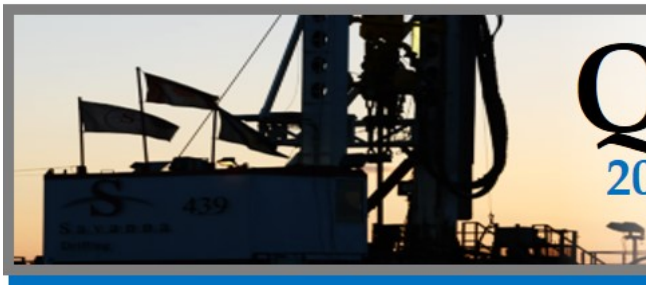

# Q3 2020 Hemisphere energy corporation

TSX-V: HME
www.hemisphereenergy.ca

## Q3 2020 HIGHLIGHTS

- Achieved revenue of $5.9 million.
- Realized an operating netback of $4.7 million, including hedging gains of $0.9 million.
- Attained quarterly adjusted funds flow from operations of $3.4 million or $0.04 per share (basic).
- Maintained average quarterly production at 1,686 boe/d (99% heavy crude oil).
- Reduced operating and transportation expenses to $9.31/boe, a 21% decrease from the third quarter of 2019.
- Achieved an operating netback of $30.41/boe, including a $5.51/boe hedging gain.
- Lowered net debt to $27.4 million, an 11% decrease from the end of the second quarter 2020.
- Corporate Liability Management Ratio (LMR) with the Alberta Energy Regulator was 12.23 as of the end of the third quarter of 2020.

## CORPORATE UPDATE

Hemisphere had a very successful third quarter with oil prices recovering significantly from those seen during the second quarter. Combined with flat production and considerable reductions in operating costs, the Company attained adjusted funds flow from operations ("funds flow") of $3.4 million ($0.04 per basic share). With minimal capital expenditures, Hemisphere was able to focus on debt reduction. As a result, net debt was lowered to $27.4 million by the end of the third quarter, yielding an annualized net debt to funds flow ratio of 2.0.

Hemisphere's production averaged 1,686 boe/d (99% heavy crude oil) through the third quarter of 2020, up slightly by 2.5% over the second quarter. The Company has already converted one of its Atlee Buffalo G pool wells to an injector, and plans to convert three more wells in the pool to injectors over the next few months to further optimize waterflood performance. Emphasis continues to be placed on production efficiencies, which has resulted in a 21% reduction in operating and transportation costs as compared to the third quarter of 2019. Hemisphere has focused heavily on debt repayment over the past year, and has lowered its net debt position by $8.6 million, or 24% as compared to the third quarter of 2019.

Overcoming unprecedented challenges presented this year, Hemisphere has recorded $13.3 million in revenue, $10.9 million in operating netback, and $6.9 million ($0.08 per basic share) in funds flow, with capital expenditures of just under $1.1 million during the first nine months of 2020. Over this same period, average production has grown by 18% from the first three quarters of 2019 to 1,768 boe/d (99% heavy crude oil) this year, and operating and transportation costs have been reduced by 30% from the comparable period in 2019 to $9.06/boe this year.

## CORPORATE OUTLOOK

In the coming quarters, Hemisphere will continue to move its plans forward to convert its Atlee Buffalo G oil pool from water to polymer flood. Approval for polymer flood conversion has already been received by the Alberta Energy Regulator, and engineering design is progressing with expectations for injection start-up in mid-2021. This enhanced oil recovery project has substantial long-term value potential in terms of incremental and accelerated reserve recovery, and sets the stage for follow-up polymer flood conversion in the neighboring Atlee Buffalo F oil pool.

## Q3 2020 FINANCIAL AND OPERATING HIGHLIGHTS

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | | **2020** | | 2019 | | **2020** | | 2019 |
| **OPERATING** | | | | | | | | |
| **Average daily production** | | | | | | | | |
| Oil (bbl/d) | | **1,675** | | 1,670 | | **1,754** | | 1,440 |
| Natural gas (Mcf/d) | | **70** | | 404 | | **87** | | 329 |
| NGL (bbl/d) | | **-** | | 1 | | **-** | | 1 |
| Combined (boe/d) | | **1,686** | | 1,738 | | **1,768** | | 1,496 |
| Oil and NGL weighting | | **99%** | | 96% | | **99%** | | 96% |
| **Average realized sales prices** | | | | | | | | |
| Oil ($/bbl) | **$** | **38.14** | $ | 53.21 | **$** | **27.59** | $ | 55.63 |
| Natural gas ($/Mcf) | | **2.13** | | 0.80 | | **2.01** | | 1.74 |
| NGL ($/bbl) | | **-** | | 55.62 | | **-** | | 43.79 |
| Combined ($/boe) | **$** | **37.96** | $ | 51.34 | **$** | **27.47** | $ | 53.96 |
| **Operating netback ($/boe)** | | | | | | | | |
| Petroleum and natural gas revenue | **$** | **37.96** | $ | 51.34 | **$** | **27.47** | $ | 53.96 |
| Royalties | | **(3.75)** | | (6.95) | | **(2.28)** | | (7.07) |
| Operating costs | | **(6.79)** | | (9.37) | | **(6.53)** | | (10.51) |
| Transportation costs | | **(2.52)** | | (2.45) | | **(2.53)** | | (2.49) |
| Operating field netback(1) | **$** | **24.90** | $ | 32.57 | **$** | **16.13** | $ | 33.88 |
| Realized commodity hedging gain (loss) | | **5.51** | | (1.93) | | **6.37** | | (3.03) |
| Operating netback(2) | $ | **30.41** | $ | 30.64 | **$** | **22.50** | $ | 30.85 |
| **FINANCIAL** | | | | | | | | |
| Petroleum and natural gas revenue | **$** | **5,889,668** | $ | 8,207,658 | **$** | **13,305,661** | $ | 22,039,005 |
| Operating field netback(1) | | **3,862,969** | | 5,206,705 | | **7,813,633** | | 13,838,733 |
| Operating netback(2) | | **4,718,540** | | 4,898,806 | | **10,899,880** | | 12,600,471 |
| Cash flow provided by operating activities | | **3,097,786** | | 3,803,907 | | **7,292,033** | | 6,966,814 |
| Adjusted funds flow from operations(3) | | **3,416,449** | | 3,558,673 | | **6,944,853** | | 8,753,556 |
| Per share, basic and diluted | | **0.04** | | 0.04 | | **0.08** | | 0.10 |
| Net income | | **1,442,021** | | 2,854,615 | | **407,810** | | 4,777,972 |
| Per share, basic and diluted | | **0.02** | | 0.03 | | **0.00** | | 0.05 |
| Capital expenditures | | **392,199** | | 6,386,377 | | **1,067,373** | | 9,978,618 |
| Net debt(4) | | **27,363,336** | | 35,934,983 | | **27,363,336** | | 35,934,983 |
| Gross term Loan(5) | **$** | **29,967,750** | $ | 34,426,600 | **$** | **29,967,750** | $ | 34,426,600 |

*Notes:*
*(1) Operating field netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis.*
*(2) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.*
*(3) Adjusted Funds Flow From operations is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for any decommissioning expenditures, and may not be comparable to measures used by other companies.*
*(4) Net debt is a non-IFRS measure calculated as current assets minus current liabilities including gross term loan, and excluding fair value of financial instruments and lease liabilities.*
*(5) Gross term loan is calculated as the total USD draws, less any payments, on the term loan translated to Canadian Dollars at the period end exchange rate.*

| | Nine months ended September 30 | |
|---|---|---|
| | **2020** | 2019 |
| **SHARE CAPITAL** | | |
| Common shares outstanding | **87,882,302** | 89,408,302 |
| Stock options outstanding | **8,584,000** | 8,184,000 |
| Warrants outstanding | **13,750,000** | 13,750,000 |
| Fully Diluted | **110,216,302** | 111,342,302 |
| Weighted-average shares outstanding – basic | **88,446,525** | 89,820,390 |
| Weighted-average shares outstanding –diluted | **89,174,530** | 90,520,664 |

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as at November 18, 2020

The following Management's Discussion and Analysis ("MD&A") is a review of the operations and current financial position for the three and nine months ended September 30, 2020 for Hemisphere Energy Corporation ("Hemisphere" or the "Company") and should be read in conjunction with the unaudited interim condensed financial statements and related notes for the three and nine months ended September 30, 2020, and the audited annual financial statements and related notes for the year ended December 31, 2019. These documents and additional information relating to the Company, including the Company's Annual Information Form, are available on SEDAR at www.sedar.com or the Company's website at www.hemisphereenergy.ca.

The information in this MD&A is based on the unaudited interim condensed financial statements which were prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of unaudited interim condensed financial statements including IAS 34 "Interim Financial Reporting", as issued by the International Accounting Standards Board ("IASB").

This MD&A contains non-IFRS measures, additional IFRS measures and forward-looking statements. Readers are cautioned that this document should be read in conjunction with Hemisphere's disclosure under "Non-IFRS and additional IFRS Measures" and "Forward-Looking Statements" included at the end of this MD&A. All figures are in Canadian dollars unless otherwise noted.

### Business

Hemisphere produces oil and natural gas from its Atlee Buffalo and Jenner properties in southeast Alberta. The Company is headquartered in Vancouver, British Columbia and is traded on the TSX Venture Exchange under the symbol "HME".

**Atlee Buffalo, Alberta**

The Company owns and operates all of its wells in the Atlee Buffalo area. The property is accessible year-round and is located northeast of Brooks in southeastern Alberta. Hemisphere has a 100% working interest in 8,800 net acres.

**Jenner, Alberta**

Hemisphere owns and operates all of its wells and has a land position of 8,664 net acres in the Jenner area. The property is accessible year-round and is located 30 kilometers west of the Company's Atlee Buffalo property in southeastern Alberta.

### Operating Results

The Company generated adjusted funds flow (AFF) from operations of $3,416,449 ($0.04/share) during the third quarter of 2020, as compared to adjusted funds flow from operations of $3,558,673 ($0.04/share) during the third quarter of 2019, a slight decrease of $142,224. Adjusted funds flow for the nine months ended September 30, 2020 decreased 21% to $6,944,853 ($0.08/share) from $8,753,556 ($0.10/share) for the same period in 2019.

The decrease in AFF from operations for three months and nine months ended September 30, 2020 is due primarily to a respective 26% and 49% decrease in the combined average realized sales price, which was somewhat offset by a 48% and 62% decrease in royalties, and a 30% and 26% decrease in operating costs over the respective comparable periods of 2019.

For the three and nine months ended September 30, 2020, the Company reported net income of $1,442,021 ($0.02/share) and $407,810 ($0.00/share) respectively, compared to net incomes of $2,854,615 ($0.03/share) and $4,777,972 ($0.05/share) respectively for the three and nine months ended September 30, 2019. This decrease of $4,370,162 in the first three quarters of 2020 is generally the result of decreased oil and natural gas revenues of $8,733,344 combined with an impairment of $3,859,110 and increased foreign exchange loss of $2,633,753, offset by a reduction in royalties and operating and transportation expenses of $1,781,598 and $926,646 respectively, as well as increases in realized and unrealized hedging gains of $4,324,509 and $3,341,072 respectively.

### Production

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| **By product:** | **2020** | 2019 | **2020** | 2019 |
| Oil (bbl/d) | **1,675** | 1,670 | **1,754** | 1,440 |
| Natural gas (Mcf/d) | **70** | 404 | **87** | 329 |
| NGL (bbl/d) | **-** | 1 | **-** | 1 |
| Total (boe/d) | **1,686** | 1,738 | **1,768** | 1,496 |
| Oil and NGL weighting | **99%** | 96% | **99%** | 96% |

In the third quarter of 2020, the Company's average daily production was 1,686 boe/d (99% oil and NGL) which is a decrease of 52 boe/d from the 1,738 boe/d achieved in the comparable quarter of 2019. For the nine months ended September 30, 2020, the Company's average daily production was 1,768 boe/d (99% oil and NGL), representing an 18% increase from 1,496 boe/d for the same period in 2019. This increase in production can be attributed to 11 new wells drilled and placed on production within the third quarter of 2019, as well as the continued success of the base waterflood performance in the Upper Mannville F and G pools, and in spite of the shut-in of the high water cut Jenner wells during the quarter.

### Average Benchmark and Realized Prices

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| **Benchmark prices** | | | | |
| WTI ($US/bbl)(1) | **$ 40.93** | $ 56.47 | **$ 38.31** | $ 57.04 |
| Exchange rate (1 $US/$C) | **1.3316** | 1.3205 | **1.3528** | 1.3291 |
| WTI ($C/bbl) | **54.50** | 74.57 | **51.83** | 75.81 |
| WCS Diff ($C/bbl) | **12.08** | 16.19 | **18.85** | 15.55 |
| WCS ($C/bbl)(2) | **42.41** | 58.38 | **32.98** | 60.26 |
| AECO natural gas ($US/Mcf)(3) | **2.27** | 1.00 | **2.10** | 1.57 |
| **Average realized prices** | | | | |
| Crude oil ($C/bbl) | **38.14** | 53.21 | **27.59** | 55.63 |
| Natural gas ($C/Mcf) | **2.13** | 0.80 | **2.01** | 1.74 |
| NGL ($C/bbl) | **-** | 55.62 | **68.84** | 43.79 |
| Combined ($C/boe) | **$ 37.96** | $ 51.34 | **$ 27.47** | $ 53.96 |

*Notes:*
*(1) Represents posting prices of West Texas Intermediate Oil.*

*(2) Represents posting prices of Western Canadian Select.*
*(3) Represents the Alberta 30 day spot AECO posting prices.*

The Company's oil and natural gas sales and financial results are significantly influenced by changes in commodity prices. The West Texas Intermediate pricing ("WTI") at Cushing, Oklahoma is the benchmark reference price for North American crude oil prices. Canadian oil prices, including Hemisphere's crude oil, are based on price postings, which is WTI-adjusted for transportation, quality and the currency conversion rates from United States dollar ("USD") to Canadian dollar.

The Company's combined average realized price decreased by 26% from $51.34/boe during the three months ended September 30, 2019 to $37.96/boe during three months ended September 30, 2020. The Company's combined average realized price decreased by 49% from $53.96/boe during the nine months ended September 30, 2019 to $27.47/boe during the nine months ended September 30, 2020. This decrease is the result of decreases in realized WTI pricing of US$15.54/bbl and US$18.73/bbl respectively, combined with increases to the differential between WCS and WTI pricing of $4.11/bbl and ($3.30)/bbl respectively, for the three and nine ended September 30, 2020 over the comparable periods in 2019.

As at the date of this MD&A, the Company held derivative commodity contracts as follows:

| Product | Type | Volume | Price | Index | Term |
|---|---|---|---|---|---|
| Crude oil | Collar | 120 bbl/d | US$40.00-US$68.25 | WTI-NYMEX | January 1, 2020 – December 31, 2020 |
| Crude oil | Collar | 200 bbl/d | US$40.00-US$67.05 | WTI-NYMEX | September 1, 2020 – December 31, 2020 |
| Crude oil | Swap | 425 bbl/d | US$54.85 | WTI-NYMEX | October 1, 2020 – December 31, 2020 |
| Crude oil | Collar | 275 bbl/d | US$40.00-US$65.50 | WTI-NYMEX | January 1, 2021 – March 31, 2021 |
| Crude oil | 3-Way | 350 bbl/d | US$40.00(put)/US$48.60(put)/US$60(call) | WTI-NYMEX | January 1, 2021 – March 31, 2021 |
| Crude oil | 3-Way | 625 bbl/d | US$40.00(put)/US$48.00(put)/US$60(call) | WTI-NYMEX | April 1, 2021 – June 31, 2021 |

At September 30, 2020 the commodity contracts were fair valued as an asset of $1,388,472 recorded on the balance sheet, an unrealized loss for the three month period of $1,319,060 and an unrealized gain for the nine month period of $2,518,015 respectively (September 30, 2019 – gain of $875,506 and loss of $823,057 respectively).

## Revenue

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Oil | **$ 5,875,899** | $ 8,174,202 | **$ 13,257,267** | $ 21,868,981 |
| Natural gas | **13,769** | 29,746 | **48,177** | 156,575 |
| NGL | **-** | 3,710 | **217** | 13,449 |
| Total | **$ 5,889,668** | $ 8,207,658 | **$ 13,305,661** | $ 22,039,005 |

Revenue for the three and nine months ended September 30, 2020 decreased by 28% and 40%, respectively, from the comparable periods in 2019. These declines are attributed to decreases of 26% and 49% in the Company's combined average realized prices during the periods respectively over the comparable periods in 2019.

## Operating Netback

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| **Operating netback** | | | | |
| Revenue | **$ 5,889,668** | $ 8,207,658 | **$ 13,305,661** | $ 22,039,005 |
| Royalties | **(582,409)** | (1,111,091) | **(1,106,149)** | (2,887,747) |
| Operating costs | **(1,053,565)** | (1,497,806) | **(3,162,256)** | (4,294,097) |
| Transportation costs | **(390,725)** | (392,056) | **(1,223,623)** | (1,018,429) |
| Operating field netback[1] | **$ 3,862,969** | $ 5,206,705 | **$ 7,813,633** | $ 13,838,733 |
| Realized commodity hedging gain (loss) | **855,571** | (307,899) | **3,086,247** | (1,238,262) |
| Operating netback[2] | **$ 4,718,540** | $ 4,898,805 | **$ 10,899,880** | $ 12,600,470 |
| **Operating netback ($/boe)** | | | | |
| Revenue | **$ 37.96** | $ 51.34 | **$ 27.47** | $ 53.96 |
| Royalties | **(3.75)** | (6.95) | **(2.28)** | (7.07) |
| Operating costs | **(6.79)** | (9.37) | **(6.53)** | (10.51) |
| Transportation costs | **(2.52)** | (2.45) | **(2.53)** | (2.49) |
| Operating field netback[1] | **$ 24.90** | $ 32.57 | **$ 16.13** | $ 33.89 |
| Realized commodity hedging gain (loss) | **5.51** | (1.93) | **6.37** | (3.03) |
| Operating Netback[2] | **$ 30.41** | $ 30.64 | **$ 22.50** | $ 30.86 |

*Notes:*

*(1) Operating field netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent.*

*(2) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent.*

Royalties for the three months ended September 30, 2020 were $3.75/boe, representing a 46% decrease from the three months ended September 30, 2019. Royalties for the nine months ended September 30, 2020 were $2.28/boe, representing an 68% decrease from the same period in 2019. This was primarily the result of lower realized prices combined with many of Hemisphere's newly drilled 2019 wells remaining on royalty holiday.

Operating costs include all costs for gathering, processing, dehydration, compression, water processing and marketing of the oil, natural gas and NGLs, as well as additional costs incurred periodically for maintenance and repairs. Operating costs for the three months ended September 30, 2020 decreased on an absolute basis by $444,241 or 30% and on a per boe basis by $2.58 or 28% over the comparable period in 2019. For the nine months ended September 30, 2020 operating costs decreased on an absolute basis by $1,131,841 or 26% and on a per boe basis by $3.98 or 38% over the comparable period in 2019. As a direct result of the historically low realized commodity prices due to the ongoing global pandemic the Company took steps to reduce operating costs. The Company shut in the majority of high water cut production in Jenner, worked with vendors and oilfield service providers for temporary rate reductions, optimized maintenance work, optimized chemical use, and reduced operator overtime. The Company continues to work to find efficiencies in its operations to keep operating costs low.

Transportation costs include all costs incurred to transport emulsion, oil and gas sales to processing and distribution facilities. Transportation costs were $2.52/boe during the third quarter of 2020, which is a $0.07/boe increase over the comparable quarter in 2019. Transportation costs were $2.53/boe for the nine months ended September 30, 2020, which represents a $0.04/boe increase over the same period in 2019. This slight increase in trucking costs for the nine months ended September 30, 2020 over the comparable periods in 2019 is due to the use of varied sales points to which oil is trucked.

Operating netback for the three and nine months ended September 30, 2020 were $30.41/boe and $22.50/boe respectively, 1% and 27% lower than the comparable quarters in 2019. This is mainly due to the 26% and 49% decrease in the Company's combined average realized price over the comparable periods, offset by the lower royalties and operating costs discussed above, and the respective $5.51/boe and $6.37/boe hedging gains in the comparable three and nine month periods of 2020 (losses of $1.93/boe for the three months and of $3.03/boe for the nine months ended September 30, 2019).

**Exploration and Evaluation**

Exploration and evaluation expense generally consists of certain geological and geophysical costs, expiry of undeveloped lands, and costs of uneconomic exploratory wells. Exploration and evaluation expenses for the three months ended September 30, 2020 and 2019 were $12,275 and $15,441, respectively. For the nine months ended September 30, 2020 and 2019, exploration and evaluation expenses were $36,958 and $52,929, respectively.

**Depletion and Depreciation**

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Depletion expense | **$ 1,118,119** | $ 1,617,171 | **$ 3,487,177** | $ 4,078,315 |
| Depreciation expense | **28,606** | 28,356 | **85,403** | 81,516 |
| Total | **$ 1,146,725** | $ 1,645,527 | **$ 3,572,580** | $ 4,159,831 |
| $ per boe | **$ 7.39** | $ 10.29 | **$ 7.37** | $ 10.18 |

The depletion rate is calculated using the unit-of-production method on Proved and Probable oil and natural gas reserves, taking into account the future development costs ("FDC") to develop and produce undeveloped and non-producing reserves.

Depletion and depreciation expenses for the three months ended September 30, 2020 decreased to $7.39/boe from $10.29/boe for the same period in 2019. For the nine months ended September 30, 2020, depletion and depreciation expenses decreased to $7.37/boe from $10.18/boe for the same period in 2019. The decrease in depletion expense for the three and nine months ended September 30, 2020 over the comparable periods in 2019 is primarily due to amortization of production over a larger reserve base from the Company's December 31, 2019 independent engineer's evaluation report as prepared by McDaniel and Associates Consultants Ltd.

**Impairment**

At September 30, 2020 the Company performed an assessment of potential impairment indicators on each of its Cash Generating Units (CGUs), and management determined that no impairment test on its petroleum and natural gas assets was required.

As at March 31, 2020 and December 31, 2019, 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 amount of $3,615,333 as at March 31, 2020 (as at December 31, 2019 - $7,705,533). Accordingly, the Company recognized an impairment charge of $3,859,110 as at March 31, 2020 (as at December 31, 2019 - $2,908,641). 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.

### Capital Expenditures

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Land and lease | **$ 1,812** | $ 82,923 | **$ 10,286** | $ 110,646 |
| Geological and geophysical | **250,191** | 16,625 | **682,325** | 323,921 |
| Drilling and completions | **124,357** | 4,981,297 | **338,448** | 7,486,378 |
| Facilities and infrastructure | **15,839** | 1,305,533 | **36,314** | 2,057,674 |
| Total capital expenditures(1) | **$ 392,199** | $ 6,386,377 | **$ 1,067,373** | $ 9,978,618 |

*Note:*
*(1) Total capital expenditures exclude decommissioning obligations and non-cash items.*

The development capital spent during the first three quarters of 2020 focused on projects that have long-term operating costs savings and will increase oil recovery.

### General and Administrative

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Gross general and administrative | **$ 732,655** | $ 604,124 | **$ 2,012,107** | $ 1,645,764 |
| Capitalized general and administrative | **(177,755)** | (121,055) | **(525,142)** | (454,594) |
| Total | **$ 554,900** | $ 483,070 | **$ 1,486,965** | $ 1,191,170 |
| $ per boe | **$ 3.58** | $ 3.02 | **$ 3.07** | $ 2.92 |

General and administrative ("G&A") expenses increased on an absolute basis by 15% and 25% for the three and nine months ended September 30, 2020, and on a per boe basis $0.56/boe and $0.15/boe respectively over the comparable period in 2019. The G&A costs increased due to production growth resulting in higher consulting fees and staffing costs in the first three quarters of 2020. G&A cost increases were somewhat offset by a reduction in wages of $81,312 through claims made to the Canada Revenue Agency under the Canada Emergency Wage Subsidy program to support businesses through the COVID-19 pandemic and subsequent economic downturn.

The Company capitalizes some general and administrative expenses which can be attributed to any costs incurred during the period relating to its development and exploration activities. For the three and nine months ended September 30, 2020, capitalized general and administrative expenses increased by 47% and 16% over the respective comparable periods in 2018.

### Share-based Payments

Share-based payments are non-cash expenses which reflect the estimated value of stock options issued to directors, employees and consultants of the Company.

In June of 2020 the Company granted 1,500,000 stock options to officers, directors, employees and consultants at an exercise price of $0.12 over five years, all of which vested immediately. The Company uses a Black-Scholes option pricing model to calculate the fair value of stock option grants where the corresponding expense is recognized over the option vesting period. The total valuation of the vested options from grants in the nine months ended September 30, 2020, was $150,866, of which $115,664 was expensed as stock-based compensation and $35,202 was capitalized.

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Share-based payments | **$ -** | $ - | **$ 115,664** | $ 117,079 |
| Capitalized costs | **-** | - | **35,202** | 62,866 |
| Total share-based payments | **$ -** | $ - | **$ 150,866** | $ 179,945 |

### Finance Expense

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Loan interest | **$ 701,282** | $ 857,710 | **$ 2,340,978** | $ 2,620,745 |
| Lease interest | **9,837** | 11,039 | **29,967** | 34,518 |
| Accretion of debt issuance costs | **54,891** | 86,908 | **323,045** | 199,972 |
| Amortization of deferred charges | **48,792** | 64,216 | **208,165** | 179,499 |
| Accretion of decommissioning liabilities | **32,256** | 37,233 | **96,768** | 111,699 |
| Total | **$ 847,058** | $ 1,057,107 | **$ 2,998,923** | $ 3,146,433 |
| $ per boe | **$ 4.72** | $ 8.52 | **$ 6.19** | $ 7.70 |

Loan interest for the three and nine months ended September 30, 2020 decreased by $156,428 and $279,767 over the respective periods in 2019 which is the result of a decrease in the 3-month LIBOR rate for the quarter, upon which the term loan quarterly interest is calculated, combined with a reduction in the principle of the Term Loan via repayments. The Company also recorded $9,837 and $29,967 of lease interest on right-of-use assets liability under IFRS 16 for the three and nine months ended September 30, 2020. The finance expense per boe has decreased by 45% and 20% over the comparable three and nine month periods in 2019 due to the decreases in absolute costs, combined with a larger production base for the period.

Accretion expense represents the adjusted present value of the Company's decommissioning obligations which include the abandonment and reclamation costs associated with wells and facilities. During the three and nine months ended September 30, 2020 accretion expense decreased by 13% over the comparable periods in 2019.

### Tax Pools

The Company has approximately $68 million of tax pools available to be applied against future income for tax purposes. Based on available pools and current commodity prices, the Company does not expect to pay current income tax in 2020 and any taxes payable beyond 2020 will primarily be a function of commodity prices, capital expenditures and production volumes.

| | Deduction Rate | **December 31, 2019** |
|---|---|---|
| Canadian exploration expense (CEE) | 100% | **$ 3,336,823** |
| Canadian development expense (CDE) | 30% | **19,140,307** |
| Canadian oil and gas property expense (COGPE) | 10% | **4,932,180** |
| Non-capital losses carry forwards (NCL) | 100% | **37,947,967** |
| Undepreciated capital cost (UCC) | 20-55% | **1,086,076** |
| Share issuance costs and other | Various | **1,140,239** |
| **Total** | | **$ 67,583,592** |

## Summary of Quarterly Results

| | 2020 | | | 2019 | | | | 2018 |
|---|---|---|---|---|---|---|---|---|
| | **Sep. 30 Q3(1)** | Jun. 30 Q2(2) | Mar. 31 Q1(3) | Dec. 31 Q4(4) | Sep. 30 Q3(5) | Jun. 30 Q2(5) | Mar. 31 Q1(7) | Sep. 30 Q4(8) |
| Average daily production (boe/d) | 1,686 | 1,645 | 1,973 | 2,166 | 1,738 | 1,367 | 1,379 | 1,378 |
| Oil and natural gas revenue | 5,889,668 | 2,452,793 | 4,963,201 | 9,472,078 | 8,207,658 | 7,396,095 | 6,435,252 | 2,886,840 |
| Operating field netback(9) | 3,862,969 | 1,259,793 | 2,690,808 | 6,284,329 | 5,206,705 | 4,357,767 | 4,274,261 | 1,023,282 |
| Cash provided by operating activities | 3,097,786 | 826,988 | 3,367,261 | 3,530,061 | 3,803,907 | 2,536,247 | 626,659 | 231,079 |
| Adjusted funds flow from (used in) operations(10) | 3,416,449 | 1,363,914 | 2,164,492 | 4,334,995 | 3,558,673 | 2,559,898 | 2,634,984 | (725,431) |
| Per share, basic and diluted | 0.04 | 0.02 | 0.02 | 0.05 | 0.04 | 0.03 | 0.03 | (0.01) |
| Net income (loss) | 1,442,021 | (3,187,206) | 2,152,995 | (2,543,542) | 2,854,615 | 2,812,582 | (889,224) | 25,334 |
| Per share, basic and diluted | 0.02 | (0.04) | 0.02 | (0.03) | 0.03 | 0.03 | (0.01) | 0.00 |
| Combined average realized price ($/boe) | 37.96 | 16.38 | 27.64 | 47.53 | 51.34 | 59.44 | 51.85 | 22.78 |
| Operating netback ($/boe)(11) | 30.41 | 17.74 | 19.63 | 30.70 | 30.64 | 31.10 | 30.89 | 5.14 |

*Notes:*

*(1) The increases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to an increase in realized commodity prices.*
*(2) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to a decrease in realized commodity prices.*
*(3) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to a decrease in realized commodity prices.*
*(4) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in production rates and realized commodity prices.*
*(5) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in production rates.*
*(6) The increases in revenue and netbacks are due to increases in realized commodity prices.*
*(7) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in realized commodity prices.*
*(8) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due to a sharp decrease in realized commodity prices.*
*(9) Operating field netback per boe is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis*
*(10) Adjusted funds flow from operations is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and may not be comparable to measures used by other companies.*
*(11) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.*

## Outstanding Share Capital

| | November 18, 2020 | **September 30, 2020** | December 31, 2019 |
|---|---|---|---|
| Fully diluted share capital | | | |
| Common shares issued and outstanding | 86,938,302 | **87,882,302** | 88,902,302 |
| Stock options | 8,584,000 | **8,584,000** | 8,184,000 |
| Warrants | 13,750,000 | **13,750,000** | 13,750,000 |
| Total fully diluted shares outstanding | 109,272,302 | **110,216,302** | 111,817,302 |

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 until July 1, 2020. The Company has since purchased and canceled 1,301,000 shares under this NCIB for $179,273 as at June 30, 2020, for an average cost of $0.14 per share. This includes 320,000 shares purchased and canceled in the first half of fiscal 2020 for $55,593 at an average cost of $0.17 per share.

Further, on June 29, 2020 the Company announced the renewal of the normal course issuer bid (NCIB) to purchase and cancel, from time to time, up to 7,869,931 common shares of the Company until July 1, 2021. During the three months ended September 30, 2020, the Company has purchased and canceled 700,000 shares under the NCIB for $81,121 at an average cost of $0.12 per share.

Subsequent to the quarter ended September 30, 2020, the Company has purchased and canceled an additional 944,000 shares under the NCIB for $111,097 at an average cost of $0.12 per share.

The Company has the following stock options that are outstanding and exercisable as at November 18, 2020:

| Exercise Price | Grant Date | Expiry Date | Balance Outstanding November 18, 2020 | Balance Exercisable November 18, 2020 |
|---|---|---|---|---|
| $0.08 | February 11, 2016 | February 11, 2021 | 1,595,000 | 1,595,000 |
| $0.08 | February 12, 2016 | February 12, 2021 | 125,000 | 125,000 |
| $0.25 | September 21, 2017 | September 21, 2022 | 4,914,000 | 4,914,000 |
| $0.28 | October 2, 2017 | October 2, 2022 | 150,000 | 100,000 |
| $0.25 | January 1, 2018 | January 1, 2023 | 250,000 | 250,000 |
| $0.12 | March 1, 2019 | March 1, 2024 | 50,000 | 50,000 |
| $0.12 | June 17, 2020 | June 17, 2025 | 1,500,000 | 1,500,000 |
| | | | 8,584,000 | 8,584,000 |
| Weighted-average exercise price | | | $0.19 | $0.19 |

## Liquidity and Capital Management

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 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 also attempts 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.

a) Financing

The Company's net cash used in financing activities during the three and nine months ended September 30, 2020 were $3,466,899 and $5,595,230 respectively. These funds are primarily a repayment of US$4,000,000 (CAD$5,301,800) towards the Company's term loan in the first nine months of 2020, plus shares purchased under the NCIB, and lease liability payments in the period.

b) 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, 2020 the Company had a term loan balance of US$22.5 million (CAD$29,967,750 at period close exchange rate) resulting from total draws of US26.5 million less total repayments of US$4.0 million. In October 2020, the Company paid down an additional US$1.25 million (CAD$1,650,625) on the term loan.

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 Term Loan is subject to certain quarterly financial and performance covenants from the quarter ended June 31, 2020 to the maturity date of the loan on September 15, 2022:

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. Minimum average production shall not be less than 1,500 boe/d.
4. Proved developed producing coverage ratio, based on reserve reports internally prepared by Hemisphere, shall not be less than 1.00 to 1.00.
5. Total proved reserves coverage, based on reserve reports internally prepared by Hemisphere, shall not be less than 1.50 to 1.00.

Covenants table for the quarter ended September 30, 2020:

| Ratio | | | Required | Actual Sep. 30, 2020 |
|---|---|---|---|---|
| **1.** | Interest Coverage Ratio | Greater than | 3.00 | 5.79 |
| **2.** | Total Leverage Ratio | Less than | 3.25 | 1.82 |
| **3.** | Minimum Average Production Boe/d | Greater than | 1,500 | 1,686 |
| **4.** | Proved Developed Producing Coverage Ratio | Greater than | 1.00 | 1.52 |
| **5.** | Total Proved Reserves Coverage Ratio | Greater than | 1.50 | 2.63 |

Further details on the calculations of the covenants can be found in the Credit Agreement and the amendment thereto filed on SEDAR at [www.sedar.com](http://www.sedar.com) on September 22, 2017 and February 1, 2018 respectively, under the Company's profile.

c) Capital Management

The Company manages its capital with the following objectives:

- Ensure sufficient 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

- Maximize shareholder return through enhancing the Company's share value.

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.

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, incurring additional indebtedness under the 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.

## Commitment

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, 2020, the gross balance of the Term Loan was $29,967,750 (US$22,500,000), exclusive of the debt issuance costs. The Term Loan matures on September 15, 2022.

| | | 2020 | 2021 | 2022 | 2023 | Total |
|---|---|---|---|---|---|---|
| Lease operating costs | $ | 19,659 | 78,636 | 78,636 | 32,765 | 209,626 |
| Term loan | | - | - | 29,967,750 | - | 29,967,750 |
| Term loan interest | | 636,815 | 2,547,259 | 1,910,444 | - | 5,094,518 |
| | $ | 656,474 | 2,625,895 | 31,956,830 | 32,765 | 35,271,964 |

## Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet transactions.

## Proposed Transactions

As of the effective date, there are no outstanding proposed transactions.

## Changes in Accounting Policies

New Accounting Standard

In October 2018, the IASB issued amendments to the definition of IFRS 3 "Business Combinations". The amendments are intended to provide additional guidance to determine if a transaction should be recorded as a business combination or an asset acquisition. The amendments clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess if an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. This standard is effective January 1, 2020 and will be applied prospectively. No business combinations were completed by the Company as of the date of these financial statements.

Government Grants

Since commencement of the Canada Emergency Wage Subsidy ("CEWS") program on March 15, 2020, the Company has applied for a subsidy for its eligible employees. Government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions associated with the grant are met. Claims under government grant programs related to income are deducted in reporting the related expense and are recorded in the period in which the eligible expenses were incurred.

## 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 September 30, 2020, 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.

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.

## Risks

The Company's activities expose it to a variety of risks that arise as a result of its exploration, development, production and financing activities. These risks and uncertainties include, among other things, volatility in market prices for oil and natural gas, general economic conditions in Canada, the US and globally and other factors described under "Risk Factors" in Hemisphere's most recently filed Annual Information Form which is available on the Company's website at www.hemisphereenergy.ca or on SEDAR at www.sedar.com. Readers are cautioned that this list of risk factors should not be construed as exhaustive.

The following provides information about the Company's exposure to some risks associated with the oil and gas industry, as well as the Company's objectives, policies and processes for measuring and managing risk.

**Business Risk**

Oil and gas exploration and development involves a high degree of risk whereby many properties are ultimately not developed to a producing stage. There can be no assurance that the Company's future exploration and development activities will result in discoveries of commercial bodies of oil and gas. Whether an oil and gas property will be commercially viable depends on a number of factors including the particular attributes of the reserve and its proximity to infrastructure, as well as commodity prices and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, and environmental protection. The exact effect of these factors cannot be accurately predicted, and the combination of these factors may result in an oil and gas property not being profitable.

**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, 2020 | | December 31, 2019 |
|---|---|---|---|---|
| Accounts receivable | | | | |
| Marketing receivables | $ | 1,569,705 | $ | 2,773,405 |
| Trade receivables | | 328,532 | | 11,438 |
| Receivables from joint ventures | | 5,383 | | 6,809 |
| Reclamation deposits | | 115,535 | | 115,535 |
| | $ | 2,019,155 | $ | 2,907,187 |

The Company sells the majority of its oil production to a single oil 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 its oil marketer.

**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 September 30, 2020, the Company had net debt (current assets less current liabilities excluding fair value of financial instruments and lease liabilities, and including the outstanding term loan) of $27,363,336 (December 31, 2019 - $31,982,764). The Company funds its operations through operating cash flows and the term loan. At September 30, 2020, the Company has an additional US$3.5 million of borrowing base committed with its lender, which it can draw from for future capital programs, subject to the lender's approval.

**Market risk**

Market risk is the risk that changes in market prices, such as, foreign exchange rates, commodity 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.

*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 $300,000 annual effect on net income.

*Foreign currency risk*

The Company's functional and reporting currency is Canadian dollars. The Company does not sell or transact in any foreign currency; except 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, 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 $271,000 effect on the annual net income.

*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 adjusted funds flow from operations, and ability to raise capital. The Company has derivative commodity contracts in place as further disclosed within this MD&A.

*Other price risk*

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

*COVID-19 Risk*

The Company's business, operations and financial condition has been significantly adversely affected by COVID-19. Actions taken to reduce the spread of COVID-19 have resulted in volatility and disruptions in regular business operations, supply chains and financial markets, as well as declining trade and market sentiment. COVID-19 as well as other factors have resulted in the deepest drop in crude oil prices that global markets have seen since 1991. With the rapid spread of COVID-19 and additional oil supply expected to come on-stream over the near term, oil prices and global equity markets have deteriorated significantly and are expected to remain under pressure. The extreme supply / demand imbalance is anticipated to cause a reduction in industry spending in 2020. These events and conditions have caused a significant decrease in the valuation of oil and natural gas companies and a decrease in confidence in the oil and natural gas industry. COVID-19 also poses a risk on the financial capacity of the Company's contract counterparties and potentially their ability to perform contractual obligations. These difficulties have been exacerbated in Canada by political and other actions resulting in uncertainty surrounding regulatory, tax, royalty changes and environmental regulation.

## Non-IFRS Measures

This document contains the terms "adjusted funds flow from (used in) operations," "operating netback", "operating field netback" and "net debt" which are not recognized measures under IFRS and may not be comparable to similar measures presented by other companies.

a) The Company considers adjusted funds flow from operations to be a key measure that indicates the Company's ability to generate the funds necessary to support future growth through capital investment and to repay any debt. Adjusted funds flow from operations is a measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for decommissioning expenditures, and may not be comparable to measures used by other companies. Adjusted funds flow from operations per share is calculated using the same weighted-average number of shares outstanding as in the case of the earnings per share calculation for the period.

A reconciliation of funds flow from operations to cash provided by operating activities is presented as follows:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Cash provided by operating activities | **$ 3,097,786** | $ 3,803,907 | **$ 7,292,033** | $ 6,966,814 |
| Change in non-cash working capital | **316,959** | 245,234 | **(460,450)** | (1,786,742) |
| Adjust: Decommissioning obligation expenditures | **1,704** | - | **113,270** | - |
| Adjusted funds flow from operations | **$ 3,416,449** | $ 3,558,673 | **$ 6,944,853** | $ 8,753,556 |
| Per share, basic and diluted | **$ 0.04** | $ 0.04 | **$ 0.08** | $ 0.10 |

a) Operating field netback is a benchmark used in the oil and natural gas industry and a key indicator of profitability relative to current commodity prices. Operating field netback is calculated as oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis. These terms should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income or loss as determined in accordance with IFRS as an indicator of the Company's performance.

Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.

b) Net debt is closely monitored by the Company to ensure that its capital structure is maintained by a strong balance sheet to fund the future growth of the Company. Net debt is used in this document in the context of liquidity and is calculated as the total of the Company's current assets less current liabilities, excluding the fair value of financial instruments, and including the gross term loan. There is no IFRS measure that is reasonably comparable to net debt.

The following table outlines the Company calculation of net debt:

| | As at | |
|---|---|---|
| | **September 30, 2020** | December 31, 2019 |
| Current assets[(1)] | **$ 3,693,596** | $ 4,301,975 |
| Current liabilities[(1)] | **(1,089,182)** | (1,866,538) |
| Gross Term Loan[(2)] | **(29,967,750)** | (34,418,200) |
| Net debt | **$ (27,363,336)** | $ (31,982,764) |

*Note:*

*(1) Excluding fair value of financial instruments and lease liabilities.*

*(2) Gross term loan is calculated as the total USD draws, less any payments, on the term loan translated to Canadian Dollars at the period end exchange rate.*

## Boe Conversion

*Within this document, petroleum and natural gas volumes and reserves are converted to a common unit of measure, referred to as a barrel of oil equivalent ("boe"), using a ratio of 6,000 cubic feet of natural gas to one barrel of oil. Use of the term boe may be misleading, particularly if used in isolation. The conversion ratio is based on an energy equivalent method and does not necessarily represent a value equivalency at the wellhead.*

## Forward-Looking Statements

*In the interest of providing Hemisphere's shareholders and potential investors with information regarding the Company, including management's assessment of the future plans and operations of Hemisphere, certain statements contained in this MD&A (particularly the Message to Shareholders) constitute forward-looking statements or information (collectively "forward-looking statements") within the meaning of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "could", "plan", "intend", "should", "believe", "outlook", "potential", "target" and similar words suggesting future events or future performance. In particular, but without limiting the foregoing, this document (particularly the Message to Shareholders) contains forward-looking statements pertaining to the following: volumes and estimated net present value of the future net revenue of Hemisphere's oil and natural gas reserves; future oil and natural gas prices; future operational activities; and plans for continued growth in the Company's production, reserves and cash flow; the compliance of the Company under its credit agreements, and the expectation for the increasing of the Company's reserves with continued successful waterflood operations. In addition, statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and can be profitably produced in the future.*

*With respect to forward-looking statements contained in this MD&A, the Company has made assumptions regarding, among other things: future capital expenditure levels; future oil and natural gas prices and differentials between light, medium and heavy oil prices; results from operations including future oil and natural gas production levels; future exchange rates and interest rates; Hemisphere's ability to obtain equipment in a timely manner to carry out development activities; Hemisphere's ability to market its oil and natural gas successfully to current and new customers; the impact of increasing competition; Hemisphere's ability to obtain financing on acceptable terms; and Hemisphere's ability to add production and reserves through our development and exploitation activities.*

*Although Hemisphere believes that the expectations reflected in the forward-looking statements contained in this MD&A, and the assumptions on which such forward-looking statements are made, are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned not to place undue reliance on forward-looking statements included in this MD&A, as there can be no assurance that the plans, intentions or expectations upon which the forward-looking statements are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause Hemisphere's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things, the following: volatility in market prices for oil and natural gas; general economic conditions in Canada, the U.S. and globally; and the other factors described under "Risk Factors" in Hemisphere's most recently filed Annual Information Form available on the Company's website at www.hemisphereenergy.ca or on SEDAR at www.sedar.com. Readers are cautioned that this list of risk factors should not be construed as exhaustive.*

*The forward-looking statements contained in this MD&A speak only as of the date of this document. Except as expressly required by applicable securities laws, Hemisphere does not undertake any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

## Analogous Information

*The information concerning analogue pools in this MD&A (particularly in the Message to Shareholders, included with the Annual Report) may be considered to be "analogous information" within the meaning of applicable securities laws. Such information was obtained by Hemisphere management throughout the year ended December 31, 2019 from various public sources including information available to Hemisphere through the Alberta Energy Regulator. Management believes that the performance of such pools is analogous to the pools in which the Company has an interest at its Atlee Buffalo property area and is relevant as it may help to demonstrate the reaction of such pools to waterflood stimulations. Hemisphere is unable to confirm whether the analogous information was prepared by a qualified reserves evaluator or auditor or in accordance with National Instruments 51-101 – Standards of Disclosure for Oil and Gas Activities and the COGE Handbook and therefore, the reader is cautioned that the data relied upon by Hemisphere may be in error and/or may not be analogous to the oil pools in which Hemisphere holds an interest.*

## Reserves Advisories

*It should not be assumed that the net present value of the estimated net revenues of the reserve presented in herein represent the fair market value of the reserves. There is no assurance that the forecast prices and costs assumptions upon which such estimates are made will be attained and variances could be material. The reserve estimates of Hemisphere's crude oil, natural gas liquids and natural gas reserves and any estimated recovery factors provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual crude oil, natural gas and natural gas liquids reserves may be greater than or less than the estimates provided herein.*

## Original Oil in Place

*The reference to Original Oil-In-Place ("OOIP") in the Message to Shareholders is equivalent to Discovered Petroleum Initially-In-Place ("DPIIP"). DPIIP, as defined in the Canadian Oil and Gas Handbook, is that quantity of petroleum that is estimated, as of a given date, to be contained in known accumulations prior to production. The recoverable portion of DPIIP includes production, reserves and contingent resources; the remaining portion of DPIIP is unrecoverable. It should not be assumed that any portion of the OOIP/DPIIP set forth in the presentation is recoverable other than the portion which has been attributed reserves by McDaniel & Associates Consultants Ltd. There is uncertainty that it will be commercially viable to produce any portion of the OOIP/DPIIP other than the portion that is attributed reserves. The OOIP/DPIIP set forth in the Message to Shareholders has been provided for the sole purpose of highlighting the potential recovery factors for the reservoirs in which the Company holds an interest. The OOIP/DPIIP volumes set forth in the Message to Shareholders are from the mapping of the reservoirs by McDaniel & Associates Consultants Ltd. (who is independent of Hemisphere) in connection with preparing the Company's reserve report effective as of December 31, 2019.*