

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. Independent auditors appointed by the shareholders have examined the financial statements. Their report is presented with the financial statements. The Audit Committee, consisting of independent members of the Board of Directors, has reviewed the financial statements with management and the independent auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Vancouver, British Columbia
April 24, 2019

(signed) *"Don Simmons"*

Don Simmons, President & CEO

(signed) *"Dorlyn Evancic"*

Dorlyn Evancic, Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Hemisphere Energy Corporation,

Opinion

We have audited the financial statements of Hemisphere Energy Corporation (the "Entity"), which comprise:

- the statements of financial position as at December 31, 2018 and December 31, 2017
- the statements of loss and comprehensive loss for the years then ended
- the statements of changes in shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the financial statements, including a summary of significant accounting policies.

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

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2018 and December 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

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

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

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

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

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

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

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

We have nothing to report in this regard.

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

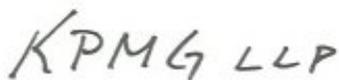
We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained

up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is John Waiand.

A handwritten signature in dark ink that reads "KPMG LLP". The letters are slightly slanted and connected, with a stylized 'K' and 'P'.

Chartered Professional Accountants

Calgary, Canada

April 24, 2019

STATEMENTS OF FINANCIAL POSITION

(Expressed in Canadian dollars)

	Note	December 31, 2018	December 31, 2017
Assets			
Current assets			
Cash and cash equivalents		\$ 1,780,658	\$ 1,372,991
Accounts receivable		287,169	1,368,208
Prepaid expenses		190,762	214,247
Fair value of financial instruments	5(c)	636,801	-
		2,895,390	2,955,446
Non-current assets			
Reclamation deposits	10	115,535	115,535
Fair value of financial instruments	5(c)	219,175	-
Exploration and evaluation assets	8	3,195,215	4,894,108
Property and equipment	9	52,226,110	39,894,023
Deferred charges	12	546,063	1,210,691
Total assets		\$ 59,197,488	\$ 49,069,803
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		\$ 2,246,175	\$ 2,645,307
Fair value of financial instruments		-	1,579,726
		2,246,175	4,225,033
Non-current liabilities			
Term loan	12	33,323,584	17,465,518
Fair value of financial instruments		-	843,556
Decommissioning obligations	10	7,756,866	6,176,112
		43,326,625	28,710,219
Shareholders' Equity			
Share capital	13	54,724,441	54,724,441
Contributed surplus		1,014,623	649,775
Warrant reserve	13(c)	1,043,136	1,043,136
Deficit		(40,911,337)	(36,057,768)
Total shareholders' equity		15,870,863	20,359,584
Total liabilities and shareholders' equity		\$ 59,197,488	\$ 49,069,803

Commitments (Note 15)

Subsequent events (Note 18)

The accompanying notes are an integral part of these financial statements.

Approved by the Board of Directors

(signed) "Bruce McIntyre"

Bruce McIntyre, Director

(signed) "Don Simmons"

Don Simmons, Director

STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

(Expressed in Canadian dollars)

	Note	Years Ended December 31	
		2018	2017
Revenue			
Oil and natural gas revenue	7	\$ 17,756,439	\$ 10,974,634
Royalties		(3,081,225)	(1,817,607)
		14,675,214	9,157,027
Realized loss on financial instruments		(2,644,783)	(18,654)
Unrealized (loss) gain on financial instruments	5(c)	3,279,258	(2,423,282)
Net revenue		15,309,689	6,715,091
Expenses			
Production and operating		5,614,899	4,225,131
Exploration and evaluation	8	932,374	576,586
Depletion and depreciation	9	4,460,900	3,097,839
General and administrative		1,875,256	1,584,837
Share-based payments	13(b)	263,235	233,508
Impairment of property and equipment	9	1,574,872	-
		14,721,536	9,717,901
Results from operating activities		588,153	(3,002,810)
Finance expense	11	(3,298,569)	(1,078,380)
Foreign exchange gain (loss)		(2,143,153)	(262,731)
Loss before tax		(4,853,569)	(4,343,921)
Deferred tax recovery	17	-	547,746
Net loss and comprehensive loss for the			
Year		\$ (4,853,569)	\$ (3,796,175)
Net loss per share, basic and diluted	13(d)	\$ (0.05)	\$ (0.04)

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Expressed in Canadian dollars)

	Note	Number of common shares	Share Capital	Contributed Surplus	Warrant Reserve	Deficit	Total Equity
Balance, December 31, 2016		85,745,102	\$ 53,838,621	\$ 1,192,106	\$ -	\$ (33,136,591)	\$ 21,894,136
Flow-through share issuance		4,048,200	1,133,496	-	-	-	1,133,496
Share issuance costs		-	(85,748)	-	-	-	(85,748)
Flow-through share premium		-	(161,928)	-	-	-	(161,928)
Share-based payments	13(b)	-	-	332,669	-	-	332,669
Expiry of stock options		-	-	(875,000)	-	875,000	-
Warrant Issue – net deferred tax	13(c)	-	-	-	1,043,136	-	1,043,136
Net loss for the year		-	-	-	-	(3,796,175)	(3,796,175)
Balance, December 31, 2017		89,793,302	\$ 54,724,441	\$ 649,775	\$ 1,043,136	\$ (36,057,768)	\$ 20,359,584
Balance, December 31, 2017		89,793,302	\$ 54,724,441	\$ 649,775	\$ 1,043,136	\$ (36,057,768)	\$ 20,359,584
Share-based payments	13(b)	-	-	364,848	-	-	364,848
Net loss for the year		-	-	-	-	(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

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

(Expressed in Canadian dollars)

	Years Ended December 31	
	2018	2017
Operating activities		
Net loss for the year	\$ (4,853,569)	\$ (3,796,175)
Items not affecting cash:		
Accretion of debt issuance costs	293,681	48,738
Accretion of decommissioning costs	138,345	107,727
Amortization of deferred charges	202,332	87,837
Deferred tax recovery	-	(547,746)
Depletion and depreciation	4,460,900	3,097,839
Exploration and evaluation expense	932,374	576,586
Share-based payments	263,235	233,508
Unrealized loss (gain) on financial instruments	(3,279,258)	2,423,282
Unrealized loss on foreign exchange	2,279,935	244,453
Impairment	1,574,872	-
	2,012,847	2,476,049
Changes in non-cash working capital	217,224	(560,801)
Cash provided by operating activities	2,230,071	1,915,248
Investing activities		
Property and equipment expenditures	(12,398,208)	(4,580,698)
Exploration and evaluation expenditures	(3,659,109)	(4,108,542)
Changes in non-cash working capital	488,168	1,044,020
Cash used in investing activities	(15,569,149)	(7,645,220)
Financing activities		
Shares issued for cash, net of issue costs	-	1,047,748
Change in bank indebtedness	-	(11,247,537)
Proceeds from term loan (net of issue costs – Note 12)	13,746,745	17,302,753
Changes in non-cash working capital	-	-
Cash provided by financing activities	13,746,745	7,102,964
Net change in cash	407,667	1,372,991
Cash, beginning of year	1,372,991	-
Cash, end of year	\$ 1,780,658	\$ 1,372,991

Supplemental cash flow information (Note 16)

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2018 and December 31, 2017

(Expressed in Canadian dollars)

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. The Company has no subsidiaries.

2. Basis of Presentation

(a) Statement of compliance

These audited annual financial statements ("Financial Statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

These Financial Statements were authorized for issuance by the Board of Directors on April 24, 2019.

(b) Basis of presentation

These Financial Statements have been prepared on a historical cost basis, except for certain financial instruments and share-based payments, which are stated at their fair values. These policies have been applied consistently for all periods presented, other than as described in note 3.

(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.

Reserve estimation including engineering data, geological and geophysical data, projected future rates of production, commodity pricing, operating costs and timing of future expenditures, are subject to significant judgment and interpretation. These estimates are a critical part of many of the estimated amounts and calculations contained in the financial statements. These estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations. These determinations are updated at least on an annual basis.

As part of its capital management process the Company prepares budgets and forecasts, which are used by management and the Board of Directors to direct and monitor the strategy and ongoing operations and liquidity of the Company. Budgets and forecasts are subject to significant judgment and estimates relating to activity levels, future cash flows and the timing thereof and other factors which may or may not be within the control of the Company. See further discussions relating to liquidity in Note 5.

Significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the financial statements include:

- (i) Impairment testing – internal and external sources of information including petroleum and natural gas prices, expected production volumes, anticipated recoverable quantities of proved and probable reserves and rates used to discount future cash flow estimates. Judgement is required to assess these factors when determining if the carrying amount of an asset is impaired, or in the case of previously impaired asset, whether the carrying amount of the asset has been restored.
- (ii) Depletion and depreciation – oil and natural gas reserves, including future prices, costs and reserve base to use on calculation of depletion.
- (iii) Decommissioning obligations – estimates relating to amounts, likelihood, timing, inflation and discount rates.
- (iv) Share-based payments – expected life of the options, risk-free rate of return and stock price volatility
- (v) Determinations of cash generating units ("CGUs") – geographic location, commodity type, reservoir characteristics and lowest level of cash inflows.
- (vi) Determining the technical feasibility and commercial viability of exploration and evaluation assets.
- (vii) Business combinations - estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of petroleum and natural gas properties based upon the estimation of recoverable quantities of Proved and Probable reserves being acquired
- (viii) Provisions - exercise of significant judgment and estimates of the outcome of future events.
- (ix) Deferred tax asset – the amounts recorded for deferred tax assets are based on estimates as to the timing of the reversal of temporary differences, substantially enacted tax rates, and the likelihood of tax assets being realized. The availability of tax pools and other deductions are subject to audit and interpretation by tax authorities.

3. Significant Accounting Policies

(a) Revenue

The Company has adopted IFRS 15 effective January 1, 2018 and applied IFRS 15 to all of its contracts with customers using the modified respective method. Under this method, prior period financial statements have not been restated. Management reviewed the Company's revenue streams and major contracts with customers using the IFRS 15 principles-based five-step model and concluded there were no material changes to earnings or in the timing of when production revenue is recognized. As a result, no adjustments were required in the January 1, 2018 opening balance sheet.

The adoption of IFRS 15 results in new disclosure requirements contained in note 7 of these audited financial statements. The Company primarily earns revenue from sales of the production of light oil, heavy oil, natural gas and natural gas liquids. The Company may earn revenue from fees charged to third parties for processing and other services (i.e., gas and other product processing, etc.) provided at locations where the Company has processing facilities, however, the Company does not currently conduct any third party processing.

Revenues from the sale of crude oil, natural gas liquids and natural gas is recognized based on the consideration specified in contracts with customers. The Company recognizes revenue when it transfers control of the product to the customer, which is generally when legal title passes to the customer which is when it is physically transferred to the pipeline or other transportation method agreed upon and collection is reasonably assured. Any revenues from processing activities are recognized over time as processing occurs, and are generally billed monthly.

The Company evaluates its arrangements with third parties and partners to determine if the Company is acting as the principal or as an agent. The Company is considered the principal in a transaction when it has primary responsibility for the transaction. If the Company acts in the capacity of an agent rather than as a principal in a transaction, then the revenue is recognized on a net basis, only reflecting the fee, if any, realized by the Company from the transaction.

(b) Jointly owned assets

Some of the Company's petroleum and natural gas activities involve jointly owned assets and are conducted under joint operating agreements. Accordingly the financial statements reflect the Company's proportionate share of joint assets, liabilities, revenues and expenses.

(c) Property and equipment and exploration and evaluation assets

(i) Pre-exploration expenditures

Expenditures made by the Company before acquiring the legal right to explore in a specific area do not meet the definition of an asset and therefore are expensed as incurred.

(ii) Exploration and evaluation expenditures

Costs incurred once the legal right to explore has been acquired are capitalized as exploration and evaluation assets. These costs include, but are not limited to, exploration license expenditures, leasehold property acquisition costs, evaluation costs, drilling costs directly attributable to an identifiable well, and directly attributable general and administrative costs. These costs are accumulated in cost centers by property and are not subject to depletion until technical feasibility and commercial viability has been determined.

Exploration and evaluation assets are assessed for impairment at each reporting date when facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability are considered to be determinable when Proved and Probable reserves have been identified. A review of each exploration license or field is carried out quarterly to ascertain whether Proved and Probable reserves have been discovered. Upon determination of Proved and Probable reserves, exploration and evaluation assets attributable to those reserves are tested for impairment and reclassified from exploration and evaluation assets to petroleum and natural gas properties.

(iii) Property and equipment

Items of property and equipment, which include petroleum and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and impairment losses.

Gains and losses on disposal of an item of property and equipment, including petroleum and natural gas properties, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized in profit or loss.

(iv) Capitalization of costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are recognized as petroleum and natural gas properties only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized petroleum and natural gas properties generally represent costs incurred in developing Proved and/or Probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(v) Depletion and depreciation

Depletion of petroleum and natural gas properties is determined using the unit-of-production method based on production volumes in relation to total estimated Proved and Probable reserves as determined annually by independent engineers and determined in accordance with National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities. Natural gas reserves and production are converted at the energy equivalent of six thousand cubic feet to one barrel of oil.

The calculation of depletion and depreciation is based on total capitalized costs plus estimated future development costs of Proved and Probable non-producing and undeveloped reserves.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids, which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as Proved and Probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proved component of Proved and Probable reserves are 90 percent and 10 percent, respectively.

Such reserves may be considered commercially viable if management has the intention of developing and producing them. Such intention is based upon:

- A reasonable assessment of the future economics of such production;
- A reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- Evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered Proved if supported by either actual production or conclusive formation tests. The area of reservoir considered Proved includes (a) that portion delineated by drilling and defined by as-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower Proved limit of the reservoir.

Reserves that can be produced economically through application of improved recovery techniques such as fluid injection are only included in the Proved classification when successful testing by a pilot project, the operation of an installed program in the reservoir or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

Depreciation of other equipment is provided for on a 20-30% declining balance basis. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(vi) Impairment

Exploration and evaluation assets are grouped together with the Company's CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to developed and producing assets (petroleum and natural gas properties).

Exploration and evaluation assets are assessed for impairment when they are reclassified to developing and producing assets, as part of the petroleum and natural gas properties, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For developed and producing assets, an impairment is recorded when the recoverable amount of a CGU is less than the respective carrying amount. Recoverable amount is the higher of its fair value less cost to sell and value in use. Fair value is the price that would be received from selling an asset in an orderly transaction between market participants. Fair value less costs to sell can be determined by using observable market information or by using discounted future net cash flows of Proved and Probable reserves using forecasted prices and costs. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU.

Judgment is required to assess when indicators of impairment or reversals exist and whether calculation of the recoverable amount of an asset is necessary. Management considers internal and external sources of information including petroleum and natural gas prices, expected production volumes, anticipated recoverable quantities of proved and probable reserves and rates used to discount future cash flow estimates. Judgment is required to assess these factors when determining if the carrying amount of an asset is impaired, or in the case of previously impaired asset, whether the carrying amount of the asset has been restored.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of goodwill, if any, allocated to the units and then to reduce carrying amounts of other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been

determined, net of depletion and depreciation, if no impairment loss had been recognized.

(d) Decommissioning obligations

Decommissioning obligations are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is included as finance expense whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision.

(e) Share-based payments

The Company has a stock option plan that is described in Note 13(b). Share-based payments to employees are measured at the fair value of the instruments issued and are amortized over the vesting periods. The offset to the recorded cost is to Company's contributed surplus.

Consideration received on the exercise of stock options is recorded as share capital and the related contributed surplus is transferred to capital stock. Charges for options that are forfeited before vesting are reversed from contributed surplus. For those options that expire after vesting, the recorded value is transferred to deficit.

(f) Share Capital and warrants

The Company uses the fair value method for valuing stock options, restricted and performance share awards, performance warrants and warrants. Under the fair value method, compensation costs attributable to all stock options, restricted and performance share awards, performance warrants and warrants granted are measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus or warrants. A forfeiture rate is estimated on the date of grant and is adjusted to reflect the actual number of awards that vest. Performance share awards are also subject to a performance multiplier that is adjusted to reflect the final number of awards. The fair value of each option, performance warrant or warrant granted is estimated using the Black-Scholes option pricing model that takes into account the grant date, the exercise price and expected life of the option, performance warrant or warrant, the price of the underlying security, the expected volatility, the risk-free interest rate and dividends, if any, on the underlying security. The fair value of each restricted and performance share award is determined with reference to the trading price of the Company's common shares on the date of grant. Upon the exercise of the stock options, restricted and performance share awards, performance warrants and warrants, consideration received together with the amount previously recognized in contributed surplus or warrants is recorded as an increase to share capital and the contributed surplus or warrants balance is reduced.

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

(g) Flow-through shares and units

The Company, from time to time, may issue flow-through common shares to finance a portion of its petroleum and natural gas exploration activities. Canadian income tax law permits the Company to renounce to the flow-through shareholders the income tax attributes of certain petroleum and natural gas exploration and evaluation costs financed by such shares. A liability is recognized for any premium on the flow-through shares in excess of a regular common share and is subsequently reversed as the Company incurs qualifying the designated Canadian exploration or development expenses.

(h) Income taxes

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss, except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current income tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

(i) Per share amounts

Basic per share amounts are calculated by dividing the income or loss attributable to common shareholders of the Company by the weighted-average number of common shares outstanding during the period. Diluted income or loss per share is determined by dividing the income or loss attributable to common shareholders by the weighted-average number of shares outstanding adjusted for the effects of dilutive instruments such as options and warrants.

The Company uses the treasury stock method to compute the dilutive effect of stock options and warrants. Under this method the dilutive effect on earnings per share is calculated

presuming the exercise of outstanding stock options and warrants. It assumes that proceeds received from the exercise of stock options and warrants would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

(j) Changes in accounting policies

- i) IFRS 15 - In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2018. The new standard provides a single, principles-based five-step analysis of transactions to determine the nature of an entity's obligation to perform and whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.
- ii) IFRS 9 - In July 2014, the IASB finalized the remaining elements of IFRS 9 – Financial Instruments, which includes new requirements for the classification and measurement of financial assets, amends the impairment model and outlines a new general hedge accounting standard.

On January 1, 2018, the Company adopted all of the requirements of IFRS 9, "Financial Instruments" ("IFRS 9") which replaces IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The adoption of IFRS 9 had no material impact to the Company's financial statements.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost; fair value through other comprehensive income ("FVOCI"); or fair value through profit or loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale. IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 as at January 1, 2018 for each class of the Company's financial assets and financial liabilities:

Financial instrument	Measurement category	
	IAS 39	IFRS 9
Cash and cash equivalents	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Financial derivative contracts	Fair value via profit or loss	Fair value via profit or loss
Accounts payable and accrued liabilities	Financial liabilities at amortized cost	Amortized cost
Term loan	Financial liabilities at amortized cost	Amortized cost

There were no adjustments to the carrying amounts of the Company's financial instruments as a result of the change in classification from IAS 39 to IFRS 9. The Company does not apply hedge accounting.

IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" ("ECL") model. The Company measures loss allowances at an amount equal to expected lifetime ECLs. Lifetime ECLs are the anticipated ECLs that result from all possible default events over the expected life of a financial asset. ECLs are a probability-weighted estimate of credit loss and are discounted at the effective interest rate of the related financial asset. The application of the new expected credit loss model did not have a significant impact on the Company's financial assets.

k) Future accounting pronouncements

At the date of these financial statements the standards and interpretations listed below were issued but not yet effective. The adoption of these standards may result in future changes to existing accounting policies and disclosures. The Company is currently evaluating the impact that these standards will have on results of operations and financial position.

IFRS 16 - In January 2016, the IASB issued IFRS 16 Leases, which replaces the current IFRS guidance on leases under IAS 17. Under the current guidance, lessees are required to determine if the lease is a finance or operating lease, based on specified criteria. Finance leases are recognized on the balance sheet, while operating leases are recognized in profit or loss when the expense is incurred.

Under IFRS 16, lessees must recognize a lease liability and a right-of-use asset for virtually all lease contracts. The recognition of the present value of minimum lease payments for certain contracts currently classified as operating leases will result in increases to assets, liabilities, depletion, depreciation and amortization, and finance expense, and a decrease to production, operating and transportation expenses upon implementation. Cash flows associated with lease repayments will be allocated between operating and financing activities based on their interest repayment and principal repayment portions. An optional exemption to not recognize certain short-term leases and leases of low value can be applied by lessees. For lessors, the accounting remains essentially unchanged.

The standard will be effective for the Company on January 1, 2019. The Company is currently evaluating the impact of adopting IFRS 16 on the Company's financial statements and is in the final stage of gathering and analyzing contracts that will fall into scope of this standard. The Company expects adjustments for surface land rights,

certain leased vehicles and field equipment; however, the full extent of the impact has not yet been finalized as the Company has not completed reviewing all of the contracts that it has in place.

There are no other standards and interpretations in issue but not yet adopted that are expected to have a material effect on the reported earnings or net assets of the Company.

4. Financial Instruments

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, changes in assumptions can significantly affect estimated fair values. At December 31, 2018, the Company's financial instruments include cash and cash equivalents, accounts receivable, reclamation deposits, term loan, and accounts payable and accrued liabilities.

The fair values of cash and cash equivalents, accounts receivable, reclamation deposits and accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of these financial instruments. The fair value of the term loan is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date, which approximates the carrying value.

a) Fair value hierarchy

Fair value measurements of financial instruments are required to be classified using a fair value hierarchy that reflects the significance of inputs in making the measurements. The levels of the fair value hierarchy are defined as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs for the asset or liability that are not based on observable market data.

b) Non-derivative financial instruments

Financial assets

At initial recognition, financial assets are classified into four main categories: loans and receivables; held-to-maturity investments; available for sale financial assets; or financial assets at fair value through profit or loss. All financial assets are recognized initially at fair value, normally being the transaction price, plus any directly attributable transaction costs. Transaction costs for instruments at fair value through profit or loss are recognized immediately in earnings.

The subsequent measurement of financial assets depends on their classification.

Loans, receivables and held-to-maturity investments are subsequently measured at amortized cost using the effective interest method, less any impairment losses. Gains and losses are recognized in earnings when the asset is derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets are subsequently measured at fair value, with changes in fair value recognized directly in other comprehensive income until the asset is derecognized or determined to be impaired, at which time the cumulative change in fair value previously reported in other comprehensive income is recognized in earnings.

Financial assets at fair value through profit or loss are subsequently measured at fair value, with changes in those fair values recognized in earnings.

Financial assets are derecognized when the contractual rights to the cash flows expire, or when substantially all the risks and rewards of ownership of the financial asset are transferred to a third party.

Financial assets and liabilities are shown separately in the statement of financial position unless the Company has a legal right to offset the amounts and intends to either settle on a net basis or to realize the asset and settle the liability simultaneously, in which case they are presented on a net basis.

Impairment of financial assets

A financial asset that is not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that a loss event has occurred after initial recognition and has had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

The Company considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant financial assets are tested for impairment on an individual basis. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. The remaining financial assets are assessed collectively for impairment in groups that share similar credit risk characteristics.

In assessing collective impairment the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

All impairment losses are recognized in earnings.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in earnings.

Financial liabilities

At initial recognition, financial liabilities are classified as either financial liabilities at fair value through profit or loss, or other financial liabilities. All financial liabilities are recognized initially at fair value, normally being the transaction price less any directly attributable transaction costs. Transaction costs for instruments at fair value through profit or loss are recognized immediately in earnings.

The subsequent measurement of financial liabilities depends on their classification.

Financial liabilities at fair value through profit or loss are subsequently measured at fair value, with changes in those fair values recognized in earnings.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Financial liabilities are derecognized when the contractual obligation expires, is discharged, or cancelled. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognized in earnings.

c) Financial derivative instruments

The Company may use financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices and foreign exchange. These instruments are not used for trading or speculative purposes.

The Company has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Company considers all derivative contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recognized at fair value. Transaction costs are recognized in earnings when incurred.

Physical delivery contracts are entered into for the purpose of delivery of oil in accordance with the Company's expected sale requirements, and therefore are not recorded in the statement of financial position. These contracts are recorded in revenue on their settlement dates.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized in earnings.

5. 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:

	December 31, 2018	December 31, 2017
Accounts receivable		
Marketing receivables	\$ 168,284	\$ 1,284,474
Trade receivables	\$ 104,454	\$ 76,437
Receivables from joint ventures	14,431	7,297
Reclamation deposits	115,535	115,535
	\$ 402,704	\$ 1,483,743

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 25th 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 December 31, 2018, the Company had net debt (current assets less current liabilities excluding fair value of financial instruments, and outstanding term loan) of \$35,446,384 (December 31, 2017 - \$18,558,361). The Company funds its operations through operating cash flows and the term loan, which included proceeds drawn of \$13,746,745 (2017 - 17,302,753) net of issue costs. At December 31, 2018, the Company has an additional US\$4 million of borrowing base committed with its lender, which it can draw for future capital programs.

(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 \$355,000 effect on net loss.

(ii) Foreign currency risk

The Company's functional and reporting currency is the Canadian dollar. The Company does not sell or transact in any foreign currency; except; i) the Company's commodity prices are largely denominated in United States dollars ("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. ii) the Company's Term Loan is denominated in USD, and as 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 100 basis points change in the foreign exchange rate would have a \$240,000 effect on the annual net 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 does have hedging swap agreements in place as further disclosed herein.

At December 31, 2018, the Company held derivative commodity contracts as follows:

Product	Type	Volume	Price	Index	Term	Dec. 31, 2018 Fair Value
Crude oil	Swaption	150 bbl/d	US\$54.65	WTI-NYMEX	July 1, 2018 – February 28, 2019	108,442
Crude oil	Swap	250 bbl/d	US\$19.20	WCS	January 1, 2019 – March 31, 2019	(14,106)
Crude oil	Swap	200 bbl/d	US \$18.10	WCS	February 1, 2019 – March 31, 2019	22,939
Crude oil	Swap	250 bbl/d	US\$50.67	WTI-NYMEX	January 1, 2019 – December 31, 2019	418,910
Crude oil	Collar	130 bbl/d	US\$40.00-US\$74.50	WTI-NYMEX	March 1, 2019 – December 31, 2019	100,616
Crude oil	Swap	200 bbl/d	US\$50.67	WTI-NYMEX	January 1, 2020 – August 31, 2020	106,961
Crude oil	Collar	120 bbl/d	US\$40.00-US\$68.25	WTI-NYMEX	January 1, 2020 – December 31, 2020	93,208
Crude oil	Collar	200 bbl/d	US\$40.00-US\$67.05	WTI-NYMEX	September 1, 2020 – December 31, 2020	42,525
Crude oil	Collar	275 bbl/d	US\$40.00-US\$65.50	WTI-NYMEX	January 1, 2021 – March 31, 2021	(23,519)
Total						\$855,976

At December 31, 2018, the commodity contracts were fair valued as an asset of \$855,976 and an unrealized gain of \$3,279,258 for the year ended December 31, 2018.

At December 31, 2017, the Company held derivative commodity contracts as follows:

Product	Type	Volume	Price	Index	Term	Dec. 31, 2017 Fair Value
Crude oil	Swap	150 bbl/d	US\$54.65	WTI-NYMEX	November 1, 2017 – June 30, 2018	(188,617)
Crude oil	Swap	300 bbl/d	US\$50.67	WTI-NYMEX	January 1, 2018 – December 31, 2018	(1,189,728)
Crude oil	Option	150 bbl/d	US\$54.65	WTI-NYMEX	July 1, 2018 – February 28, 2019	(255,121)
Crude oil	Swap	250 bbl/d	US\$50.67	WTI-NYMEX	January 1, 2019 – December 31, 2019	(595,793)
Crude oil	Swap	200 bbl/d	US\$50.67	WTI-NYMEX	January 1, 2020 – August 1, 2020	(194,024)
Total						\$(2,423,282)

At December 31, 2017, the commodity contracts were fair valued as a liability of \$2,423,282 and an unrealized loss of \$2,423,282 for the year ended December 31, 2017.

(iv) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk or foreign currency risk. The Company is not exposed to significant other price risk.

6. 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, 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 year.

7. 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 5(a). As at December 31 2018, production revenue sold to customers was comprised primarily from three marketers which account for \$162,699 of the accounts receivable balance.

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

	Year Ended December 31	
	2018	2017
Oil	\$ 17,539,990	\$ 10,715,271
Natural gas	184,511	229,682
NGL	31,938	29,679
Total	\$ 17,756,439	\$ 10,974,634

8. 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, plant and equipment is made when reserves are assigned or the exploration project has been completed. For the year ended December 31, 2018, the Company transferred \$3,910,309 (December 31, 2017 - \$1,898,255) to property, plant and equipment, capitalized general and administrative expenses of \$173,487 (December 31, 2017 - \$157,564) to exploration and evaluation assets, and recognized exploration and evaluation expense of \$932,374 (December 31, 2017 - \$576,586), which relate to expired or uneconomic properties.

Cost	
Balance, December 31, 2016	\$ 3,260,407
Additions	4,108,542
Exploration and evaluation expense	(576,586)
Transfer to property, plant and equipment	(1,898,255)
Balance, December 31, 2017	\$ 4,894,108
Additions	3,659,109
Exploration and evaluation expense	(932,374)
Transfer to property, plant and equipment	(4,425,628)
Balance, December 31, 2018	\$ 3,195,215

9. Property, Plant and Equipment

	Petroleum and Natural Gas		Other Equipment		Total
Cost					
Balance, December 31, 2016	\$	67,142,548	\$	114,492	\$ 67,257,040
Additions		4,580,698		-	4,580,698
Decrease in decommissioning obligations		1,171,705		-	1,171,705
Capitalized share-based payments		99,161		-	99,161
Transfer from exploration and evaluation assets		1,898,255		-	1,898,255
Balance, December 31, 2017	\$	74,892,367	\$	114,492	\$ 75,006,859
Additions		12,398,208		-	12,398,208
Change 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	\$ 93,374,716
Accumulated Depletion, Depreciation, Amortization and Impairment					
Balance, December 31, 2016	\$	31,929,680	\$	85,316	\$ 32,014,996
Depletion and depreciation for the year		3,090,462		7,377	3,097,839
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
Net Book Value					
December 31, 2017	\$	39,872,225	\$	21,799	\$ 39,894,023
December 31, 2018	\$	52,209,791	\$	16,319	\$ 52,226,110

The Company's additions for property, plant and equipment included capitalized general and administrative expenses of \$336,301 and \$228,964 for the years ended December 31, 2018 and 2017, respectively.

The calculation for depletion at December 31, 2018 includes estimated future development costs of \$50,819,300 (December 31, 2017 - \$34,424,000) associated with the development of the Company's Proved plus Probable reserves.

At December 31, 2018, the Company performed an assessment of potential impairment indicators on each of its CGUs, and management determined that an impairment test on its petroleum and natural gas assets was required due to volatile and low commodity prices. It was determined that the carrying amount of Jenner exceeded its recoverable value of \$11,682,760 for the year ended December 31, 2018 (year ended December 31, 2017 - \$16,411,131). Accordingly, the Company recognized an impairment charge of \$1,413,268 as at December 31, 2018 (December 31, 2017 - \$nil). It was also determined that the Company would impair its three non-core natural gas properties which were not assigned economic reserves. Accordingly, the Company recognized an impairment charge in aggregate of \$161,604 for the three natural gas properties as at December 31, 2018 (December 31, 2017 - \$nil). No impairment was recognized for Atlee Buffalo as its recoverable value exceeded the carrying amount.

The recoverable amounts were determined with fair value less costs to sell using a discounted cash flow method and categorized in Level 3 of the fair value hierarchy. Key assumptions in the determination of cash flows from reserves include crude oil and natural gas prices, loss factors and discount rates specific to the underlying composition of assets residing in each CGU. The pre-tax discount rates ranged from 10% to 15% depending on the nature of the reserves. The following tables show the future commodity price estimates used by the Company's independent reserves evaluator at December 31, 2018:

2018	2019	2020	2021	2022	2023	2024	2025	2026	Thereafter
WTI (US\$/bbl)	56.50	63.80	67.60	71.60	73.10	74.50	76.00	77.50	+2%/yr
WCS (C\$/bbl)	47.50	58.00	64.40	68.40	69.80	71.20	72.60	74.00	+2%/yr
AECO(Cdn\$/MMbtu)	1.85	2.20	2.55	3.05	3.20	3.30	3.35	3.40	+2%/yr

10. 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 December 31, 2018 is \$11,993,913 (December 31, 2017 - \$9,912,034). These payments are expected to be made over the next 43 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, 2017 - 2.24%). Inflation of 2.1% (December 31, 2017 - 1.80%) has also been factored into the calculation of amounts in the table below. The Company also has \$115,535 (December 31, 2017 - \$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.

The change in estimates for the years ended December 31, 2018 and 2017 resulted from the decommissioning obligations being revalued at the year-end risk-free and inflation rates.

	December 31, 2018	December 31, 2017
Decommissioning obligations, beginning of year	\$ 6,176,112	\$ 4,896,681
Increase in estimated future obligations	1,154,722	847,114
Change in estimate	287,687	324,591
Accretion expense	138,345	107,727
Decommissioning obligations, end of year	\$ 7,756,866	\$ 6,176,112

11. Finance Expenses

	Year Ended December 31	
	2018	2017
Finance expense:		
Cash interest expense	\$ 2,664,211	\$ 834,078
Amortization of deferred charges	293,681	87,837
Accretion of debt issuance costs	202,332	48,738
Accretion of decommissioning liabilities	138,345	107,727
Total	\$ 3,298,569	\$ 1,078,380

12. 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 obtain an increased commitment of 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 December 31, 2018 the Company has drawn US\$26.0 million (CAD\$35,458,800 - at closing US exchange rate). 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 10.66%.

The below table outlines the changes in the term loan and deferred charges compared to the prior year:

	Term Loan		Deferred Charges	
	2018	2017	2018	2017
Balance, beginning of year	\$ 17,465,518	\$ -	\$ (1,210,691)	\$ -
Principal amount issued	14,199,400	18,530,810		
Foreign exchange adjustment	2,279,936	244,453		
Transfer of deferred issuance costs cash	(534,379)	(746,074)	81,724	(481,983)
Transfer of deferred issuance costs warrants	(380,573)	(612,409)	380,573	(816,545)
Deferred charges /amortized	-	-	202,332	87,837
Accretion of debt issuance costs	293,681	48,738		
Balance, end of year	33,323,584	17,465,518	(546,063)	(1,210,691)

The Company drew US\$11.0 million (CAD\$14,199,400) on the term loan in the year (2017 – US\$15.0 million; CAD\$18,530,810), and incurred additional debt issuance costs of \$452,655 (2017 – \$1,228,057), for net proceeds of \$13,746,745.

The below table summarizes the sum of issuance costs included in both the term loan and deferred charges as at December 31, 2018:

	Term Loan	Deferred Charges	Total
Principal amount of Term Loan issued	\$ 32,730,210	\$ -	\$ 32,730,210
Foreign exchange adjustment	2,524,389	-	2,524,380
Debt issuance costs	(1,280,453)	(400,259)	(1,680,712)
Value allocated to warrants	(992,982)	(435,973)	(1,428,955)
Amortization of deferred charges	-	290,169	290,169
Accretion of debt issuance costs	342,419	-	342,419
Balance, end of year – liability (asset)	\$ 33,323,584	\$ (546,063)	\$ 32,777,521

The Company has recognized a portion of the debt issuance costs and value allocated to the warrants (Note 13(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, which are listed below from the fourth quarter ended December 31, 2018 and onward:

1. Interest coverage ratio for the quarter ended December 31, 2018 shall not be less than 2.50 to 1.00; quarter ended March 31, 2019 and each quarter thereafter shall not be less than 3.00 to 1.00. This ratio is calculated using amounts from the reporting quarter only.

Interest coverage ratio, as defined in the Credit Agreement, means the ratio as of the last day of any fiscal quarter of (a) Adjusted EBITDAX as defined below for the applicable fiscal quarter to (b) Interest Expense for such fiscal quarter.

2. Total leverage ratio for the quarter ended December 31, 2018 shall not be more than 4.25 to 1.00; quarters ended March 31, 2019 and June 30, 2019 shall not be more than 3.50 to 1.00; quarter ended September 30, 2019 and each quarter thereafter shall not be more than 3.25 to 1.00.

Total leverage ratio, as defined in the Credit Agreement, means the ratio as of the last day of any fiscal quarter of (a) Total Debt as of such date to (b) Adjusted EBITDAX for the fiscal quarter ending on such date calculated on an annualized basis, whereas Adjusted EBITDAX from the reporting quarter is factored by four.

3. The Company also has a financial covenant for its cash general and administrative costs (“G&A costs”) that it shall not exceed 105% of the cash costs cap of \$2.5 million per annum as at December 31, 2018.

The Term Loan is also subject to certain performance covenants surrounding production and reserves as denoted in the table below. For the quarter ending December 31, 2018 the Company has met its required minimum average production and its general and administrative costs covenants. The two financial covenants (being the interest coverage ratio and total leverage ratio covenants) and two reserve-based covenants (being the PDP coverage ratio and total proved reserve coverage ratio covenants) were waived for the quarter ended December 31, 2018.

Ratio		Required	Actual Dec. 31, 2018	
1.	Interest Coverage Ratio	Greater than	2.50	Waived
2.	Total Leverage Ratio	Less than	4.25	Waived
3.	Minimum Average Production	Greater than	1,100	1,378 Boe/d
4.	Proved Developed Producing Coverage Ratio	Greater than	1.00	Waived
5.	Total Proved Reserves Coverage Ratio	Greater than	1.50	Waived
6.	General and Administrative Costs	Less than	\$2.65	\$2.39 \$MM

13. Share Capital

(a) Authorized

Unlimited number of common shares without par value.

Issued and outstanding

As at December 31, 2018, the Company had 89,793,302 (December 31, 2017 – 89,793,302) common shares issued and outstanding.

No shares were issued during the year ended December 31, 2018.

(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 December 31, 2018 and 2017 are as follows:

Exercise Price	Grant Date	Expiry Date	Balance Outstanding Dec. 31, 2017	Changes in the Year			Balance Outstanding Dec. 31, 2018	Balance Exercisable Dec. 31, 2018
				Granted	Exercised	Expired		
\$0.24	29-Jan-15	29-Jan-20	1,075,000	-	-	-	1,075,000	1,075,000
\$0.39	1-Mar-15	1-Mar-20	100,000	-	-	-	100,000	100,000
\$0.08	11-Feb-16	11-Feb-21	1,685,000	-	-	-	1,685,000	1,685,000
\$0.08	12-Feb-16	12-Feb-21	125,000	-	-	-	125,000	125,000
\$0.25	21-Sep-17	21-Sep-22	5,034,000	-	-	-	5,034,000	3,356,000
\$0.28	2-Oct-17	2-Oct-22	150,000	-	-	-	150,000	100,000
\$0.25	01-Jan-18	01-Jan-23	-	250,000	-	-	250,000	83,333
			8,169,000	250,000	-	-	8,419,000	6,524,333
Weighted-average exercise price			\$0.21	\$0.25	-	-	\$0.21	\$0.20

Exercise Price	Grant Date	Expiry Date	Balance Outstanding Dec. 31, 2016	Changes in the Year			Balance Outstanding Dec. 31, 2017	Balance Exercisable Dec. 31, 2017
				Granted	Exercised	Expired		
\$0.70	8-Feb-12	8-Feb-17	1,400,000	-	-	(1,400,000)	-	-
\$0.24	29-Jan-15	29-Jan-20	1,075,000	-	-	-	1,075,000	1,075,000
\$0.39	1-Mar-15	1-Mar-20	100,000	-	-	-	100,000	100,000
\$0.08	11-Feb-16	11-Feb-21	1,685,000	-	-	-	1,685,000	1,685,000
\$0.08	12-Feb-16	12-Feb-21	125,000	-	-	-	125,000	125,000
\$0.25	21-Sep-17	21-Sep-22	-	5,034,000	-	-	5,034,000	1,678,000
\$0.28	2-Oct-17	2-Oct-22	-	150,000	-	-	150,000	50,000
			4,385,000	5,184,000	-	(1,400,000)	8,169,000	4,713,000
Weighted-average exercise price			\$0.32	\$0.25	-	\$0.70	\$0.21	\$0.19

For the year ended December 31, 2018, the Company recognized \$364,848 (December 31, 2017 - \$332,669) in share-based payments of which \$263,235 (December 31, 2017 - \$233,508) was expensed as stock-based compensation and \$101,613 (December 31, 2017 - \$99,161) was capitalized to property, plant and equipment. These share-based payments were from the granting of 250,000 incentive stock options during 2018 (December 31, 2017 - 5,184,000) to directors, officers, employees and consultants of the Company at an exercise price of \$0.25 each, of which 83,333 vested immediately.

The fair value of the granted stock options was determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Year Ended December 31	
	2018	2017
Expected life (years)	5.00	5.00
Interest rate	1.86%	1.81%
Volatility	66.18%	66.18%
Fair value at grant date	\$ 0.25	\$ 0.14

The weighted-average exercise price for stock options granted during the year ended December 31, 2018 was \$0.25 (year ended December 31, 2017 - \$0.14). The forfeiture rate has been estimated at 5% (December 31, 2017 - 5%).

For the year ended December 31, 2018, the Company removed \$nil (year ended December 31, 2017 - \$875,000) from contributed surplus and recorded a corresponding recovery in deficit for expired stock options.

(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 12). 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 12. Further, a deferred tax liability of \$385,818 was incurred with regard to the warrants resulting in a net carrying amount of \$1,043,136.

As at December 31, 2018, the Company had 13,750,000 outstanding and exercisable share purchase warrants.

(d) Loss per share

	Years Ended December 31	
	2018	2017
Net loss for the year	\$ (4,853,569)	\$ (3,796,176)
Weighted-average number of common shares outstanding, basic	89,793,302	88,495,660
Dilutive stock options and warrants	-	-
Weighted-average number of common shares outstanding, diluted	89,793,302	88,495,660
Loss per share, basic and diluted	\$ (0.05)	\$ (0.04)

For the years ended December 31, 2018 and 2017, the Company incurred a loss; therefore, dilutive stock options and warrants were nil.

14. Related Party Transactions

Compensation to key executive personnel, consisting of the Company's officers, directors and Chairman, was paid as follows:

	Years Ended December 31	
	2018	2017
Salaries and wages	\$ 940,000	\$ 768,333
Share-based payments	137,499	172,575

15. Commitment

	2019	2020	2021	2022	2023	Total
Office Rental	\$ 142,864	142,864	142,864	142,864	59,527	630,983
Term Loan	-	-	-	35,458,800	-	35,458,800
Term Loan Interest	3,127,466	3,127,466	3,127,466	2,345,600	-	11,727,998
	\$ 3,270,330	3,270,330	3,270,330	37,947,264	59,527	47,817,781

The Company has a commitment to make monthly rental payments pursuant to the office rental agreement until May 30, 2023.

16. Supplemental Cash Flow Information

	Year Ended December 31	
	2018	2017
Provided by (used in):		
Accounts receivable	\$ 1,081,039	\$ (460,005)
Prepaid expenses	23,485	(44,431)
Accounts payable and accrued liabilities	(399,132)	987,655
Total changes in non-cash working capital	\$ 705,392	\$ 483,219
Provided by (used in):		
Operating activities	\$ 217,224	\$ (560,801)
Investing activities	488,168	1,044,020
Total changes in non-cash working capital	\$ 705,392	\$ 483,219

Cash interest paid on the Company's debts during the year ended December 31, 2018 was \$2,664,211 compared to \$834,078 for the year ended December 31, 2017.

17. Income Taxes

The reconciliation of income tax computed at the current statutory tax rate of 27.00% (year ended December 31, 2017 – 26.55 to income tax expense is:

	Year Ended December 31	
	2018	2017
Loss before tax	\$ (4,853,569)	\$ (4,343,921)
Statutory income tax rate	27%	26.55%
Expected income tax expense (recovery)	(1,310,464)	(1,153,739)
Non-deductible items	79,205	63,166
Other	2,679	(20,328)
Effect of change in tax rate	24	(84,797)
Amounts renounced on flow-through	-	144,116
Change in deferred tax asset	1,228,556	503,836
Deferred tax recovery	\$ -	\$ (547,746)

The combined deferred tax rate has increased from 26.55% to 27% as a result of the increase in the British Columbia tax rate from 11% to 12% effective January 1, 2018.

The tax affected items that give rise to significant portions of the deferred tax asset at December 31, 2018 and 2017 are presented below:

	December 31, 2018	December 31, 2017
Deferred tax assets		
Non-capital losses	\$ 4,460,192	\$ 3,218,319
Share issue costs	-	49,651
Decommissioning obligations	2,094,354	1,667,551
Financial instruments	-	654,286
Term loan	12,774	-
	6,567,320	5,589,807
Deferred income tax liability		
Property and equipment	(6,336,206)	(4,975,292)
Financial instruments	(231,114)	-
Term loan	-	(614,515)
	\$ -	\$ -

The Company assessed the probability that future taxable profit will be available against which the Company can utilize the benefits of tax pools in excess of the carrying amount of assets and has not recognized a deferred tax asset in respect of the following deductible temporary differences.

	December 31, 2018	December 31, 2017
Net-capital loss carryforwards	95,333	95,333
Non-capital losses	19,795,031	15,319,328
Share issue cost	101,171	143,182
Debt issue cost	1,098,959	982,446
	\$ 21,090,494	\$ 16,540,289

As at December 31, 2018, the Company has non-capital losses of approximately \$36,314,261 that may be applied to reduce future Canadian taxable income, expiring as follows:

Available to		
2026	\$	546,873
2027		340,994
2028		215,784
2029		311,713
2030		323,389
2031		556,859
2032		1,736,206
2033		2,540,111
2035		7,173,180
2036		7,644,779
2037		6,040,309
2038		8,884,064
	\$	36,314,261

18. Subsequent Events

Subsequent to the year end, the Company entered into the following commodity price contracts:

Product	Type	Volume	Price	Index	Term
Crude oil	Collar	200 bbl/d	US\$56.00-US\$59.00	WTI-NYMEX	April 1, 2019 – June 30, 2019
Crude oil	Swap	100 bbl/d	US\$12.60	WCS	April 1, 2019 – June 30, 2019
Crude oil	Swap	350 bbl/d	US\$10.50	WCS	May 1, 2019 – June 30, 2019
Crude oil	Swap	250 bbl/d	US\$13.50	WCS	April 1, 2019 – September 30, 2019
Crude oil	Swap	200 bbl/d	US\$13.65	WCS	April 1, 2019 – September 30, 2019
Crude oil	Swap	100 bbl/d	US\$17.30	WCS	July 1, 2019 – September 30, 2019
Crude oil	Swap	100 bbl/d	US\$15.45	WCS	July 1, 2019 – September 30, 2019
Crude oil	Collar	100 bbl/d	US\$55.00-US\$63.25	WTI-NYMEX	July 1, 2019 – September 30, 2019
Crude oil	Collar	100 bbl/d	US\$55.00-US\$66.00	WTI-NYMEX	April 1, 2019 – December 31, 2019



OFFICERS

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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

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Gregg Vernon, P.Eng.⁽¹⁾⁽⁴⁾

Richard Wyman, B.Sc., MBA⁽¹⁾⁽⁴⁾

- ⁽¹⁾ Audit Committee
- ⁽²⁾ Compensation/Nominating Committee
- ⁽³⁾ Corporate Governance Committee
- ⁽⁴⁾ Reserves Committee

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