Pender Street West, Vancouver, British Columbia, Canada V6C 1L6

### 2. Basis of Presentation

(a) Statement of compliance

The interim condensed financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" of International Financial Reporting Standards ("IFRS").

These interim condensed financial statements have been prepared following the same accounting policies and methods of computation as the audited annual financial statements of the Company for the year ended December 31, 2018 except as detailed in note 2(e) below. These interim condensed financial statements should be read in conjunction with the financial statements and notes thereto in the Company's annual filings for the year ended December 31, 2018.

These financial statements were authorized for issuance by the Board of Directors on November 13, 2019.

(b) Basis of presentation

These Financial Statements have been prepared on a historical cost basis, except for financial instruments and share-based payments, which are stated at their fair values.

(c) Functional and presentation currency

These Financial Statements are presented in Canadian dollars, which is the Company's functional currency.

(d) Use of estimates and judgments

The preparation of these Financial Statements in conformity with IFRS requires management to make judgments, estimates and assumptions that may affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may materially differ from these estimates.

Estimates and their underlying assumptions are reviewed on an ongoing basis and are based on management's experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

(e) Changes in accounting policy

Effective January 1, 2019, the Company adopted IFRS 16, "Leases" ("IFRS 16"). The Company has applied IFRS 16 using the modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effect as an adjustment to opening deficit and applies the standard prospectively. Therefore, the comparative information in the Company's financial statements have not been restated. On adoption, management elected to use the following practical expedients permitted under IFRS 16:

- account for leases with a remaining term of less than twelve months as at January 1, 2019 as short-term leases;
- account for lease payments as an expense and not recognize a right-of-use asset if the underlying asset is of a low dollar value (less than US$5 thousand); and
- the use of hindsight in determining the lease term where the contract contains terms to extend or terminate the lease.

The effect of initially applying the standard was a $452,152 increase to right-of-use assets, with a corresponding lease liability recorded. The right-of-use asset was measured at the amount equal to the lease liability on January 1, 2019 with no impact on deficit.

The preparation of the interim condensed financial statements in accordance with IFRS 16 requires management to make judgments, estimates, and assumptions that affect the reported amount of assets, liabilities, income, and expenses. Actual results could differ significantly from these estimates. Key areas where management has made judgments, estimates, and assumptions related to the application of IFRS 16 are listed below:

- Incremental borrowing rate: The incremental borrowing rates are based on judgments including economic environment, term, currency, and the underlying risk inherent to the asset. The carrying balance of the right-of-use assets, lease obligations, and the resulting interest and depletion and depreciation expense, may differ due to changes in the market conditions and lease term.
- Lease term: Lease terms are based on assumptions regarding extension terms that allow for operational flexibility and future market conditions.

The following accounting policy came into effect on January 1, 2019:

When the Company is a lessee, it recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated from the commencement date to the earlier of the end of useful life of the right-of-use assets or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property, plant and equipment. In addition, the right-of-use asset is reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option.
When the lease liability is re-measured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amounts of the right-of-use asset has been reduced to nil.

The Company presents right-of-use assets in "property, plant and equipment" and lease obligations in "lease liabilities" in the statement of financial position.

## 3. Financial Risk Management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as credit risk, liquidity risk and market risk. This note presents information about the Company's exposure to each of these risks. Management sets controls to manage such risks and monitors them on an ongoing basis pertaining to market conditions and the Company's activities.

(a) 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 payment obligations. This risk arises principally from the Company's receivables from joint operators and oil and natural gas marketers, and reclamation deposits. The credit risk associated with reclamation deposits is minimized substantially by ensuring this financial asset is placed with major financial institutions with strong investment-grade ratings by a primary ratings agency. The credit risk associated with accounts receivable is mitigated as the Company monitors monthly balances to limit the risk associated with collections. The Company does not anticipate any default. There are no balances over 90 days past due or impaired.

The maximum exposure to credit risk is as follows:

| | **September 30, 2019** | December 31, 2018 |
|---|---|---|
| Accounts receivable | | |
| Marketing receivables | **$ 3,278,864** | $ 168,284 |
| Trade receivables | **83,240** | 104,454 |
| Receivables from joint ventures | **7,102** | 14,431 |
| Reclamation deposits | **115,535** | 115,535 |
| | **$ 3,484,741** | $ 402,704 |

The Company sells the majority of its oil production through one marketer and, therefore, is subject to concentration risk which is mitigated by management's policies and practices related to credit risk, as discussed above. Historically, the Company has never experienced any collection issues with any of its marketers.

(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when they become due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company.

The Company also prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company will also attempt to match its payment cycle with collection of crude oil and natural gas revenues on the $25^{th}$ of each month.

In light of the current volatility in oil and gas prices and uncertainty regarding the timing for recovery in such prices as well as pipeline and transportation capacity constraints, management's ability to prepare financial forecasts is challenging. The economic climate may lead to adverse changes in cash flow, working capital levels or debt balances, which may also have a direct impact on the Company's liquidity and ability to generate profits in the future.

At September 30, 2019, the Company had net debt (current assets less current liabilities excluding fair value of financial instruments, and including the term loan) of $35,934,983 (December 31, 2018 - $35,446,384), which includes the gross term loan (Note 11) of $34,426,600 (December 31, 2018 - $35,458,800). The Company funds its operations through operating cash flows and the term loan, which has an additional US$4 million of borrowing base committed by its lender at September 30, 2019 plus an additional US$5 million of principle loan capacity.

(c) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, other prices and interest rates will affect the value of the financial instruments. Market risk is comprised of interest rate risk, foreign currency risk, commodity price risk and other price risk.

(i) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Borrowings under the Company's Term Loan are subject to variable interest rates. A one percent change in interest rates would have a $344,000, annual effect on net loss.

(ii) Foreign currency risk

The Company's functional and reporting currency is Canadian dollars. The Company is subject to foreign currency risk related to; i) the Company's commodity prices are largely denominated in USD, and as a result the prices that the Company receives are affected by fluctuations in the exchange rates between the USD and the Canadian dollar. The exchange rate effect cannot be quantified, but generally an increase in the value of the Canadian dollar compared to the USD will reduce the prices received by the Company for its crude oil and natural gas sales. The Company does not have any foreign currency mark-to-market swaps in place; and ii) the Company's Term Loan is denominated in USD and, as a result, the amount that the Company will be obligated to repay at the term of the loan will be affected by fluctuations in the exchange rate between the USD and the Canadian dollar at that time. A one percent change in the foreign exchange rate would have a $286,000 effect on the annual net loss and comprehensive loss.

(iii) Commodity price risk

Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the USD. Significant changes in commodity prices may materially impact the Company's funds flow from operations and ability to raise capital. The Company has hedging swap agreements in place as further disclosed within this document and the financial statements.

At September 30, 2019, the Company held derivative commodity contracts as follows:

| Product | Type | Volume | Price | Index | Term | | September 30, 2019 Fair Value |
|---|---|---|---|---|---|---|---|
| Crude oil | Swap | 250 bbl/d | US$50.67 | WTI-NYMEX | January 1, 2019 – December 31, 2019 | | 96,439 |
| Crude oil | Collar | 130 bbl/d | US$40.00-US$74.50 | WTI-NYMEX | March 1, 2019 – December 31, 2019 | | (1,239) |
| Crude oil | Collar | 100 bbl/d | US$55.00-US$66.00 | WTI-NYMEX | March 1, 2019 – December 31, 2019 | | (35,441) |
| Crude oil | Collar | 100 bbl/d | US$58.00-US$66.15 | WTI-NYMEX | March 1, 2019 – December 31, 2019 | | (60,250) |
| Crude oil | Swap | 200 bbl/d | US$50.67 | WTI-NYMEX | January 1, 2020 – August 31, 2020 | | 79,982 |
| Crude oil | Collar | 120 bbl/d | US$40.00-US$68.25 | WTI-NYMEX | January 1, 2020 – December 31, 2020 | | (46,255) |
| Crude oil | Collar | 200 bbl/d | US$40.00-US$67.05 | WTI-NYMEX | September 1, 2020 – December 31, 2020 | | (33,527) |
| Crude oil | Collar | 275 bbl/d | US$40.00-US$65.50 | WTI-NYMEX | January 1, 2021 – March 31, 2021 | | (32,628) |
| | | | | | Total | $ | (32,919) |

At September 30, 2019 the commodity contracts were fair valued as an asset of $32,919 and an unrealized gain for the three month period of $875,506 and an unrealized loss for the nine month period of $823,057 respectively (September 30, 2018 – loss of $721,244 and $3,313,880 respectively).

## 4. Capital Management

The Company manages its capital with the following objectives:

(a) To ensure sufficient financial flexibility to achieve the Company's ongoing business objectives including the replacement of production, funding of future growth opportunities and pursuit of accretive acquisitions; and

(b) To maximize shareholder return through enhancing the Company's share value.

The Company monitors its capital structure and makes adjustments according to market conditions in an effort to meet its objectives given the current outlook of the business and industry in general. The capital structure of the Company is composed of shareholders' equity and the Term Loan. The Company may manage its capital structure by issuing new shares, repurchasing outstanding shares, obtaining additional financing from the Company's term loan, issuing new debt instruments, or other financial or equity-based instruments, adjusting capital spending, or disposing of assets. The capital structure is reviewed on an ongoing basis. There were no changes to capital management during the period.

## 5. Revenue

The Company sells its production pursuant to variable-price contracts. The transaction price for variable-price contracts is based on a benchmark 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. Under the contracts, the Company is required to deliver variable volumes of heavy oil, natural gas or natural gas liquids to the contract counterparty.

Production revenue is recognized when the Company gives up control of the unit of production at the delivery point agreed to under the terms of the contract. The amount of production revenue recognized is based on the agreed transaction price and the volumes delivered. Any variability in the transaction price relates specifically to the Company's efforts to transfer production and therefore the resulting revenue is allocated to the production delivered in the period to which the variability relates. The Company does not have any factors considered to be constraining in the recognition of revenue with variable pricing factors. Production revenues are normally collected on the business day nearest the 25th day of the month following production.

The Company's production revenues were primarily generated in its core areas of the Mannville oil play in the Atlee Buffalo and Jenner areas of southeastern Alberta. The Company's customers are oil and natural gas marketers and joint operations partners in the oil and natural gas business and are subject to normal credit risks. Concentration of credit risk is mitigated by management's policies and practices related to credit risk as discussed in note 3(a). As at September 30, 2019, production revenue sold to customers was comprised of three marketers which account for $3,278,864 of the accounts receivable balance.

The following table presents the Company's total revenues disaggregated by revenue source:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Oil | **$ 8,174,202** | $ 5,820,348 | **$ 21,868,981** | $ 14,737,045 |
| Natural gas | **29,746** | 30,662 | **156,575** | 108,471 |
| NGL | **3,710** | 5,752 | **13,449** | 24,082 |
| Total | **$ 8,207,658** | $ 5,856,762 | **$ 22,039,005** | $ 14,869,598 |

## 6. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Company's exploration projects, which are pending the determination of Proved and Probable reserves. A transfer from exploration and evaluation assets to property and equipment is made when reserves are assigned or the exploration project has been completed. For the nine months ended September 30, 2019, the Company had $7,578,229 transfers (September 30, 2018 - $463,899) to property and equipment, capitalized general and administrative expenses of $264,243 (September 30, 2018 - $103,462) to exploration and evaluation assets, and recognized exploration and evaluation expense of $52,929 (September 30, 2018 - $36,074).

| **Cost** | | |
|---|---|---|
| Balance, December 31, 2017 | $ | 4,894,108 |
| Additions | | 3,659,109 |
| Exploration and evaluation expense | | (932,374) |
| Transfer to property and equipment | | (4,425,628) |
| Balance, December 31, 2018 | $ | 3,195,215 |
| Additions | | 8,119,456 |
| Exploration and evaluation expense | | (52,929) |
| Transfer to property and equipment | | (7,578,229) |
| **Balance, September 30, 2019** | **$** | **3,683,513** |

## 7. Property and Equipment

| **Cost** | | Petroleum and Natural Gas | | Right of Use and Other Assets | | Total |
|---|---|---|---|---|---|---|
| Balance, December 31, 2017 | $ | 74,892,367 | $ | 114,492 | $ | 75,006,859 |
| Additions | | 12,398,208 | | - | | 12,398,208 |
| Increase in decommissioning obligations | | 1,442,408 | | - | | 1,442,408 |
| Capitalized share-based payments | | 101,614 | | - | | 101,614 |
| Transfer from exploration and evaluation assets | | 4,425,628 | | - | | 4,425,628 |
| Balance, December 31, 2018 | $ | 93,260,225 | $ | 114,492 | $ | 93,374,717 |
| Right-of-use assets | | - | | 452,152 | | 452,152 |
| Additions | | 1,834,707 | | 24,455 | | 1,859,162 |
| Increase in decommissioning obligations | | 714,103 | | - | | 714,103 |
| Capitalized share-based compensation | | 62,865 | | - | | 62,865 |
| Transfer from exploration and evaluation assets | | 7,457,229 | | - | | 7,578,229 |
| **Balance, September 30, 2019** | **$** | **103,450,129** | **$** | **591,099** | **$** | **104,041,228** |
| **Accumulated Depletion, Depreciation, Amortization and Impairment Losses** | | | | | | |
| Balance, December 31, 2017 | $ | 35,020,142 | $ | 92,693 | $ | 35,112,835 |
| Depletion and depreciation for the year | | 4,455,420 | | 5,480 | | 4,460,900 |
| Impairment Loss | | 1,574,872 | | - | | 1,574,872 |
| **Balance, December 31, 2018** | **$** | **41,050,434** | **$** | **98,173** | **$** | **41,148,607** |
| Depletion and depreciation for the period | | 4,078,315 | | 81,516 | | 4,159,831 |
| **September 30, 2019** | **$** | **45,128,749** | **$** | **179,689** | **$** | **45,308,438** |
| **Net Book Value** | | | | | | |
| December 31, 2018 | $ | 52,209,791 | $ | 16,319 | $ | 52,226,110 |
| **September 30, 2019** | **$** | **58,321,380** | **$** | **411,412** | **$** | **58,732,790** |

The Company's additions for property and equipment included capitalized general and administrative expenses of $190,351 for the nine months ended September 30, 2019 (September 30, 2018 - $311,084).

The calculation of depletion at September 30, 2019 includes estimated future development costs of $42,083,900 (December 31, 2018 - $50,819,300) associated with the development of the Company's Proved plus Probable reserves.

## 8. Decommissioning Obligations

The Company's decommissioning obligation is estimated based on its 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 Company uses Alberta Energy Regulator guidelines for determining abandonment and reclamation estimates.

The Company estimates the total undiscounted and inflated amount of cash flows required to settle its decommissioning obligations as at September 30, 2019 is $12,686,913 (September 30, 2018 - $7,129,193). These payments are expected to be made over the next 42 years with the costs to be incurred between 2027 and 2061. The discount factor, being the risk-free rate related to the liability, is 1.92% (December 31, 2018 – 1.92%). Inflation of 2.1% (December 31, 2018 – 2.1%) has also been factored into the calculation of amounts in the table below. The Company also has $115,535 (December 31, 2018 - $115,535) in various reclamation bonds for its properties held by the Alberta Energy Regulator and British Columbia Ministry of Energy, Mines and Petroleum Resources.

| | **Nine Months Ended September 30, 2019** | Year Ended December 31, 2018 |
|---|---|---|
| Decommissioning obligations, beginning of period | **$ 7,756,866** | $ 6,176,112 |
| Increase in estimated future obligations | **714,102** | 1,154,722 |
| Change in estimate | **-** | 287,687 |
| Accretion expense | **111,699** | 138,345 |
| Decommissioning obligations, end of period | **$ 8,582,667** | $ 7,756,866 |

## 9. Lease Liabilities

The Company has lease liabilities for contracts related to financing facilities, surface leases, vehicles and office equipment. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The discount rate used for the period ended September 30, 2019 was 10.92%. The following table summarizes lease liabilities at September 30, 2019:

| | **Nine Months Ended September 30, 2019** |
|---|---|
| Balance, January 1, 2019 | $ 452,152 |
| Interest expense | 34,519 |
| Lease payments | (90,177) |
| **Balance, September 30, 2019** | **$ 396,495** |
| Current Portion | $ 98,835 |
| Long-term portion | 297,660 |

## 10. Finance Income and Expense

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Finance expense: | | | | |
| Loan interest | **$ 857,710** | $ 707,182 | **$ 2,620,745** | $ 1,789,708 |
| Lease interest | **11,039** | - | **34,518** | - |
| Accretion of debt issuance costs | **86,908** | 51,625 | **199,972** | 148,815 |
| Amortization of deferred charges | **64,216** | 76,129 | **179,499** | 225,094 |
| Accretion of decommissioning liabilities | **37,233** | 34,587 | **111,699** | 103,759 |
| Total | **$ 1,057,107** | $ 869,523 | **$ 3,416,433** | $ 2,267,376 |

## 11. Term Loan

On September 15, 2017, the Company entered into a first lien senior secured credit agreement (the "Credit Agreement") with a third-party lender (the "Lender") providing for a multi-draw, non-revolving term loan facility of a maximum aggregate principal amount of up to US$35.0 million. Security granted by the Company under the Credit Agreement included a demand debenture for US$75.0 million which provides for a first ranking security interest and floating and fixed charges over all of the real and personal property present and after acquired of the Company.

An initial commitment amount of US$15.0 million (the "Term Loan") was granted at inception and on January 23, 2018 and June 1, 2018 the Company amended its credit agreement with its Lender to increase the commitment amount by US$5.0 million and US$10.0 million respectively. This brings the Company's aggregate amount committed by the Lender under the Term Loan to US$30.0 million.

As at September 30, 2019 the Company has drawn US$26.0 million (CAD$34,426,600), and has subsequently drawn an additional US$500,000 (CAD$661,000). The Company's ability to access additional commitments in excess of US$30.0 million is subject to approval of the Lender based on review and approval of the Company's future development plans.

The interest rate for the Term Loan is the three-month United States dollar London Interbank Offered Rate ("LIBOR") with a LIBOR floor of 1%, plus 7.50% payable quarterly, for a five-year term with a maturity date of September 15, 2022. In conjunction, the Company issued 13,750,000 warrants entitling the Lender to purchase one common share of Hemisphere at an exercise price of $0.28/share prior to September 15, 2022. The effective interest rate is 10.92%.

The below tables summarize the Term Loan and Deferred Costs associated with the Term Loan, respectively, at September 30, 2019:

| **Term Loan** | **Nine Months Ended September 30, 2019** | **Year Ended December 31, 2018** |
|---|---|---|
| Term Loan, beginning of period | $ 33,323,584 | $ 17,465,518 |
| Principal amount of Term Loan issued | - | 14,199,400 |
| Foreign exchange adjustment | (1,703,001) | 2,279,937 |
| Transfer of debt issuance costs – cash | (66,425) | (534,379) |
| Transfer of debt issuance costs – warrants | - | (380,573) |
| Accretion of debt issuance costs | 199,972 | 293,681 |
| **Balance, end of period** | **$ 31,754,130** | **$ 33,323,584** |

| **Deferred Costs** | | **September 30, 2019** | | **December 31, 2018** |
|---|---|---|---|---|
| Deferred costs, beginning of period | $ | (546,063) | $ | (1,210,691) |
| Debt issuance costs – cash | | - | | 81,724 |
| Debt issuance costs – warrants | | - | | 380,573 |
| Amortization of deferred costs | | 179,500 | | 202,332 |
| **Deferred costs, end of period** | **$** | **(366,563)** | **$** | **(546,063)** |

The Company has recognized a portion of the debt issuance costs and value allocated to the warrants (Note 12(c)) against the Term Loan based on the proportion of the facility drawn, with the balance included in deferred charges. The portion recognized against the Term Loan will be accreted using the effective interest method (refer to effective interest rate above) through finance expense while the deferred charge balance is being straight-line amortized over the five-year term. As future draws are made under the term Loan, the unamortized proportion of the deferred charges will be transferred against the debt obligation and accreted also using the effective interest method.

The Term Loan is subject to certain financial covenants which are listed below from the quarter ended September 30, 2019:

1. Interest coverage ratio shall not be less than 3.00 to 1.00.

2. Total leverage ratio shall not be more than 3.25 to 1.00.

3. The Company also has an annual financial covenant for its cash general and administrative costs for a base sum of $2.725 million per annum for the year ending December 31, 2019.

The Term Loan is also subject to certain performance covenants surrounding production and reserves as denoted in the table below. For the quarter ended September 30, 2019 the Company has met all of its financial and performance covenants in effect, as follows:

| **Ratio** | | | **Required** | **Actual Sep. 30, 2019** | |
|---|---|---|---|---|---|
| **1.** | Interest Coverage Ratio | Greater than | 3.00 | 5.08 | |
| **2.** | Total Leverage Ratio | Less than | 3.25 | 1.99 | |
| **3.** | Minimum Average Production | Greater than | 1,500 | 1,738 | Boe/d |
| **4.** | Proved Developed Producing Coverage Ratio | Greater than | 1.00 | 1.54 | |
| **5.** | Total Proved Reserves Coverage Ratio | Greater than | 1.50 | 2.02 | |

## 12. Share Capital

(a) Common Shares

The Company has an unlimited number of common shares authorized without par value.

As at September 30, 2019, the Company had 89,408,302 common shares issued and outstanding, including the following transactions, as listed in the Statement of Shareholders' Equity.

- In March 2019, 90,000 shares were issued on the exercise of stock options.

- On June 27, 2019 the Company announced notice of a normal course issuer bid (NCIB) to purchase and cancel, from time to time, up to 8,016,731 common shares of the Company. The Company has since purchased and canceled 475,000 shares as at September 30, 2019, and has subsequently purchased and canceled an additional 254,500 shares.

(b) Stock options

The Company has a stock option plan in place and is authorized to grant stock options to officers, directors, employees and consultants whereby the aggregate number of shares reserved for issuance may not exceed 10% of the issued shares at the time of grant and 5% of the issued shares to each optionee. Stock options are non-transferable and have a maximum term of five years. Stock options terminate no later than 90 days (30 days for investor-related services) upon termination of employment or employment contract and one year in the case of retirement, death or disability. The grant price is determined using the closing price of the Company's shares from the day prior to the grant.

Details of the Company's stock options as at September 30, 2019 are as follows:

| | | | Changes in the Period | | | | |
|---|---|---|---|---|---|---|---|
| Exercise Price | Expiry Date | Balance Outstanding December 31, 2018 | Granted | Exercised | Canceled | Balance Outstanding September 30, 2019 | Balance Exercisable September 30, 2019 |
| $0.24 | 29-Jan-20 | 1,075,000 | - | - | (75,000) | 1,000,000 | 1,000,000 |
| $0.39 | 1-Mar-20 | 100,000 | - | - | - | 100,000 | 100,000 |
| $0.08 | 11-Feb-21 | 1,685,000 | - | (90,000) | - | 1,595,000 | 1,595,000 |
| $0.08 | 12-Feb-21 | 125,000 | - | - | - | 125,000 | 125,000 |
| $0.25 | 21-Sep-22 | 5,034,000 | - | - | (120,000) | 4,914,000 | 3,276,000 |
| $0.28 | 2-Oct-22 | 150,000 | - | - | - | 150,000 | 100,000 |
| $0.25 | 1-Jan-23 | 250,000 | - | - | - | 250,000 | 166,667 |
| $0.12 | 1-Mar-24 | - | 50,000 | - | - | 50,000 | 50,000 |
| | | 8,419,000 | 50,000 | (90,000) | (195,000) | 8,184,000 | 6,412,667 |
| Weighted-average exercise price | | $0.21 | $0.12 | $0.08 | $0.25 | $0.21 | $0.20 |

Share-based payments are non-cash expenses which reflect the estimated value of stock options issued to directors, employees and consultants of the Company. For the three and nine months ended September 30, 2019, the Company recorded total share-based payments of $nil and $117,079 respectively, compared to $56,854 and $174,952 for the same periods in 2018.

In March of 2019 the Company granted 50,000 stock options to a consultant at an exercise price of $0.12 each, all of which vested immediately. The Company uses a Black-Scholes option pricing model to calculate the fair value of stock option grants and the factors used were; volatility 66.18%, risk free rate 1.80%, expected life 5 years and forfeiture rate of 5%.

The total valuation of the vested options from grants in the first nine months of 2019, as well as the vesting of options issued but unvested in prior fiscal years, was $179,945, of which $117,079 was expensed as stock-based compensation and $62,866 was capitalized.

(c) Share purchase warrants

On September 15, 2017, the Company issued 13,750,000 warrants to a third-party lender in conjunction with its Term Loan (Note 11). Each warrant entitles the holder to purchase one common share of Hemisphere at an exercise price of $0.28 per share prior to September 15, 2022. The exercise price of the warrants represented a 40% premium to the 30-day volume weighted average price ("VWAP") of Hemisphere's common shares at market close on September 14, 2017. The warrants are subject to a forced exercise clause which applies upon a 30-day VWAP equaling or exceeding $1.40 per share. The warrants are non-transferable.

The Company ascribed a value to the warrants of $1,428,954 by comparing the fair value of the Term Loan both with and without the warrant feature determining the difference in value to be related to the warrants. The effective rates have been disclosed in Note 11. Further, a deferred tax liability of $385,818 was incurred with regard to the warrants that is applied against the recorded warrant reserve and also recovered against the net loss.

As at September 30, 2019, the Company had 13,750,000 outstanding and exercisable share purchase warrants.

(d) Income (Loss) per share

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Income (Loss) for the period | **$ 2,854,615** | $ (236,344) | **$ 4,777,972** | $ (4,878,900) |
| Weighted average number of common shares outstanding, basic | **89,843,523** | 89,793,302 | **89,843,523** | 89,793,302 |
| Dilutive stock options | **793,024** | - | **700,274** | - |
| Weighted average number of common shares outstanding, diluted | **90,567,902** | 89,793,302 | **90,520,664** | 89,793,302 |
| Income (Loss) per share, basic and diluted | **$ 0.03** | $ (0.00) | **$ 0.05** | $ (0.00) |

For the three and nine months ended September 30, 2019, the Company had dilutive stock options of 793,024 and 700,274, respectively. For the comparable periods in 2018 the Company incurred a loss; therefore, dilutive stock options and share purchase warrants were nil.

## 13. Commitment

| | | 2019 | 2020 | 2021 | 2022 | 2023 | Total |
|---|---|---|---|---|---|---|---|
| Lease operating costs | $ | 19,107 | 76,428 | 76,428 | 76,428 | 31,845 | 280,236 |
| Term loan | | - | - | - | 34,426,600 | - | 34,426,600 |
| Term loan interest | | 845,077 | 3,380,307 | 3,380,307 | 2,535,230 | - | 10,140,921 |
| | $ | 864,184 | 3,456,735 | 3,456,735 | 37,038,258 | 31,845 | 44,847,757 |

The Company has a commitment to make monthly rental payments pursuant to the office rental agreement at its current location until May 31, 2023.

As at September 30, 2019, the gross balance of the Term Loan was $34,426,600 (US$26,000,000), exclusive of the debt issuance costs. The Term Loan matures on September 15, 2022.

## 14. Supplemental Cash Flow Information

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Provided by (used in): | | | | |
| Accounts receivable | **$ (1,339,152)** | $ (307,339) | **$ (3,082,036)** | $ (767,735) |
| Prepaid expenses | **9,667** | 68,198 | **10,184** | 97,757 |
| Accounts payable and accrued liabilities | **3,491,840** | 2,761,324 | **3,799,515** | 2,939,591 |
| Total changes in non-cash working capital | **$ 2,162,355** | $ 2,522,183 | **$ 727,663** | $ 2,269,613 |
| Provided by (used in): | | | | |
| Operating activities | **$ 245,234** | $ 805,359 | **$ (1,786,742)** | $ (739,284) |
| Investing activities | **1,917,121** | 1,716,824 | **2,514,405** | 3,008,897 |
| Total changes in non-cash working capital | **$ 2,162,355** | $ 2,522,183 | **$ 727,663** | $ 2,269,613 |

Cash interest paid on the Company's debts during the three and nine months ended September 30, 2019 were $857,709 and $2,620,744 respectively. For the three and nine months ended September 30, 2019 and 2018, cash interest paid on the Company's debts were $707,182 and $1,789,709, respectively.

## OFFICERS

**Don Simmons, P.Geol.**
*President & Chief Executive Officer*

**Dorlyn Evancic, CPA, CGA**
*Chief Financial Officer*

**Ian Duncan, P.Eng.**
*Chief Operating Officer*

**Andrew Arthur, P.Geol.**
*Vice President, Exploration*

**Ashley Ramsden-Wood, P.Eng.**
*Vice President, Engineering*

## BOARD OF DIRECTORS

**Charles O'Sullivan, B.Sc.,** *Chairman*(2)

**Frank Borowicz, QC, CA (Hon)**(1)(2)

**Bruce McIntyre, P.Geol.**(1)(3)

**Don Simmons, P.Geol.**(3)

**Gregg Vernon, P.Eng.**(2)

**Richard Wyman, B.Sc., MBA**(1)(3)

*(1) Audit Committee*
*(2) Compensation & Corporate Governance Committee*
*(3) Reserves Committee*

## BANKER

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*Calgary, Alberta*

## LEGAL COUNSEL

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*Calgary, Alberta*
**Harper Grey LLP**
*Vancouver, British Columbia*

## AUDITOR

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*Calgary, Alberta*

## INDEPENDENT ENGINEER

**McDaniel Associates & Consultants Ltd.**
*Calgary, Alberta*

## TRANSFER AGENT

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*Vancouver, British Columbia*

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