TORC Oil & Gas Ltd

# Management's Discussion and Analysis

For the three months and years ended

December 31, 2018 and 2017

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("the MD&A") is dated February 25, 2019. The MD&A should be read in conjunction with TORC Oil & Gas Ltd.'s ("TORC" or the "Company") audited financial statements as at and for the years ended December 31, 2018 and December 31, 2017. The reader should be aware that historical results are not necessarily indicative of future performance.

The financial data presented below has been prepared in accordance with International Financial Reporting Standards ("IFRS"), unless otherwise indicated.

TORC's reporting and measurement currency is the Canadian dollar. Amounts in this MD&A are in Canadian dollars unless otherwise stated.

## Barrel of Oil Equivalent

Where amounts are expressed on a barrel of oil equivalent ("Boe") basis, natural gas volumes have been converted to Boe using a ratio of 6,000 cubic feet of natural gas to one barrel of oil equivalent. This conversion ratio is based upon an energy equivalent conversion method primarily applicable at the burner tip and does not represent value equivalence at the wellhead. Boe figures may be misleading, particularly if used in isolation.

## Non-GAAP Measurements

The MD&A contains the terms *"funds flow", "adjusted funds flow, including transaction related costs", "adjusted funds flow, excluding transaction related costs", "net debt"* and *"operating netback"*, which are commonly used in the oil and natural gas industry, but not defined by IFRS and therefore may not be comparable to performance measures presented by others. Investors should be cautioned, however, that these measures should not be construed as an alternative to both net income and net cash from operating activities, which are determined in accordance with IFRS, as indicators of the Company's performance.

*Funds flow* represents cash flow from operating activities prior to change in non-cash operating working capital. *Adjusted funds flow, including transaction related costs* represents cash flow from operating activities prior to changes in non-cash operating working capital and settlement of decommissioning obligations. *Adjusted funds flow, excluding transaction related costs* represents cash flow from operating activities prior to changes in non-cash operating working capital, settlement of decommissioning obligations and transaction related costs. Management considers these measures to be useful as they assist in the determination of the Company's ability to generate liquidity necessary to finance capital expenditures, settlement of decommissioning obligations and funding of its dividend. Transaction related costs are incurred during asset and/or corporate acquisitions and are typically not considered a cost incurred in the normal course of business. As a result, excluding transaction related costs from adjusted funds flow further assists in the determination of the Company's ability to generate liquidity in the normal course of business.

*Net debt* is calculated as current assets (excluding financial derivative assets) less: i) current liabilities (excluding financial derivative liabilities) and ii) bank debt. Management considers this measure to be useful in determining the Company's leverage.

*Operating netback* represents revenue and realized gain or loss on financial derivatives, less royalties, operating expenses and transportation expenses and has been presented on a per Boe basis. In addition to *operating netback*, the Company also discloses *operating netback (prior to hedging)*, which is calculated as *operating netback* excluding realized gain or loss on financial derivatives. Management believes that in addition to net income, *operating netback* and *operating netback (prior to hedging)* are useful measures as they assist in the determination of the Company's operating performance and profitability.

*(continued)*

The reconciliation between funds flow and adjusted funds flow, as defined above, and net cash from operating activities, as defined by IFRS, is as follows:

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Net cash from operating activities (defined by IFRS) | **$73,653** | $55,611 | **$294,347** | $187,815 |
| Changes in non-cash operating working capital | **(22,615)** | 4,020 | **(10,997)** | 19,715 |
| Funds flow | **$51,038** | $59,631 | **$283,350** | $207,530 |
| Settlement of decommissioning obligations | **3,351** | 342 | **3,724** | 801 |
| Adjusted funds flow, including transaction related costs | **$54,389** | $59,973 | **$287,074** | $208,331 |
| Transaction related costs | **-** | 616 | **1,750** | 616 |
| Adjusted funds flow, excluding transaction related costs | **$54,389** | $60,589 | **$288,824** | $208,947 |

The reconciliation of net debt, as defined above, is as follows:

| | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|
| Current assets (excluding financial derivative assets) | **$33,613** | $46,094 |
| Less: current liabilities (excluding financial derivative liabilities) | **(103,418)** | (83,548) |
| Less: bank debt | **(335,488)** | (242,684) |
| Net debt | **($405,293)** | ($280,138) |

The reconciliation for operating netback is found within this MD&A.

## Forward-Looking Statements

*This MD&A contains forward-looking statements. More specifically, it contains forward-looking statements respecting: (i) the anticipated sources of funding for the Company's capital program, (ii) the sufficiency of liquidity and capital resources to fund the Company's capital program, ongoing operations, and execution of its business plan, (iii) planned 2019 annual exploration and development expenditures and the allocation thereof, (iv) the expected impact of IFRS 16 on the Company's financial statements, and (v) the Company's risk management activities and the benefits to be obtained therefrom.*

*The forward-looking statements contained in this MD&A are based on certain key expectations and assumptions made by TORC, including expectations and assumptions concerning the impact of increasing competition, the general stability of the economic and political environment in which TORC operates, the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner, drilling results, the ability of the operator of the projects which the Company has an interest in to operate the field in a safe, efficient and effective manner, TORC's ability to obtain financing on acceptable terms, changes in the Company's banking facility, field production rates and decline rates, changes in operating and transportation costs, the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration, the timing and costs of pipeline, storage and facility construction and expansion, the ability of the Company to secure adequate product transportation, future petroleum and natural gas prices, currency, exchange and interest rates, the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates and TORC's ability to successfully market its petroleum and natural gas products. Readers are cautioned that the foregoing list of factors is not exhaustive.*

*Although TORC believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because TORC can give no assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks, including, without limitation, factors and risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, changes in royalty rates and other governmental regulations, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, the inability to fully realize the benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and inability to access sufficient capital from internal and external sources. Additional information on these and other factors and risks that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com) or at the Company's website (www.torcoil.com). Furthermore, the forward looking statements contained in this document are made as at the date of this document and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.*

## Acquisitions

On July 26, 2018, the Company closed an acquisition of a private oil company with over 1,000 boepd of light oil producing assets in southeast Saskatchewan and $5.0 million of working capital (the "Privateco Acquisition"). Total consideration paid for the Privateco Acquisition (including the $5.0 million of working capital) consisted of cash of $51.2 million as well as the issuance of 2.08 million common shares of TORC, valued at $7.75 per common share at the acquisition closing date, for total net consideration of $67.4 million including customary adjustments. The consideration paid for the Privateco Acquisition, net of positive working capital acquired, totaled $62.4 million, including customary adjustments.

On June 27, 2018, the Company closed an acquisition of various properties and working interests in and around its core southeast Saskatchewan area. The acquisition includes over 3,200 boepd of complementary, light oil producing assets in southeast Saskatchewan and Manitoba (the "June Acquisition"). Total consideration paid for the June Acquisition included cash of $120.2 million as well as the issuance of 13.5 million common shares of TORC, valued at $7.08 per common share at the acquisition closing date, for total net consideration of $216.0 million, including customary adjustments.

## Results of Operations

### Production

| | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Crude oil (Bbl per day) (1) | **23,546** | 18,350 | **20,943** | 17,642 |
| NGL (Bbl per day) (1) (2) | **1,554** | 985 | **1,365** | 790 |
| Natural gas (Mcf per day) (3) | **18,380** | 15,306 | **18,183** | 14,634 |
| Total (Boe per day) | **28,163** | 21,886 | **25,339** | 20,871 |
| | | | | |
| Production mix: | | | | |
| Crude oil | **84%** | 84% | **83%** | 85% |
| NGL | **5%** | 4% | **5%** | 3% |
| Crude oil and NGL ("Liquids") | **89%** | 88% | **88%** | 88% |
| Natural gas | **11%** | 12% | **12%** | 12% |

(1) "Bbl" refers to barrels.
(2) "NGL" refers to natural gas liquids.
(3) "Mcf" refers to thousand cubic feet.

Production in the three months and year ended December 31, 2018 increased 29% and 21%, respectively, compared to the three months and year ended December 31, 2017 (the "Corresponding Periods"). In addition to the Company's ongoing successful drilling activities, the increase includes production from the June Acquisition, the Privateco Acquisition, and acquisitions of various properties in 2017 (the "2017 Net Asset Acquisitions").

## Pricing

| | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| *Average realized prices:* | | | | |
| Crude oil ($ per Bbl) | **$52.34** | $64.58 | **$67.78** | $58.55 |
| NGL ($ per Bbl) | **28.76** | 30.30 | **29.49** | 24.64 |
| Crude oil and NGL ($ per Bbl) | **$50.88** | $62.83 | **$65.44** | $57.10 |
| Natural gas ($ per Mcf) | **1.40** | 1.40 | **1.23** | 1.81 |
| Boe ($ per Boe) | **$46.26** | $56.49 | **$58.50** | $51.70 |

During the three months and year ended December 31, 2018, TORC realized crude oil prices of $52.34 per Bbl and $67.78 per Bbl, respectively (Corresponding Periods: $64.58 per Bbl and $58.55 per Bbl, respectively).

During the three months and year ended December 31, 2018, TORC's crude oil discount to WTI converted to Canadian dollars approximated $25.41 per Bbl and $16.20 per Bbl, respectively (Corresponding Periods: $5.81 per Bbl and $7.56 per Bbl, respectively) due to significantly higher domestic crude oil differentials in 2018 driven primarily by take away capacity limitations. In the three months and year ended December 31, 2018, TORC's crude oil differential to Edmonton Par averaged a premium of $9.53 per Bbl and a discount of $1.61 per Bbl, respectively (Corresponding Periods: discounts of $4.37 per Bbl and $4.30 per Bbl, respectively) due to the fact that approximately 85% of TORC's crude oil is produced in southeast Saskatchewan and sold at Cromer, Manitoba, which is downstream of crude oil delivery points that experienced significant apportionments in the fourth quarter of 2018. The crude oil pricing differentials are largely a function of North American refinery supply/demand fundamentals as well as crude oil quality and transportation. To date in the first quarter of 2019, domestic crude oil differentials have tightened significantly relative to the differentials experienced in the fourth quarter of 2018.

In the three months and year ended December 31, 2018, the Company realized gas prices of $1.40 per Mcf and $1.23 per Mcf, respectively (Corresponding Periods: $1.40 per Mcf and $1.81 per Mcf, respectively). In the three months and year ended December 31, 2018, the Company's realized gas price was 10% and 18% below AECO benchmarks, respectively (Corresponding Periods: 17% and 16% below AECO benchmarks, respectively). Gas price differentials are a function of North American supply/demand fundamentals, heat content of gas as well as available pipeline capacity.

In the three months and year ended December 31, 2018, the average realized prices across all products were $46.26 per Boe and $58.50 per Boe, respectively. For the three months and year ended December 31, 2018, the average realized prices were lower by $10.23 per Boe and higher by $6.80 per Boe, respectively, compared to the Corresponding Periods.

| | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| **Average Benchmark Prices:** | | | | |
| Crude oil – WTI *(US$ per Bbl)* | **$58.83** | $55.35 | **$64.78** | $50.94 |
| Crude oil – Edmonton Par *(CDN$ per Bbl)* | **$42.81** | $68.95 | **$69.39** | $62.85 |
| Natural gas – AECO Daily Spot *($ per Mcf)* | **$1.55** | $1.68 | **$1.50** | $2.15 |
| Natural gas – AECO Monthly Spot *($ per Mcf)* | **$1.89** | $1.95 | **$1.53** | $2.42 |
| Exchange rate – *(CDN$/US$)* | **1.32** | 1.27 | **1.30** | 1.30 |

## Revenues

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Crude oil | **$113,447** | $109,078 | **$518,482** | $377,327 |
| NGL | **4,059** | 2,700 | **14,425** | 6,922 |
| Natural gas | **2,355** | 1,963 | **8,100** | 9,591 |
| | **$119,861** | $113,741 | **$541,007** | $393,840 |

Revenues in the three months and year ended December 31, 2018 increased 5% and 37%, respectively, compared to the Corresponding Periods. The increase in the three months ended December 31, 2018 is primarily due to increased production volumes from drilling activity and acquisitions (previously described), offset by lower average crude oil prices in the fourth quarter of 2018. The increase in the year ended December 31, 2018 is primarily due to higher average 2018 crude oil prices and increased production volumes from drilling activity and acquisitions (previously described).

Revenues from the sale of crude oil and NGL continued to be greater than 95% of all revenues.

## Royalties

| *($ thousands, unless otherwise noted)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Royalties | **$21,436** | $20,446 | **$94,943** | $67,646 |
| $ per Boe | **$8.27** | $10.15 | **$10.27** | $8.88 |
| Percentage of revenue | **18%** | 18% | **18%** | 17% |

The Company's corporate royalty rate (as a percentage of revenue) for the three months and year ended December 31, 2018 remained consistent, compared to the Corresponding Periods.

## Operating and Transportation Expenses

| *($ thousands, unless otherwise noted)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Operating expenses | **$33,361** | $25,079 | **$117,004** | $89,415 |
| $ per Boe | **$12.88** | $12.46 | **$12.65** | $11.74 |
| Transportation expenses | **$3,177** | $2,471 | **$12,021** | $8,876 |
| $ per Boe | **$1.23** | $1.23 | **$1.30** | $1.17 |
| Operating and transportation expenses | **$36,538** | $27,550 | **$129,025** | $98,291 |
| $ per Boe | **$14.11** | $13.69 | **$13.95** | $12.91 |

For the three months and year ended December 31, 2018, the Company’s combined operating and transportation expenses were $14.11 per Boe and $13.95 per Boe, respectively, an increase of 3% and 8%, respectively, compared to the Corresponding Periods. This increase is reflective of costs trending higher as crude oil prices recover.

## Operating Netbacks (1)

| ($ per Boe, unless otherwise noted) | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Average daily production (Boepd) | **28,163** | 21,886 | **25,339** | 20,871 |
| Crude oil ($ per Bbl) | **$52.34** | $64.58 | **$67.78** | $58.55 |
| NGL ($ per Bbl) | **$28.76** | $30.30 | **$29.49** | $24.64 |
| Natural gas ($ per Mcf) | **$1.40** | $1.40 | **$1.23** | $1.81 |
| Average price | **$46.26** | $56.49 | **$58.50** | $51.70 |
| Realized loss on financial derivatives (hedging) | **($0.25)** | - | **($0.35)** | - |
| Royalties | **($8.27)** | ($10.15) | **($10.27)** | ($8.88) |
| Operating | **($12.88)** | ($12.46) | **($12.65)** | ($11.74) |
| Transportation | **($1.23)** | ($1.23) | **($1.30)** | ($1.17) |
| Operating netback | **$23.63** | $32.65 | **$33.93** | $29.91 |
| Operating netback (prior to hedging) | **$23.88** | $32.65 | **$34.28** | $29.91 |

(1) See Non-GAAP Measurements.

## General and Administrative Expenses

During the three months and year ended December 31, 2018, the Company incurred the following general and administrative expenses ("G&A"):

| ($ thousands) | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| General and administrative expenses | **$3,990** | $3,956 | **$17,404** | $13,020 |
| Capitalized general and administrative expenses (1) | **(850)** | (1,170) | **(5,096)** | (3,391) |
| Total general and administrative | **$3,140** | $2,786 | **$12,308** | $9,629 |
| $ per Boe | **$1.21** | $1.38 | **$1.33** | $1.26 |

(1) Capitalized general and administrative expenses are those G&A expenditures which are directly attributable to the acquisition or exploration activities of the Company, and are therefore reclassified to property, plant and equipment, dependent on their nature.

In the three months and year ended December 31, 2018, total general and administrative expenses increased 13% and 28%, respectively, compared to the Corresponding Periods. The increase is due to increases in staffing and administrative costs associated with the continued growth of the Company and the recovery of the economy.

On a per Boe basis, in the three months and year ended December 31, 2018, G&A decreased 12% and increased 6%, respectively, compared to the Corresponding Periods.

## Transaction Related Costs

| *($ thousands, unless otherwise noted)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Transaction related costs | **-** | $616 | **$1,750** | $616 |
| $ per Boe | **-** | $0.31 | **$0.19** | $0.08 |

Transaction related expenses are those costs related to acquisitions that cannot be capitalized as part of the cost of such transactions under IFRS. These costs generally include, but are not limited to, legal fees, advisory fees, regulatory and administrative integration expenses.

The transaction related costs in the year ended December 31, 2018 are associated with the Privateco Acquisition and the June Acquisition (previously described) and amount to 0.6% of the cost of the acquisitions.

## Finance Costs

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Interest expense and financing charges | **$3,721** | $2,370 | **$12,638** | $9,327 |
| $ per Boe | **$1.44** | $1.18 | **$1.37** | $1.22 |
| Accretion on decommissioning obligations | **$2,220** | $1,906 | **$8,171** | $6,869 |
| $ per Boe | **$0.86** | $0.95 | **$0.88** | $0.90 |
| Total | **$5,941** | $4,276 | **$20,809** | $16,196 |
| $ per Boe | **$2.30** | $2.13 | **$2.25** | $2.12 |

For the three months and year ended December 31, 2018, interest expense and financing charges increased 57% and 35%, respectively, compared to the Corresponding Periods. The increases for the three months and year ended December 31, 2018 are largely the result of higher average bank debt and a rising interest rate environment in these periods. On a per Boe basis, interest expense and financing charges for the three months and year ended December 31, 2018 increased 22% and 12%, respectively, compared to the Corresponding Periods.

For the three months and year ended December 31, 2018, accretion on decommissioning obligations increased 16% and 19%, respectively, compared to the Corresponding Periods. The increase is largely due to the additional decommissioning liabilities associated with the Privateco Acquisition, the June Acquisition, asset acquisitions in the fourth quarter of 2017, and new wells drilled during the quarter. On a per Boe basis, accretion on decommissioning obligations decreased 9% and 2%, compared to the Corresponding Periods.

## Stock-Based Compensation Expenses

Stock-based compensation expenses reflect the value ascribed to the non-cash compensation provided by the Company, and are calculated utilizing a fair value assessment methodology. These amounts are net of stock-based compensation costs capitalized to property, plant and equipment when they are related to exploration or acquisition activities (in the same manner that G&A expenses are capitalized).

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Stock-based compensation expenses | **$2,437** | $2,024 | **$16,728** | $15,449 |
| Capitalized stock-based compensation expenses | **(1,146)** | (946) | **(7,868)** | (7,254) |
| Total | **$1,291** | $1,078 | **$8,860** | $8,195 |
| $ per Boe | **$0.50** | $0.54 | **$0.96** | $1.08 |

For the three months and year ended December 31, 2018, stock-based compensation expenses increased 20% and 8%, respectively, compared to the Corresponding Periods. These increases are primarily due to the continued growth of the Company.

On a per Boe basis, for the three months and year ended December 31, 2018, stock-based compensation expenses decreased 7% and 11%, respectively, compared to the Corresponding Periods.

## Depletion and Depreciation Expenses

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Depletion and depreciation expenses | **$60,398** | $46,941 | **$218,721** | $185,827 |
| $ per Boe | **$23.31** | $23.31 | **$23.65** | $24.39 |

For the three months and year ended December 31, 2018, depletion and depreciation expenses on a total dollar basis increased 29% and 18%, respectively, compared to the Corresponding Periods. This increase is largely due to depletable base additions from the June Acquisition, the Privateco Acquisition, and 2017 Net Asset Acquisitions, as well as ongoing drilling operations. On a per Boe basis, for the three months and year ended December 31, 2018, depletion and depreciation expenses remained consistent and decreased 3%, respectively, compared to the Corresponding Periods.

## Impairment

Property, Plant and Equipment ("PP&E")

At December 31, 2018, the Company determined there to be indicators of impairment due to volatility in commodity prices in all CGUs. The Company recognized an impairment charge of $26.0 million (at December 31, 2017: $23.0 million) on its PP&E assets related to the Cardium CGU (the "Impaired PP&E Assets") due to the carrying values in the Cardium CGU exceeding the recoverable amounts. The recoverable amount (determined using value in use) of a CGU is the greater of (i) its value in use, and (ii) its fair value less costs to sell. The recoverable amount for the Impaired PP&E Assets was $349.0 million (at December 31, 2017: $376.0 million), which was based on the proved plus probable reserve values from TORC's December 31, 2018 reserve report prepared by its independent reserve engineer. The recoverable amount of the CGU was estimated based on proved plus probable reserve values using before-tax discount rates specific to the underlying composition of reserve categories and risk profile residing in the CGU and values for undeveloped land. The discount rates used in the valuation range from 8% to 15% (at December 31, 2017: 8% to 15%). There was no impairment in the Saskatchewan and Monarch CGUs.

In determining the future cash flows, the Company utilized the following benchmark pricing forecasts from its independent reserves evaluator:

| Year | Canadian Light Sweet Crude ($/Bbl) | Western Canada Select ($/Bbl) | Alberta AECO - C Spot ($/MMBtu) | Edmonton Pentanes Plus ($/Bbl) | Edmonton Butane ($/Bbl) | Edmonton Propane ($/Bbl) | Exchange Rate ($US/$CAD) |
|---|---|---|---|---|---|---|---|
| 2019 | 75.27 | 59.47 | 1.95 | 75.32 | 40.91 | 30.27 | 0.77 |
| 2020 | 77.89 | 62.31 | 2.44 | 80.00 | 50.25 | 34.51 | 0.80 |
| 2021 | 82.25 | 67.45 | 3.00 | 83.75 | 56.88 | 38.15 | 0.80 |
| 2022 | 84.79 | 69.53 | 3.21 | 85.50 | 58.01 | 39.64 | 0.80 |
| 2023 | 87.39 | 71.66 | 3.30 | 87.29 | 59.17 | 40.62 | 0.80 |
| 2024 | 89.14 | 73.10 | 3.39 | 89.11 | 60.36 | 41.62 | 0.80 |
| 2025 | 90.92 | 74.56 | 3.49 | 90.96 | 61.56 | 42.64 | 0.80 |
| 2026 | 92.74 | 76.05 | 3.58 | 92.86 | 62.79 | 43.68 | 0.80 |
| 2027 | 94.60 | 77.57 | 3.68 | 94.79 | 64.05 | 44.75 | 0.80 |
| 2028 | 96.49 | 79.12 | 3.78 | 96.76 | 65.33 | 45.83 | 0.80 |
| 2029 | 98.42 | 80.70 | 3.88 | 98.77 | 66.64 | 46.94 | 0.80 |

## Taxes

For the three months and year ended December 31, 2018, the Company recorded deferred income tax recovery of $8.4 million and deferred income tax expense of $8.7 million, respectively, which is consistent with the Company's pre-tax income (loss) during these periods (Corresponding Periods: deferred income tax recoveries of $3.9 million and $1.8 million, respectively).

## Net Income (Loss)

Net loss for the three months ended December 31, 2018 was $24.4 million and net income for the year ended December 31, 2018 was $16.9 million (Corresponding Periods: net loss of $9.4 million and $10.5 million, respectively). The increase in net income in the year ended December 31, 2018 is primarily due to the continued recovery of crude oil prices, offset by the impairment of property, plant and equipment of $26.0 million, while the net loss in the three months ended December 31, 2018 is primarily due to the impairment previously mentioned.

Basic and diluted net loss per share for the three months ended December 31, 2018 was $0.11, and basic and diluted net income per share for the year ended December 31, 2018 was $0.08 (Corresponding Periods: basic and diluted net loss per share of $0.05 and $0.06, respectively).

## Adjusted Funds Flow [1]

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Adjusted funds flow, including transaction related costs | **$54,389** | $59,973 | **$287,074** | $208,331 |
| Transaction related costs | **-** | 616 | **1,750** | 616 |
| Adjusted funds flow, excluding transaction related costs | **$54,389** | $60,589 | **$288,824** | $208,947 |
| *On a weighted average basic common share basis:* | | | | |
| Adjusted funds flow, including transaction related costs | **$0.25** | $0.31 | **$1.39** | $1.11 |
| Adjusted funds flow, excluding transaction related costs | **$0.25** | $0.32 | **$1.40** | $1.11 |
| *On a weighted average diluted common share basis:* | | | | |
| Adjusted funds flow, including transaction related costs | **$0.25** | $0.31 | **$1.38** | $1.10 |
| Adjusted funds flow, excluding transaction related costs | **$0.25** | $0.31 | **$1.39** | $1.11 |

(1) See Non-GAAP Measurements.

In the three months and year ended December 31, 2018, adjusted funds flow, excluding transaction related costs, decreased 10% and increased 38%, respectively, compared to the Corresponding Periods. The decrease in the three months ended December 31, 2018 reflects the lower realized crude oil prices in the fourth quarter of 2018, which is the result of higher than average crude oil price differentials. The increase in the year ended December 31, 2018 reflects a higher average crude oil price environment, as well as more funds flow from increased production related to ongoing drilling operations and acquisitions.

## Net Cash from Operating Activities

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| Net cash from operating activities | **$73,653** | $55,611 | **$294,347** | $187,815 |
| Net cash from operating activities per basic share | **$0.34** | $0.29 | **$1.43** | $1.00 |
| Net cash from operating activities per diluted share | **$0.34** | $0.29 | **$1.41** | $0.99 |

## Capital Expenditures

Capital expenditures are summarized as follows:

| *($ thousands)* | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| ***Cash:*** | | | | |
| Land retention costs | **$143** | $218 | **$658** | $552 |
| Geological and geophysical | **34** | 200 | **526** | 435 |
| Drilling and completions | **36,514** | 23,284 | **135,032** | 91,061 |
| Equipment and facilities | **17,434** | 8,960 | **48,377** | 37,237 |
| Administrative assets | **30** | 72 | **263** | 136 |
| Exploration and development expenditures | **54,155** | 32,734 | **184,856** | 129,421 |
| Capitalized general and administrative expenses | **850** | 1,170 | **5,096** | 3,391 |
| Exploration and development expenditures, including capitalized G&A | **55,005** | 33,904 | **189,952** | 132,812 |
| Acquisitions, net of dispositions | **4,020** | 38,967 | **184,526** | 54,734 |
| Total capital expenditures - cash items | **$59,025** | $72,871 | **$374,478** | $187,546 |
| ***Non-cash:*** | | | | |
| Acquisitions | **-** | 39,411 | **107,767** | 65,574 |
| Gain on disposition | **-** | - | **-** | 1,876 |
| Decommissioning obligations | **16,357** | 24,426 | **52,604** | 29,079 |
| Capitalized stock-based compensation | **1,146** | 946 | **7,868** | 7,254 |
| Total capital expenditures | **$76,528** | $137,654 | **$542,718** | $291,328 |

In the three months and year ended December 31, 2018, the Company drilled 16 (15.3 net) wells and 86 (71.7 net) wells, respectively, compared to 15 (12.8 net) wells and 63 (47.4 net) wells, respectively, in the Corresponding Periods.

The Company anticipates that its 2019 exploration and development capital program (excluding acquisitions) will be financed primarily through funds flow, bank debt and proceeds from equity issuances, if any. The 2019 exploration and development expenditures continue to be concentrated on the Company's primary core areas in southeast Saskatchewan, focused on both conventional and unconventional opportunities, as well as the Cardium play in central Alberta.

Throughout the year ended December 31, 2018, the Company closed various property acquisitions. Total consideration paid included cash of $184.5 million as well as the issuance of 15.6 million common shares of TORC, valued at $7.17 (weighted average) per common share on the acquisition closing dates, for total net consideration of $292.3 million including customary adjustments.

The Company does not set a budget for acquisitions. When making acquisitions, the Company considers opportunities that align with strategic parameters and evaluates and finances each prospect on a case-by-case basis.

## Share Capital

| | **Three months ended Dec 31, 2018** | Three months ended Dec 31, 2017 | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|---|
| **Weighted average outstanding common shares:** | | | | |
| Basic | **216,191,426** | 191,240,108 | **205,793,386** | 187,416,719 |
| Diluted | **216,191,426** | 191,240,108 | **208,487,806** | 187,416,719 |
| **Outstanding Securities:** | | | | |
| Common shares | **216,636,602** | 196,061,445 | **216,636,602** | 196,061,445 |
| Stock options | **-** | 110,961 | **-** | 110,961 |
| Restricted awards | **1,256,667** | 1,049,410 | **1,256,667** | 1,049,410 |
| Performance awards | **2,287,549** | 1,868,406 | **2,287,549** | 1,868,406 |

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, issuable in series.

During 2018, the Company issued 15.6 million common shares related to the Privateco Acquisition and the June Acquisition.

As at February 25, 2019, the Company had 217,305,101 common shares issued and outstanding, 2,325,254 performance awards outstanding and 1,278,932 restricted awards outstanding.

## Liquidity and Capital Resources

The Company's net debt, as defined previously in *Non-GAAP Measurements* , is as follows:

| | **As at Dec 31, 2018** | As at Dec 31, 2017 |
|---|---|---|
| Current assets (excluding financial derivative assets) | **$33,613** | $46,094 |
| Less: current liabilities (excluding financial derivative liabilities) | **(103,418)** | (83,548) |
| Less: bank debt | **(335,488)** | (242,684) |
| Net debt | **($405,293)** | ($280,138) |

Despite the Company's net debt position, it believes that funds flow, combined with its undrawn credit facility and its ability to access additional funding from capital markets, will provide sufficient resources for it to execute its business plans for the foreseeable future.

*(continued)*

The Company may access the following capital resources:

Bank debt

At December 31, 2018, the Company had a reserves-based revolving credit facility of $500 million with a syndicate of banks (the "Credit Facility"), comprised of a $55 million operating facility from the operating lender (the "Operating Facility") and a $445 million syndicated facility with a syndicate of banks (the "Syndicated Facility"). As at December 31, 2018 the amount drawn from the Credit Facility was $335.5 million. On October 31, 2018, the Credit Facility was renewed at $500 million, comprised of a $55 million operating facility and a $445 million syndicated facility. Advances under the Credit Facility are available by way of direct advances, bankers' acceptances and standby letters of credit/guarantees. Direct advances bear interest at the prime rate, U.S. base rate or LIBOR rate, as applicable, plus a margin which is dependent on the Company's debt to trailing funds flow ratio. The bankers' acceptances bear interest at the applicable bankers' acceptance rate plus a stamping fee, based on the Company's debt to trailing funds flow ratio.

Both the Syndicated Facility and the Operating Facility are available on a revolving basis until April 27, 2019. On or before April 27, 2019, at TORC's request and subject to the approval of the lending syndicate, the Credit Facility may be extended for an additional 364 day period. In the event of non-extension, the undrawn portion of the Credit Facility will be cancelled and the amount outstanding will convert to a 364 day non-revolving term facility with repayment of the Credit Facility due on April 28, 2020. The Credit Facility is secured by a fixed and floating charge debenture on all of the Company's assets.

The borrowing base is primarily based on reserves and commodity prices estimated by the lenders. The borrowing base of the Company's Credit Facility is subject to review and redetermination by the lenders on a semi-annual basis and in the event of a change in the Company's borrowing base properties (including due to a disposition of assets beyond certain defined limits or a change which results in a material adverse effect, as determined by the lenders). In the normal course, the Company's next credit facility evaluation is due to be completed by April 27, 2019.

Significant investor

The Company has a significant investor, the Canada Pension Plan Investment Board ("CPPIB"), with approximately 28% ownership in the outstanding common shares of the Company. As long as CPPIB owns greater than 10% of the outstanding common shares of the Company, it has the right to participate in future offerings of securities by the Company, whether by way of public offering or private placement. This includes any offering of common shares and securities convertible or exchangeable into common shares, up to its pro rata ownership interest immediately prior to such offering in the case of a public offering or a private placement to five or more investors, in order to maintain its pro rata percentage ownership interest in the Company, and up to all of the offering in the case of a private placement to less than five investors.

## Risk Management - Financial Derivatives

From time to time, the Company may enter into commodity price, interest rate and foreign exchange rate derivative contracts (also known as hedges) in order to protect acquisition economics and provide some stability of cash flows for capital spending planning purposes. Commodity prices, interest rates and foreign exchange rates fluctuate due to economic and political events. As well, commodity prices may fluctuate due to weather conditions and changes in supply and demand. The Company’s risk management activities are conducted pursuant to the Company’s risk management policies approved by the Board of Directors.

As at December 31, 2018, there were no commodity contracts outstanding.

Subsequent to December 31, 2018, the Company entered into the following commodity contract:

| Term | Type | Volume (Bbl/d) | Price (per Bbl in Canadian dollars) | Reference |
|---|---|---|---|---|
| Mar 1, 2019 - Dec 31, 2019 | Costless Collar | 500 | $60.00 - $92.00 | C$WTI |

## Contractual Obligations

The following table lists the Company's contractual obligations as at December 31, 2018 and the expected timing of these obligations:

| *($ thousands)* | **Total** | Less than 1 year | 1-2 years | 3-5 years | Thereafter |
|---|---|---|---|---|---|
| Trade and other payables | **$98,652** | $98,652 | - | - | - |
| Dividends payable | **4,766** | 4,766 | - | - | - |
| Operating leases (office rent) | **3,211** | 2,018 | 1,193 | - | - |
| Bank debt | **335,488** | - | 335,488 | - | - |
| Total | **$442,117** | $105,436 | $336,681 | - | - |

*Operating commitments*

The Company is, or will be, obligated to pay various costs associated with operations incurred in the normal course of business. These costs include royalties paid to provincial governments, surface and mineral lease rentals and royalties on mineral rights to various landowners, abandonment and reclamation costs, farm-in commitments and office leases. These costs are highly dependent on the future operating environment and are subject to changes in commodity prices, ownership, production volumes and government policies.

*Working capital*

The Company manages the pace of its capital spending related to drilling operations by continuously monitoring production, commodity prices and resulting cash flows. When circumstances affect cash flow in a detrimental way, the Company is capable of reducing its capital spending levels.

The industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of crude oil, NGL and natural gas. This occurs on the 25th day following the month of sale. As a result, the Company's production revenues are collected in an orderly fashion. To the extent that the Company has joint venture partners in its activities it collects the partners' share of capital and operating expenses on a monthly basis. These are subject to normal collection risk.

Accounts payable consist of amounts payable to suppliers relating to capital spending, field operating activities and office expenses. These invoices are processed within the Company's normal payment cycle.

## Business Conditions and Risks

The Company is engaged in the acquisition, exploration, development and production of crude oil and natural gas assets. TORC's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates, and the ability to access debt and equity financing at reasonable cost. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

TORC uses its technical, technological and industry knowledge to evaluate potential hydrocarbon plays in order to pay what it believes are economically sound prices that benefit shareholders. The Company's focus is on areas in which the prospects are understood by management.

The Company minimizes its business risks by operating a large number of its properties. This enables TORC to control the timing, direction and costs related to exploration and development opportunities. TORC's geological focus is on areas in which the prospects are understood by management. Technological tools are regularly used to reduce risk and increase the probability of success.

The Company complies with all government regulations and has an up-to-date emergency response plan that has been communicated to field operations by management. The Company also carries insurance coverage to protect itself against potential losses. Maintaining a highly motivated and talented staff of petroleum and natural gas professionals further minimizes the business risk.

*(continued)*

TORC relies on appropriate sources of funding to support the various stages of its business strategy:

- Internally-generated funds flow from production is used to fund business activities;
- New equity, if available on favourable terms, may be utilized to fund acquisitions and to expand capital programs, when appropriate; and
- Debt may be utilized to fund acquisitions and to expand capital programs.

The Company is exposed to commodity price and market risk for its principal products of crude oil and natural gas. Commodity prices are influenced by a wide variety of factors, most of which are beyond TORC's control. To manage this risk, from time to time, the Company may enter into a number of financial derivative contracts for hedging purposes. These derivative contracts may include contracts related to crude oil and natural gas prices, as well as foreign exchange and interest rates. The Company may also, from time to time, enter into fixed physical contracts. The Company monitors the cost and associated benefit of these instruments and contracts as well as any debt levels and utilization rates on bank lines, and utilizes these derivatives and contracts when warranted.

Inflation risks subject the Company to potential erosion of product netbacks. For example, increasing domestic prices for oil and natural gas production equipment and services can inflate the costs of operations. In addition, increasing costs of undeveloped land can inflate costs of both asset and corporate acquisitions.

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a reasonable cost and produce them in an economic and timely fashion. In periods of increased activity, these services and supplies can become difficult to obtain. The Company attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors and maintaining an appropriate inventory of production equipment.

Demand for crude oil, NGL and natural gas produced by the Company exists within Canada and the United States; however, crude oil prices are affected by worldwide supply and demand fundamentals while natural gas prices are currently primarily affected by North American supply and demand fundamentals. Demand for natural gas liquids is influenced mainly by the demand for petrochemicals in North American and off-shore markets. TORC mitigates these risks as follows:

- TORC attempts to explore for and produce crude oil that is of high quality, mitigating its exposure to adverse quality differentials;
- Natural gas production will generally be connected to established pipeline infrastructures that operate with minimal interruptions;
- Sale arrangements will vary in term and pricing structure creating a diverse portfolio that minimizes risk of exposure to any one market; and
- Financial derivative contracts may be used where appropriate to manage commodity price volatility.

## Off Balance Sheet Arrangements

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

## Critical Accounting Estimates

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and underlying assumptions are reviewed on an ongoing basis. Actual results may differ from these estimates.

*Business combinations*

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of property, plant and equipment, as well as exploration and evaluation assets acquired, generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates.

*Reserves*

The estimation of reserves is critical to various accounting estimates. It requires judgments based on available geophysical, geological, engineering and economic data. These estimates can change materially as information from ongoing exploratory, development and production activities becomes available. These estimates can also change as economic conditions impacting crude oil and natural gas prices, royalties and operating costs change. Reserve estimates can change net income through depletion expense, accretion expense from decommissioning obligations and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net income.

*Decommissioning obligations*

The calculation of decommissioning obligations is based on estimated costs to abandon and reclaim its net ownership in all wells and facilities, the estimated timing of the costs to be incurred and economic inflation and discount rates. These estimates can change due to technological advances, governmental and regulatory laws and regulations or economic conditions and can impact the amount of the decommissioning obligations and net income.

*Deferred income taxes*

The calculation of deferred income taxes includes estimates of reversal of temporary differences, tax rates substantively enacted and likelihood of assets being realized. These estimates can impact net income and deferred tax liabilities.

*(continued)*

*Future accounting pronouncements*

IFRS 16 *Leases*

In January 2016 the IASB issued IFRS 16 *Leases* ("IFRS 16"), which replaces IAS 17 *Leases* and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. The standard will come into effect for annual periods beginning on or after January 1, 2019. IFRS 16 is required to be adopted either retrospectively or using a modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it applies the standard prospectively. IFRS 16 will be adopted using the modified retrospective approach on January 1, 2019.

The Company's leases that will be recognized on its balance sheet at January 1, 2019 include leases of equipment, real estate, vehicles and surface land rights.

On initial adoption, TORC is applying the following optional expedients allowed under the new standard:

- Some classes of leases that transfer a separate good or service under the same contract that have been identified for recognition at January 1, 2019, will not be separated between their lease and non-lease components and instead will be recognized as a single lease component;
- Certain short-term leases and leases of low value assets identified on January 1, 2019, will not be recognized on the balance sheet; and
- Certain leases having similar characteristics will be measured as a portfolio by applying a single discount rate.

IFRS 16 is expected to increase the Company's total assets and liabilities in 2019 as TORC recognizes leases on its statement of financial position that were not recognized prior to adoption. Future income and comprehensive income will be impacted as the finance charges and depreciation charges associated with the lease contracts are not expected to correspond in any one period to the amount of related cash flows. Cash flows associated with lease repayments will be allocated between operating and financing activities based on their interest repayment and principal payment portions.

## Changes to Accounting Policies

IFRS 15

The Company adopted IFRS 15, *Revenue from Contracts with Customers*, on January 1, 2018. The Company used the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue contracts with customers using the IFRS 15 five-step model, which did not result in any changes to the comparative period or the opening deficit.

*Revenue recognition policy*

Revenue from the sale of petroleum and natural gas is measured based on the consideration specified in contracts with customers. The Company recognizes revenue when it transfers control of the product to the buyer. This is generally at the time the customer obtains legal title to the product and when it is physically transferred to the custody transfer point agreed with the customer, often terminals, pipelines or other transportation methods.

The Company evaluates its arrangements with third parties and partners to determine if the Company acts as the principal or as an agent. In making this evaluation, management considers if the Company obtains control of the product delivered, which is indicated by the Company having the primary responsibility for the delivery of the product, having the ability to establish prices or having inventory risk. 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. There was no impact on the Company's financial statements.

*(continued)*

IFRS 9

The Company adopted IFRS 9, *Financial Instruments*, on January 1, 2018. The transition to IFRS 9 had no impact on 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 IFRS 39 categories of *held to maturity*, *loans and receivables* and *available for sale*. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification. There was no impact on the Company's financial statements.

Impairment of financial assets: IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" model. The new impairment model applies to financial assets measured at amortized cost, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. There was no impact on the Company's financial statements.

Cash and cash equivalents, if any, and trade and other receivables continue to be measured at amortized cost and are now classified as "amortized cost". The Company's financial liabilities previously classified as "other financial liabilities" being trade and other payables, dividends payable and bank debt continue to be measured at amortized cost and are now classified as "amortized cost". The Company has not designated any financial instruments as FVOCI or FVTPL, nor does the Company use hedge accounting. There was no impact on the Company's financial statements.

## Environmental Regulation and Risk

The oil and gas industry has various environmental risks subject to regulation by various governmental bodies. Environmental legislation includes, but is not limited to, operational controls, site restoration and abandonment requirements and restrictions on emissions of various substances related to the production of oil and natural gas. Compliance with this legislation may require additional costs and a failure to comply may result in fines and penalties.

TORC is committed to minimizing the environmental impact from its operations through an environmental program which includes stakeholder communication, resource conservation and site restoration.

## Disclosure Controls and Internal Controls Over Financial Reporting

The Chief Executive Officer and Chief Financial Officer are responsible for the design and operating effectiveness of internal controls over financial reporting ("ICFR") and disclosure controls and procedures ("DCP") of the Company.

In accordance with National Instrument NI 52-109, the Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's DCP and ICFR. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's DCP and ICFR were effective as at December 31, 2018.

## Additional Information

Additional information can be obtained by contacting the Company at TORC Oil & Gas Ltd., Suite 1800, Eighth Avenue Place, 525 - 8th Avenue SW, Calgary, Alberta, Canada T2P 1G1. Additional information is also available on www.sedar.com and on the Company's website www.torcoil.com.

## Summary of Quarterly and Annual Results

| *(in $000's of dollars, except per share amounts)* | **Q4 2018 (1)** | Q3 2018 | Q2 2018 | Q1 2018 | Q4 2017 (1) | Q3 2017 (1) | Q2 2017 | Q1 2017 |
|---|---|---|---|---|---|---|---|---|
| Petroleum and natural gas sales | **119,861** | 166,977 | 134,387 | 119,782 | 113,741 | 90,038 | 96,432 | 93,629 |
| Net income (loss) | **(24,398)** | 22,747 | 13,321 | 5,224 | (9,431) | (6,335) | 2,532 | 2,744 |
| Per share – basic | **(0.11)** | 0.11 | 0.07 | 0.03 | (0.05) | (0.03) | 0.01 | 0.01 |
| Per share – diluted | **(0.11)** | 0.11 | 0.07 | 0.03 | (0.05) | (0.03) | 0.01 | 0.01 |
| Adjusted funds flow, including transaction related costs (2) | **54,389** | 94,036 | 74,637 | 64,012 | 59,973 | 44,404 | 52,471 | 51,483 |
| Per share – basic | **0.25** | 0.44 | 0.38 | 0.33 | 0.31 | 0.24 | 0.28 | 0.28 |
| Per share – diluted | **0.25** | 0.44 | 0.37 | 0.32 | 0.31 | 0.24 | 0.28 | 0.28 |
| Adjusted funds flow, excluding transaction related costs (2) | **54,389** | 95,086 | 75,337 | 64,012 | 60,589 | 44,404 | 52,471 | 51,483 |
| Per share – basic | **0.25** | 0.45 | 0.38 | 0.33 | 0.32 | 0.24 | 0.28 | 0.28 |
| Per share – diluted | **0.25** | 0.44 | 0.38 | 0.32 | 0.31 | 0.24 | 0.28 | 0.28 |
| Net cash from operating activities (3) | **73,653** | 87,364 | 75,036 | 58,294 | 55,611 | 35,853 | 56,955 | 39,396 |
| Per share – basic | **0.34** | 0.41 | 0.38 | 0.30 | 0.29 | 0.19 | 0.30 | 0.21 |
| Per share – diluted | **0.34** | 0.41 | 0.37 | 0.29 | 0.29 | 0.19 | 0.30 | 0.21 |
| Total assets | **2,318,356** | 2,347,029 | 2,293,102 | 2,036,851 | 2,036,212 | 1,978,868 | 1,961,822 | 1,939,751 |
| Total long-term financial liabilities | **335,488** | 337,289 | 333,000 | 233,088 | 242,684 | 230,000 | 198,000 | 218,044 |
| Dividends declared per share | **0.0660** | 0.0660 | 0.0640 | 0.0600 | 0.0600 | 0.0600 | 0.0600 | 0.0600 |
| Net debt (2) | **405,293** | 391,101 | 367,035 | 269,521 | 280,138 | 259,116 | 241,912 | 258,582 |

*(footnotes on next page)*

| *(in $000's of dollars, except per share amounts)* | Year ended Dec 2018 | Year ended Dec 2017 (1) | Year ended Dec 2016 (1) |
|---|---|---|---|
| Petroleum and natural gas sales | 541,007 | 393,840 | 286,989 |
| Net income (loss) | 16,894 | (10,490) | (50,443) |
| Per share – basic | 0.08 | (0.06) | (0.30) |
| Per share – diluted | 0.08 | (0.06) | (0.30) |
| Adjusted funds flow, including transaction related costs (2) | 287,074 | 208,331 | 124,464 |
| Per share – basic | 1.39 | 1.11 | 0.73 |
| Per share – diluted | 1.38 | 1.10 | 0.73 |
| Adjusted funds flow, excluding transaction related costs (2) | 288,824 | 208,947 | 125,137 |
| Per share – basic | 1.40 | 1.11 | 0.74 |
| Per share – diluted | 1.39 | 1.11 | 0.73 |
| Net cash from operating activities (3) | 294,347 | 187,815 | 125,474 |
| Per share – basic | 1.43 | 1.00 | 0.74 |
| Per share – diluted | 1.41 | 0.99 | 0.73 |
| Total assets | 2,318,356 | 2,036,212 | 1,947,618 |
| Total long-term financial liabilities | 335,488 | 242,684 | 218,743 |
| Dividends declared per share | 0.2560 | 0.2400 | 0.2650 |
| Net debt (2) | 405,293 | 280,138 | 270,900 |

*(1) The diluted number of shares is equivalent to the basic number of shares due to stock options, incentive shares, performance and restricted awards, and/or warrants being antidilutive in periods where the Company has a "net loss". Therefore, the diluted per share amounts in these periods are equivalent to the basic per share amounts.*

*(2) See Non-GAAP Measurements.*

*(3) Net cash from operating activities is determined in accordance with IFRS and includes changes in non-cash working capital.*

From 2015 to 2017, the Company successfully closed numerous strategic asset acquisitions, and sustainably managed the business through a highly volatile commodity price environment. In February 2015, the Company issued 16 million common shares to acquire assets in southeast Saskatchewan. In June 2015, the Company acquired additional assets in southeast Saskatchewan and southwest Manitoba for net consideration of $428.5 million; concurrently, the Company issued 43.4 million common shares for gross proceeds of $438.0 million. In the third quarter of 2015, the Company recorded impairment charges of $16.0 million and $43.0 million related to its E&E and PP&E assets, respectively, contributing to a net loss in this period. Similarly, in the fourth quarter of 2015, the Company recorded impairment charges of $38.2 million and $71.0 million related to its E&E and PP&E assets, respectively. In September 2016, the Company acquired assets in southeast Saskatchewan for net consideration of $90.1 million; concurrently, the Company issued 15.8 million common shares for gross proceeds of $111.3 million. In the second quarter of 2017, the Company closed two asset acquisitions, as well as disposed of certain non-core assets within the Company's existing southeast Saskatchewan area. Total consideration paid, net of the proceeds from the non-core disposition, included cash of $9.8 million as well as the issuance of 2.8 million common shares of TORC. In the fourth quarter of 2017, the Company closed various asset acquisitions and dispositions within TORC's existing Cardium and southeast Saskatchewan area. Total consideration paid, net of the cash proceeds from the non-core dispositions, included cash of $39.0 million as well as the issuance of 5.8 million common shares. Also in the fourth quarter of 2017, the Company recorded an impairment charge of $23.0 million related to its PP&E assets, resulting in a net loss in this year. In the second quarter of 2018, the Company closed an asset acquisition in and around its existing core southeast Saskatchewan area; total consideration paid included cash of $120.2 million as well as the issuance of 13.5 million common shares. In the third quarter of 2018, the Company closed the acquisition of a private oil company; total consideration paid included cash of $51.2 million as well as the issuance of 2.08 million common shares. In the fourth quarter of 2018, the Company recorded an impairment charge of $26.0 million related to its PP&E assets. These notable events, along with organic drilling growth, have resulted in an increase in total assets, comprised largely of land and wells, as well as increased petroleum and natural gas sales, influenced by commodity prices and commodity mix.

**Financial Statements**

As at and for the years ended

December 31, 2018 and 2017

# MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The accompanying financial statements of TORC Oil & Gas Ltd. were prepared by and are the responsibility of management. They have been prepared in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain assessments that reflect management's best estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects. The financial information contained elsewhere in Management's Discussion and Analysis has been reviewed to ensure consistency with the financial statements.

Management has developed and maintains systems of internal controls designed to provide reasonable assurance that all transactions are properly recorded in the Company's financial records, that procedures and policies are adhered to, that the financial statements realistically report the Company's operating and financial results, and that assets are safeguarded from unauthorized use. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2018.

KPMG LLP, an independent firm of chartered professional accountants, has been engaged to examine the financial statements in accordance with Canadian generally accepted auditing standards and to provide an independent auditors' report thereon.

The Board of Directors, through its Audit Committee, has reviewed the financial statements including notes thereto with management and KPMG LLP. The Audit Committee is composed of three unrelated and independent members of the Board of Directors and meets quarterly with the financial officers of the Company. KPMG LLP has access to the Audit Committee to review the planning and scope of testing and to discuss the results of their audit work. On the recommendation of the Audit Committee, the accompanying financial statements have been approved by the Board of Directors.

*(signed)*

Brett Herman
President and
Chief Executive Officer

*(signed)*

Jason Zabinsky
Vice President, Finance and
Chief Financial Officer

February 25, 2019
Calgary, Canada

# INDEPENDENT AUDITORS' REPORT

*To the Shareholders of TORC Oil & Gas Ltd.*

***Opinion***

We have audited the financial statements of TORC Oil & Gas Ltd. (the "Company"), which comprise:

- the statements of financial position as at December 31, 2018 and December 31, 2017
- the statements of income (loss) and comprehensive income (loss) for the years then ended
- the statements of changes in 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 Company 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 Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical 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 Company'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 Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company'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 Company'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 Company'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 Company 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 Gregory Ronald Caldwell.

*(signed)*

KPMG LLP
Chartered Professional Accountants

Calgary, Canada
February 25, 2019

# TORC Oil & Gas Ltd.

**Statements of Financial Position**
**(in $000's of Canadian dollars)**

| | Note | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|---|
| **Assets** | | | |
| Trade and other receivables | | **$30,158** | $44,206 |
| Deposits and prepaid expenses | | **3,455** | 1,888 |
| Total current assets | | **33,613** | 46,094 |
| Property, plant and equipment | 12 | **2,276,120** | 1,978,156 |
| Deferred tax asset | 14 | **8,623** | 11,962 |
| Total non-current assets | | **2,284,743** | 1,990,118 |
| Total assets | | **$2,318,356** | $2,036,212 |
| **Liabilities** | | | |
| Trade and other payables | | **$98,652** | $79,627 |
| Dividends payable | | **4,766** | 3,921 |
| Financial derivative liability | 21 | **-** | 309 |
| Total current liabilities | | **103,418** | 83,857 |
| Bank debt | 20 | **335,488** | 242,684 |
| Decommissioning obligations | 13 | **385,042** | 324,640 |
| Total non-current liabilities | | **720,530** | 567,324 |
| Total liabilities | | **$823,948** | $651,181 |
| **Equity** | | | |
| Share capital | 15 | **$2,004,805** | $1,860,907 |
| Contributed surplus | | **18,142** | 16,460 |
| Deficit | | **(528,539)** | (492,336) |
| Total equity | | **1,494,408** | 1,385,031 |
| Total liabilities and equity | | **$2,318,356** | $2,036,212 |

Subsequent event (note 21)
Commitment (note 22)

See accompanying notes to the financial statements.

Approved on behalf of the Board

*(signed)* Raymond Chan, Director

*(signed)* Brett Herman, Director

## TORC Oil & Gas Ltd.

**Statements of Income (Loss) and Comprehensive Income (Loss)**
**(in $000's of Canadian dollars, except per share amounts)**

| | Note | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|---|
| **Revenues** | | | |
| Petroleum and natural gas sales | 17 | **$541,007** | $393,840 |
| Royalties | | **(94,943)** | (67,646) |
| | | **446,064** | 326,194 |
| Realized loss on financial derivatives | | **(3,269)** | - |
| Unrealized gain on financial derivatives | 21 | **309** | 803 |
| Petroleum and natural gas sales net of royalties and derivatives | | **443,104** | 326,997 |
| **Expenses** | | | |
| Operating | | **117,004** | 89,415 |
| Transportation | | **12,021** | 8,876 |
| General and administrative | | **12,308** | 9,629 |
| Transaction related costs | 6, 7 & 8 | **1,750** | 616 |
| Finance costs | 10 | **20,809** | 16,196 |
| Stock-based compensation | 18 | **8,860** | 8,195 |
| Depletion and depreciation | 12 | **218,721** | 185,827 |
| Gain on disposition | | **-** | (2,431) |
| Impairment | 12 | **26,000** | 23,000 |
| | | **417,473** | 339,323 |
| Income (loss) before income taxes | | **25,631** | (12,326) |
| Deferred income tax expense (recovery) | 14 | **8,737** | (1,836) |
| Income (loss) and comprehensive income (loss) | | **$16,894** | ($10,490) |
| Income (loss) per share: | | | |
| Basic | 19 | **$0.08** | ($0.06) |
| Diluted | 19 | **$0.08** | ($0.06) |

See accompanying notes to the financial statements.

# TORC Oil & Gas Ltd.

**Statements of Changes in Equity**
**(in $000's of Canadian dollars, unless otherwise noted)**

| | Number of common shares (000's) | Share capital | Contributed surplus | Deficit | Total equity |
|---|---|---|---|---|---|
| Balance at December 31, 2016 | 183,099 | $1,771,238 | $14,858 | ($436,777) | $1,349,319 |
| Common shares issued (note 15) | 8,586 | 59,975 | - | - | 59,975 |
| Stock-based compensation | - | - | 15,449 | - | 15,449 |
| Issued on vesting of: Share Awards | 1,817 | - | - | - | - |
| Transfer of stock-based compensation on vesting of: Share Awards | - | 13,847 | (13,847) | - | - |
| Dividends to shareholders | - | - | - | (45,069) | (45,069) |
| Issued pursuant to the share dividend program (note 16) | 2,559 | 15,847 | - | - | 15,847 |
| Loss for the year | - | - | - | (10,490) | (10,490) |
| **Balance at December 31, 2017** | **196,061** | **$1,860,907** | **$16,460** | **($492,336)** | **$1,385,031** |
| Balance at December 31, 2017 | 196,061 | $1,860,907 | $16,460 | ($492,336) | $1,385,031 |
| Common shares issued (note 15) | 15,615 | 112,002 | - | - | 112,002 |
| Stock-based compensation | - | - | 16,728 | - | 16,728 |
| Issued on vesting of: Share Awards | 2,302 | - | - | - | - |
| Transfer of stock-based compensation on vesting of: Share Awards | - | 15,046 | (15,046) | - | - |
| Dividends to shareholders | - | - | - | (53,097) | (53,097) |
| Issued pursuant to the share dividend program (note 16) | 2,659 | 16,850 | - | - | 16,850 |
| Income for the year | - | - | - | 16,894 | 16,894 |
| **Balance at December 31, 2018** | **216,637** | **$2,004,805** | **$18,142** | **($528,539)** | **$1,494,408** |

See accompanying notes to the financial statements.

## TORC Oil & Gas Ltd.
**Statements of Cash Flows**
**(in $000's of Canadian dollars)**

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Income (loss) for the year | **$16,894** | ($10,490) |
| Depletion and depreciation | **218,721** | 185,827 |
| Stock-based compensation | **8,860** | 8,195 |
| Deferred income tax expense (recovery) | **8,737** | (1,836) |
| Accretion on decommissioning obligations | **8,171** | 6,869 |
| Unrealized gain on financial derivatives | **(309)** | (803) |
| Gain on disposition | **-** | (2,431) |
| Impairment | **26,000** | 23,000 |
| Settlement of decommissioning obligations | **(3,724)** | (801) |
| Change in non-cash working capital | **10,997** | (19,715) |
| Net cash from operating activities | **294,347** | 187,815 |
| **Cash flows used in investing activities:** | | |
| Additions to property, plant and equipment | **(186,569)** | (132,812) |
| Acquisitions | **(191,160)** | (63,809) |
| Working capital acquired on acquisition | **6,198** | - |
| Proceeds from property dispositions | **436** | 9,075 |
| Change in non-cash working capital | **19,346** | 4,753 |
| Net cash used in investing activities | **(351,749)** | (182,793) |
| **Cash flows from (used in) financing activities:** | | |
| Proceeds from bank debt | **92,804** | 23,941 |
| Dividends | **(35,402)** | (28,963) |
| Net cash from (used in) financing activities | **57,402** | (5,022) |
| Change in cash and cash equivalents | **-** | - |
| Cash and cash equivalents, beginning of year | **-** | - |
| Cash and cash equivalents, end of year | **-** | - |

See accompanying notes to the financial statements.

# TORC Oil & Gas Ltd.
**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

## 1. Reporting entity

TORC Oil & Gas Ltd. (the “Company” or "TORC") was incorporated pursuant to the Business Corporations Act (Alberta) on March 23, 2010 as 1525893 Alberta Ltd. The Company's name was changed to TORC Oil & Gas Ltd. on December 17, 2010. The Company's principal business activity is the exploration for and production of petroleum and natural gas in the Western Canadian Sedimentary Basin.

The Company's principal place of business is located at Suite 1800, Eighth Avenue Place, 525 - 8th Avenue SW, Calgary, Alberta, Canada T2P 1G1.

## 2. Basis of preparation

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and were authorized for issue by the Board of Directors on February 25, 2019.

(b) Basis of measurement and presentation

The financial statements have been prepared on the historical cost basis, except for derivative financial instruments which are measured at fair value when outstanding.

Operating expenses in the statement of income and comprehensive income are presented as a combination of function and nature to conform with industry practice. Depletion and depreciation is presented on a separate line by its nature, while operating expenses and general and administrative expenses are presented on a functional basis. Significant expenses such as key management personnel's short-term employee benefits and stock-based compensation are presented by their nature in the notes to the financial statements.

(c) Functional and presentation currency

The financial statements are presented in Canadian dollars, which is the Company’s functional currency.

(d) Use of estimates and judgments

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

Estimates and their underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and for any future years affected.

*Critical judgments in applying accounting policies:*

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

The Company’s assets are aggregated into cash generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit’s ability to generate independent cash inflows. The determination of these CGUs was based on management’s judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality. The Company has the following CGUs: Cardium, Saskatchewan and Monarch.

*(continued)*

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future operating and development costs, discount rates, market value of land and other relevant assumptions.

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves will be found so as to assess if technical feasibility and commercial viability has been achieved.

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

*Key sources of estimation uncertainty:*

The following are key estimates and their assumptions made by management affecting the measurement of balances and transactions in these financial statements.

Estimation of recoverable quantities of proved and probable reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion, depreciation and amortization of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations in accordance with National Instrument 51-101.

The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, future removal technologies in determining the removal cost, and the estimate of the liability specific discount rates to determine the present value of these cash flows.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proved and probable reserves being acquired.

The Company's estimate of stock-based compensation is dependent upon estimates of historic volatility, forfeiture rates and an assessment of achieving performance conditions.

The Company's estimate of the fair value of derivative financial instruments is dependent on estimated forward prices and volatility in those prices.

A deferred tax asset/liability is based on estimates as to the timing of the reversal of temporary differences, the amount of future taxable earnings, the availability of cash flows and substantively enacted tax rates.

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to the years presented in the financial statements by the Company, with the exception of the accounting policy changes noted below.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, substantive potential voting rights are taken into consideration. The financial statements of subsidiaries are included in consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets and liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of income and comprehensive income.

(ii) Jointly owned assets

Many of the Company's oil and natural gas activities involve jointly owned assets. The financial statements include the Company's share of these jointly owned assets and a proportionate share of the relevant revenue and related costs. The relationships with jointly owned asset partners have been referred to as joint venture in the remainder of the financial statements as is common in the Canadian oil and gas industry.

(b) Foreign currency

Transactions in foreign currencies are translated to Canadian dollars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Canadian dollars at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in the statement of income and comprehensive income.

(c) Financial instruments

Non-derivative financial assets and liabilities

Non-derivative financial assets and liabilities are comprised of cash and cash equivalents including bank overdrafts, trade and other receivables, trade and other payables, dividends payable and bank debt. Non-derivative financial assets and liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, measurement of non-derivative financial assets and liabilities depends on the classification of the financial asset or liability as *fair value through profit or loss* ("FVTPL") or *amortized cost.*

*(continued)*

Classification and measurement of financial assets and liabilities

Non-derivative financial assets and liabilities classified as FVTPL are subsequently carried at fair value, with changes recognized in net income.

Non-derivative financial assets and liabilities classified as amortized cost are subsequently carried at amortized cost using the effective interest rate method.

Currently, the Company classifies all non-derivative financial assets and liabilities as amortized cost using the effective interest rate method.

Impairment of financial assets

The Company recognizes loss allowances for expected credit losses ("ECLs") on its financial assets measured at amortized cost. Due to the nature of its financial assets, 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.

Derivative financial instruments

The Company may enter into certain financial derivative contracts (also known as "hedges") in order to manage the exposure to market risks from fluctuations in commodity prices, interest rates and foreign exchange rates. 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 commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified at FVTPL and are recorded on the statement of financial position at fair value with changes in fair value recognized in net income. Related transaction costs such as trading commissions are recognized in the statement of income and comprehensive income when incurred.

Forward physical delivery and sales contracts of oil and natural gas products are entered into under normal course of business and therefore not recorded at fair value on the statement of financial position. These physical delivery contracts are not considered to be derivative financial instruments or hedges. Settlements on these physical delivery contracts are recognized in oil and natural gas revenue on the statement of income and comprehensive income.

Share capital

Common shares are classified as equity. 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.

(d) Exploration and evaluation assets ("E&E")

Costs incurred prior to the ownership of licenses and rights to drill on properties are expensed in the statement of income and comprehensive income as incurred, if the related licenses and rights are not subsequently acquired.

The costs incurred to acquire licenses and rights to drill, including seismic costs, and the subsequent drilling and completing costs related to these licenses (including employee remuneration, materials and fuel used, rig costs and payments made to contractors) are capitalized as E&E assets until the drilling of the well is complete and the results have been evaluated.

*(continued)*

E&E assets are accumulated in cost centers pending the determination of technical feasibility and commercial viability of the drilling project. Technical feasibility and commercial viability is considered to be achieved when a project area is proved based on proved and probable reserves being determined to exist in the broader project area. Upon determination of proved and probable reserves, the related E&E assets in the associated project area are typically reclassified to a different long-term asset category, *Property, Plant and Equipment ("PP&E")* , where the assets may be subject to depletion expense.

E&E assets are measured at cost less accumulated impairment losses and not subject to depletion expense until after these assets are reclassified to PP&E.

As facts and circumstances suggest, E&E assets are tested for impairment. The Company compares the carrying amount of its total E&E assets to the assets' recoverable amount, which, for E&E assets, is generally the fair market value of undeveloped land at the time of impairment testing. In addition, E&E assets related to specific technically feasible and commercially viable cost centers are tested for impairment if and when they are reclassified to PP&E. E&E assets are aggregated with the associated cash generating units for the purposes of impairment testing.

Impairment losses recognized in prior periods are assessed as facts and circumstances suggest to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the E&E asset's carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the statement of income and comprehensive income.

(e) Property, plant and equipment ("PP&E")

There are two categories of PP&E: Developed and Producing ("D&P") assets and Other PP&E assets.

D&P assets include capital costs (i) related to drilling projects where the drilling location is already determined to hold proved and probable reserves, (ii) that have been reclassified from E&E assets because proved and probable reserves have been determined, and (iii) incurred to improve an already technically feasible and commercially viable well.

Other PP&E typically includes furniture, fixtures, leasehold improvements and office equipment.

For statement of financial position presentation, both D&P assets and Other PP&E are included in the PP&E category.

(i) Recognition and measurement

PP&E is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. For the purposes of depletion and depreciation, when significant parts of PP&E have different useful lives, they are accounted for separately so that depletion and depreciation rates appropriately reflect useful lives.

Gains and losses on disposal of PP&E, property swaps and farm-outs, including oil and natural gas interests, are determined by comparing the proceeds from disposal of fair value of the asset received or given up, with the carrying amount of the PP&E sold, and are recognized on a net basis in profit or loss.

For the purposes of impairment testing, assets are grouped into the smallest group of assets that generate independent cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. These groups of assets are called cash generating units ("CGU's").

*(continued)*

Impairment testing of PP&E is performed as facts and circumstances suggest by comparing the carrying amount of each CGU to each CGU's recoverable amount. The recoverable amount of a CGU is the greater of (i) its value in use, and (ii) its fair value less selling costs. In assessing value in use for D&P assets, the estimated future cash flows from the production of proved and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from proved and probable reserves.

Impairment losses recognized in prior periods are assessed at each reporting date to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the PP&E 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. Impairment losses and recoveries are recorded in the statement of income and comprehensive income.

(ii) Proved and probable reserves

Proved and probable reserves 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. At least annually, reserves are evaluated by independent reserve evaluators.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and 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.

Where amounts are expressed on a barrel of oil equivalent (“Boe”) basis, natural gas volumes have been converted to Boe using a ratio of 6,000 cubic feet of natural gas to one barrel of oil equivalent. This conversion ratio is based upon an energy equivalent conversion method primarily applicable at the burner tip and does not represent value equivalence at the wellhead. Boe figures may be misleading, particularly if used in isolation.

(iii) Subsequent costs

Subsequent costs are capital costs incurred to improve an existing D&P asset (such as a well) that is technically feasible and commercially viable. These costs are capitalized as D&P assets only if they increase the future economic benefits of the asset. All other expenditures are expensed in the statement of income and comprehensive income as incurred. These improvement costs include capital costs of further developing proved and probable reserves or enhancing production. The costs of routine maintenance of D&P assets are recognized in the statement of income and comprehensive income as incurred. The carrying value of any replaced or sold component is derecognized.

(iv) Depletion and depreciation

The net carrying value of D&P assets is depleted using the unit-of-production method by calculating the ratio of production in the period to the related proved and probable reserves. The carrying value to be depleted includes estimated future development costs necessary to produce proved and probable reserves. Future development costs are estimated by considering the level of development required to produce the proved and probable reserves and are reviewed by independent reserve engineers at least annually. Undeveloped land related to a proved project area, for which specific proved and probable reserves have not yet been assigned, are withheld from depletion.

*(continued)*

For Other PP&E, depreciation is recognized in the statement of income and comprehensive income on a straight-line basis over their estimated useful lives. Finance lease assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(f) Goodwill

The Company records goodwill relating to corporate acquisitions when the purchase price exceeds the fair value of the net identifiable assets and liabilities acquired by the Company. When goodwill is negative, it is recognized immediately in the statement of income and comprehensive income. The goodwill balance is assessed for impairment annually or as events occur that could result in an impairment. Goodwill is measured at cost less accumulated impairment losses.

For the purposes of impairment testing, goodwill is allocated to CGU's that are expected to economically benefit from the business combination from which the goodwill arose. An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of income and comprehensive income. Impairment losses identified in a CGU are first charged against any goodwill related to that CGU, with any remaining impairment losses charged against E&E or PP&E assets remaining in that CGU. Impairment losses of goodwill cannot be reversed.

(g) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position.

Payments made under operating leases are recognized in the statement of income and comprehensive income on a straight-line basis over the term of the lease and not recognized as a liability on the Company's statement of financial position. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(h) Stock-based compensation

The grant date fair value of stock-based compensation on equity instruments, such as stock options, incentive shares and restricted and performance awards granted to employees, is recognized as stock-based compensation expense, with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated at the grant date and is adjusted to reflect the actual number of stock-based compensation equity instruments that vest including adjustments for performance conditions. The inputs used in the calculation of the fair value of stock-based compensation are estimated on the grant date.

*(continued)*

(i) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

Examples of provisions include dismantling, decommissioning and site disturbance remediation activities, and anticipated losses from lawsuits. Provision is made for the estimated cost of these activities and capitalized in the relevant asset category or expensed in the statement of income and comprehensive income.

Decommissioning obligations

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the statement of financial position date. Subsequent to initial measurement, the obligation is adjusted at the end of each reporting 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, known as accretion, is recognized in the statement of income and comprehensive income as finance costs 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 to the extent the provision was established.

(j) Revenue

Revenue from the sale of petroleum and natural gas is measured based on the consideration specified in contracts with customers. The Company recognizes revenue when it transfers control of the product to the buyer. This is generally at the time the customer obtains legal title to the product and when it is physically transferred to the custody transfer point agreed with the customer, often terminals, pipelines or other transportation methods.

The Company evaluates its arrangements with third parties and partners to determine if the Company acts as the principal or as an agent. In making this evaluation, management considers if the Company obtains control of the product delivered, which is indicated by the Company having the primary responsibility for the delivery of the product, having the ability to establish prices or having inventory risk. 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.

Tariffs and tolls charged to other entities for use of pipelines and facilities owned by the Company are recognized as revenue as they accrue in accordance with the terms of the service or tariff and tolling agreements.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(k) Finance income and costs

Finance costs comprise of interest expense on bank debt, accretion of the discount on decommissioning obligations, and impairment losses recognized on financial assets.

Interest income is recognized as it accrues in the statement of income and comprehensive income, using the effective interest method.

*(continued)*

(l) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the statement of income and comprehensive income except to the extent that it relates to items recognized directly in equity, such as share issue costs, in which case it is recognized in equity.

Current tax 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 tax is recognized using the balance sheet 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 tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred 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 at the reporting date. Deferred 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 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.

(m) Earnings per share

Basic earnings per share is calculated by dividing the net income attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the net income attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options, incentive shares, and restricted and performance awards granted to employees.

(n) Future accounting pronouncements

IFRS 16 *Leases*

In January 2016 the IASB issued IFRS 16 *Leases* ("IFRS 16"), which replaces IAS 17 *Leases* and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. The standard will come into effect for annual periods beginning on or after January 1, 2019. IFRS 16 is required to be adopted either retrospectively or using a modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it applies the standard prospectively. IFRS 16 will be adopted using the modified retrospective approach on January 1, 2019.

The Company's leases that will be recognized on its balance sheet at January 1, 2019 include leases of equipment, real estate, vehicles and surface land rights.

On initial adoption, TORC is applying the following optional expedients allowed under the new standard:

- Some classes of leases that transfer a separate good or service under the same contract that have been identified for recognition at January 1, 2019, will not be separated between their lease and non-lease components and instead will be recognized as a single lease component;
- Certain short-term leases and leases of low value assets identified on January 1, 2019, will not be recognized on the balance sheet; and
- Certain leases having similar characteristics will be measured as a portfolio by applying a single discount rate.

*(continued)*

IFRS 16 is expected to increase the Company's total assets and liabilities in 2019 as TORC recognizes leases on its statement of financial position that were not recognized prior to adoption. Future income and comprehensive income will be impacted as the finance charges and depreciation charges associated with the lease contracts are not expected to correspond in any one period to the amount of related cash flows. Cash flows associated with lease repayments will be allocated between operating and financing activities based on their interest repayment and principal payment portions.

(o) Changes to accounting policies

IFRS 15

The Company adopted IFRS 15, *Revenue from Contracts with Customers* , on January 1, 2018. The Company used the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue contracts with customers using the IFRS 15 five-step model, which did not result in any changes to the comparative period or the opening deficit. See the revenue section above for details on the revenue recognition policy.

IFRS 9

The Company adopted IFRS 9, *Financial Instruments* , on January 1, 2018. The transition to IFRS 9 had no impact on 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 IFRS 39 categories of *held to maturity, loans and receivables and available for sale* . Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification. There was no impact on the Company's financial statements.

Impairment of financial assets: IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" model. The new impairment model applies to financial assets measured at amortized cost, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. There was no impact on the Company’s financial statements.

Cash and cash equivalents, if any, and trade and other receivables continue to be measured at amortized cost and are now classified as "amortized cost". The Company’s financial liabilities previously classified as “other financial liabilities” being trade and other payables, dividends payable and bank debt continue to be measured at amortized cost and are now classified as “amortized cost”. The Company has not designated any financial instruments as FVOCI or FVTPL, nor does the Company use hedge accounting. There was no impact on the Company's financial statements.

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 4. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instruments:

- Level 1: Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.
- Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.
- Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

Exploration and evaluation assets, and property, plant and equipment

The fair value of exploration and evaluation assets and property, plant and equipment recognized in a business combination, is based on market value. The market value of E&E assets and PP&E is the estimated amount for which E&E assets and PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests included in E&E assets and PP&E is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

Cash and cash equivalents, bank overdrafts, trade and other receivables, trade and other payables, dividends payable and bank debt

The fair value of cash and cash equivalents, bank overdrafts, trade and other receivables, trade and other payables, dividends payable and bank debt is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. As at December 31, 2018 and 2017, the fair value of cash and cash equivalents, trade and other receivables, trade and other payables and dividends payable approximated their carrying value due to their short term to maturity. The fair value of bank debt approximates its carrying value as it bears a floating rate of interest and the margin charged by the lenders are indicative of current credit spreads.

Derivatives

The fair value of financial forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate. The fair value of costless collars is based on option models that use published information with respect to volatility, prices and interest rates. The Company classifies its derivatives as Level 2. Level 2 values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Stock-based compensation

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility, weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, forfeiture rate and the risk-free interest rate (based on government bonds). Incentive shares and restricted and performance awards are fair valued based on the share price on the measurement date with a forfeiture rate applied.

**(in $000's of Canadian dollars, unless otherwise noted)**

## 5. Financial risk management

(a) Overview

The Company's activities expose it to a variety of financial risks such as credit risk, liquidity risk and market risk that arise as a result of its exploration, development, production and financing activities.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls and to monitor risks and market conditions.

(b) Credit risk

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

The carrying amount of the Company's trade and other receivables represents the maximum credit exposure.

With respect to trade and other receivables, the Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

Receivables from petroleum and natural gas marketers are collected on the 25th day of each month following production. The Company's policy to mitigate credit risk associated with these balances is to establish relationships with credit-worthy marketers, as well as to carefully assess the extent of credit granted to these parties.

Joint venture receivables are normally collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risks exist with joint venture partners as disagreements occasionally arise, increasing the risk of non-collection.

The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners. However, the Company does have the ability to withhold production from joint venture partners in the event of non-payment, as well as requiring prepayment (cash calls) for significant expenditures.

The Company does not anticipate any default as it transacts with credit-worthy customers and management does not expect any losses from non-performance by these customers. As such, a provision for doubtful accounts has not been recorded at December 31, 2018 or 2017.

The maximum exposure to credit risk for trade and other receivables at the reporting date by type of customer was:

| | **December 31, 2018** | December 31, 2017 |
|---|---|---|
| Petroleum and natural gas marketing companies | **$27,247** | $40,599 |
| Joint venture partners and other parties | **2,911** | 3,607 |
| Total trade and other receivables | **$30,158** | $44,206 |

*(continued)*

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

The Company's trade and other receivables are aged as follows:

| | **December 31, 2018** | December 31, 2017 |
|---|---|---|
| Current (less than 90 days) | **$29,936** | $43,906 |
| Past due (greater than 90 days) | **222** | 300 |
| Total | **$30,158** | $44,206 |

(c) Liquidity risk

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its obligations associated with financial liabilities. The financial liabilities on the statement of financial position consist of trade and other payables, dividends payable and bank debt. Trade and other payables and dividends payable are considered due within one year. The terms for bank debt are outlined in note 20. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities. The Company has had no defaults or breaches on its financial liabilities.

(d) Market risk

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

Although the Company generally does not sell or transact in foreign currency, the United States dollar influences the price of petroleum and natural gas sold in Canada. Furthermore, exchange rate fluctuations can affect the fair value and cash flow from derivative contracts. For the years ended December 31, 2018 and 2017, the Company did not enter into any foreign currency derivative contracts.

Commodity prices for crude oil, natural gas liquids and natural gas are also impacted by political events, meteorological conditions and changes in supply and demand. The Company may enter into commodity derivative contracts that provide downside price protection in order to provide some stability of cash flows for capital spending and planning purposes. The Company's risk management activities are conducted pursuant to its risk management policies approved by the Board of Directors.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. The Company's interest rate risk arises from its floating rate credit facility. For the years ended December 31, 2018 and 2017, the Company did not enter into any interest rate derivative contracts. Assuming all other variables remain constant, an increase or decrease of one percent in market interest rates in the year ended December 31, 2018 would have decreased or increased net income by $3.0 million.

(e) Capital management

The Company's policy is to maintain a strong capital base in order to maintain financial flexibility and to sustain the future development of the business. The Company manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile. In order to maintain the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The Company considers its capital structure to include working capital, bank debt and shareholders' equity.

The same as in the prior year, in order to optimize capital and operating efficiency, the Company monitors its net debt. Net debt is calculated as current assets (excluding financial derivative assets) less: i) current liabilities (excluding financial derivative liabilities, and ii) bank debt). In terms of net debt, the Company monitors debt levels based on a ratio of net debt to annualized adjusted funds flow. The Company defines adjusted funds flow as cash flow from operating activities prior to changes in non-cash working capital and settlement of decommissioning obligations.

**TORC Oil & Gas Ltd.**
**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 6. Corporate acquisition

On July 26, 2018, the Company acquired all of the issued and outstanding shares of a private oil company with assets in and around TORC's core southeast Saskatchewan area (the "Privateco Acquisition"). Total consideration for the Privateco Acquisition included cash of $51.2 million as well as the issuance of 2.08 million common shares of TORC, valued at $7.75 per common share on the closing date, for total net consideration of $67.4 million, including customary adjustments.

The Company believes the nature and characteristics of the Privateco Acquisition are complementary to TORC's light oil focused strategy.

The Company expensed transaction costs totaling $0.6 million related to the Privateco Acquisition.

The Privateco Acquisition has been accounted for using the acquisition method of accounting, with the operating results included in the Company's financial and operating results commencing on the closing date of the acquisition.

| | |
|---|---|
| Consideration paid | |
| 2,082,969 common shares issued | $16,143 |
| Cash | 51,240 |
| Consideration paid | $67,383 |
| | |
| Net assets acquired, at estimated fair value | |
| Property, plant and equipment | $58,869 |
| Working capital (including cash of $6.2 million) | 5,035 |
| Deferred tax asset | 5,398 |
| Decommissioning obligations | (1,919) |
| | $67,383 |

The fair value of property, plant and equipment has been determined with reference to a reserve report. The fair value of decommissioning obligations was initially estimated using a credit adjusted rate of 7%.

Included in the statement of income and comprehensive income are the following amounts relating to the Privateco Acquisition, from closing date to December 31, 2018:

| | |
|---|---|
| Petroleum and natural gas sales | $10,931 |
| Net income and comprehensive income | $3,279 |

If the Privateco Acquisition had occurred on January 1, 2018, the Company's pro forma results of petroleum and natural gas sales and net income and comprehensive income for the year ended December 31, 2018 would have been as follows:

| | TORC, as stated in the statement of income and comprehensive income | Privateco Acquisition (from Jan 1, 2018 to closing date) | Pro forma (unaudited) |
|---|---|---|---|
| Petroleum and natural gas sales | $541,007 | $14,420 | $555,427 |
| Net income and comprehensive income | $16,894 | $4,326 | $21,220 |

# TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

## 7. Southeast Saskatchewan and Manitoba asset acquisitions

On June 27, 2018, the Company closed an acquisition of properties and working interests in and around its core southeast Saskatchewan area (the "June Acquisition"). Total consideration for the June Acquisition included cash of $120.2 million as well as the issuance of 13.5 million common shares of TORC, valued at $7.08 per common share on the closing date, for total net consideration of $216.0 million, including customary adjustments.

The Company believes the nature and characteristics of the June Acquisition are complementary to TORC's light oil focused strategy.

The June Acquisition has been accounted for using the acquisition method of accounting, with the operating results included in the Company's financial and operating results commencing on the closing date of the acquisition.

| | |
|---|---|
| Consideration paid | |
| 13,531,800 common shares issued | $95,859 |
| Cash | 120,174 |
| Consideration paid | $216,033 |
| | |
| Net assets acquired, at estimated fair value | |
| Property, plant and equipment | $227,556 |
| Decommissioning obligations | (11,523) |
| | $216,033 |

The fair value of property, plant and equipment has been determined with reference to a reserve report. The fair value of decommissioning obligations was initially estimated using a credit adjusted rate of 7%.

Included in the statement of income and comprehensive income are the following amounts relating to the June Acquisition, from closing date to December 31, 2018:

| | |
|---|---|
| Petroleum and natural gas sales | $29,469 |
| Operating income (revenue less royalties, operating and transportation costs) | $17,269 |

If the June Acquisition had occurred on January 1, 2018, the Company's pro forma results of petroleum and natural gas sales and operating income for the year ended December 31, 2018 would have been as follows:

| | TORC, as stated in the statement of income and comprehensive income | June Acquisition (from Jan 1, 2018 to closing date) | Pro forma (unaudited) |
|---|---|---|---|
| Petroleum and natural gas sales | $541,007 | $38,409 | $579,416 |
| Operating income (revenue less royalties, operating and transportation costs) | $317,039 | $22,948 | $339,987 |

In addition to the June Acquisition, the Company closed various minor asset and land acquisitions (the "Other Acquisitions") for total cash consideration of $12.7 million.

The Company expensed transaction costs totaling $1.2 million related to the June Acquisition and the Other Acquisitions.

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 8. Cardium and southeast Saskatchewan asset acquisitions

During the year ended December 31, 2017, the Company acquired various properties and working interests in and around its core southeast Saskatchewan and Cardium areas (together the "2017 Asset Acquisitions"). The 2017 Asset Acquisitions included:

- On April 4, 2017, the Company closed an acquisition of various properties and working interests in southeast Saskatchewan (the "April 2017 Acquisition") for cash consideration of $6.8 million and the issuance of 2.8 million common shares of TORC, valued at $6.88 per common share on the closing date, for total consideration of $26.0 million including customary adjustments.

- On December 11, 2017, the Company closed an acquisition of various properties and working interests in southeast Saskatchewan (the "December 2017 Acquisition") for cash consideration of $21.5 million and the issuance of 5.8 million common shares of TORC, valued at $7.04 per common share on the closing date, for total consideration of $62.3 million including customary adjustments.

- At various times in 2017, the Company closed multiple acquisitions of various properties and working interests for total cash consideration of $34.5 million ("Other 2017 Acquisitions").

The Company believes the nature and characteristics of the 2017 Asset Acquisitions are complementary to TORC's light oil focused strategy.

The Company expensed transaction costs totaling $0.6 million related to the 2017 Asset Acquisitions.

The 2017 Asset Acquisitions have been accounted for using the acquisition method of accounting, with the operating results included in the Company's financial and operating results commencing on the closing date of the acquisitions.

| | April 2017 Acquisition | December 2017 Acquisition | Other 2017 Acquisitions | Total |
|---|---|---|---|---|
| Consideration paid | | | | |
| Cash | $6,785 | $21,538 | $34,484 | $62,807 |
| Common shares issued | 19,166 | 40,809 | - | 59,975 |
| Consideration paid | $25,951 | $62,347 | $34,484 | $122,782 |
| Net assets acquired, at estimated fair value | | | | |
| Property, plant and equipment | $35,421 | $65,543 | $37,927 | $138,891 |
| Deferred tax liability | (7,067) | - | - | (7,067) |
| Decommissioning obligations | (2,403) | (3,196) | (3,443) | (9,042) |
| | $25,951 | $62,347 | $34,484 | $122,782 |

The fair value of property, plant and equipment has been determined with reference to a reserve report. The fair value of decommissioning obligations was initially estimated using a credit adjusted rate of 7%.

Included in the statement of income and comprehensive income are the following amounts relating to the 2017 Asset Acquisitions, from their respective closing dates to December 31, 2017:

| | |
|---|---|
| Petroleum and natural gas sales | $13,817 |
| Operating income (revenue less royalties, operating and transportation costs) | $7,995 |

*(continued)*

## TORC Oil & Gas Ltd.
**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

If the 2017 Asset Acquisitions had occurred on January 1, 2017, the Company's pro forma results of petroleum and natural gas sales and net income and comprehensive income for the year ended December 31, 2017 would have been as follows:

| | TORC, as stated in the statement of loss and comprehensive loss | 2017 Asset Acquisitions (from Jan 1, 2017 to closing dates) | Pro forma (unaudited) |
|---|---|---|---|
| Petroleum and natural gas sales | $393,840 | $31,479 | $425,319 |
| Operating income (revenue less royalties, operating and transportation costs) | $227,903 | $18,216 | $246,119 |

### 9. Key management personnel compensation

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Remuneration and short-term benefits | **$4,215** | $3,725 |
| Stock-based compensation | **6,570** | 6,477 |
| | **$10,785** | $10,202 |
| Capitalized portion of total compensation | **(5,195)** | (5,101) |
| | **$5,590** | $5,101 |

Key management personnel includes the officers and directors of the Company.

Short-term employee benefits and stock-based compensation include both the capitalized and non-capitalized portion of these expenditures. Stock-based compensation reflects amounts amortized during the respective periods.

# TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

## 10. Finance costs

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Interest expense and financing charges | **$12,638** | $9,327 |
| Accretion on decommissioning obligations | **8,171** | 6,869 |
| | **$20,809** | $16,196 |

## 11. Supplemental cash flow information

Changes in non-cash working capital is comprised of:

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Source/(use) of cash: | | |
| Trade and other receivables | **$14,048** | ($9,820) |
| Deposits and prepaid expenses | **(1,567)** | 520 |
| Trade and other payables | **19,025** | (5,662) |
| Non-cash working capital acquired | **(1,163)** | - |
| | **$30,343** | ($14,962) |
| Related to operating activities | **$10,997** | ($19,715) |
| Related to investing activities | **19,346** | 4,753 |
| | **$30,343** | ($14,962) |

The following table summarizes interest and taxes paid:

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Interest paid | **$12,012** | $8,820 |
| Taxes paid | **-** | - |
| | **$12,012** | $8,820 |

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 12. Property, plant and equipment

| | |
|---|---|
| Cost: | |
| Balance at December 31, 2016 | $2,518,439 |
| Property acquisitions | 139,893 |
| Property dispositions | (15,264) |
| Capital expenditures | 140,066 |
| Change in decommissioning obligations | 26,633 |
| Balance at December 31, 2017 | $2,809,767 |
| Property acquisitions | 308,113 |
| Property dispositions | (436) |
| Capital expenditures | 194,437 |
| Change in decommissioning obligations | 40,571 |
| **Balance at December 31, 2018** | **$3,352,452** |

| | |
|---|---|
| Accumulated depletion, depreciation and impairment: | |
| Balance at December 31, 2016 | $624,808 |
| Depletion and depreciation | 185,827 |
| Accumulated depletion pursuant to property dispositions | (2,024) |
| Impairment | 23,000 |
| Balance at December 31, 2017 | $831,611 |
| Depletion and depreciation | 218,721 |
| Impairment | 26,000 |
| **Balance at December 31, 2018** | **$1,076,332** |

| | |
|---|---|
| Net amount: | |
| As at December 31, 2017 | $1,978,156 |
| **As at December 31, 2018** | **$2,276,120** |

At December 31, 2018, the Company had $51.7 million of property, plant and equipment which was excluded from depletion at the time and largely related to undeveloped land (December 31, 2017: $81.5 million). Estimated future development costs of $924.4 million were included in the depletion calculation (December 31, 2017: $746.3 million).

For the year ended December 31, 2018, the Company has capitalized $5.1 million of general and administrative expenses and $7.9 million of stock-based compensation, which are directly attributable to the acquisition or exploration activities of the Company (for the year ended December 31, 2017: $3.4 million and $7.3 million, respectively).

*(continued)*

**TORC Oil & Gas Ltd.**
**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

Impairment

At December 31, 2018, the Company determined there to be indicators of impairment due to volatility in commodity prices in all CGUs. The Company recognized an impairment charge of $26.0 million (at December 31, 2017: $23.0 million) on its PP&E assets related to the Cardium CGU (the "Impaired PP&E Assets") due to the carrying values in the Cardium CGU exceeding the recoverable amounts. The recoverable amount (determined using value in use) of a CGU is the greater of (i) its value in use, and (ii) its fair value less costs to sell. The recoverable amount for the Impaired PP&E Assets was $349.0 million (at December 31, 2017: $376.0 million), which was based on the proved plus probable reserve values from TORC's December 31, 2018 reserve report prepared by its independent reserve engineer. The recoverable amount of the CGU was estimated based on proved plus probable reserve values using before-tax discount rates specific to the underlying composition of reserve categories and risk profile residing in the CGU and values for undeveloped land. The discount rates used in the valuation range from 8% to 15% (at December 31, 2017: 8% to 15%). There was no impairment in the Saskatchewan and Monarch CGUs.

In determining the future cash flows, the Company utilized the following benchmark pricing forecasts from its independent reserves evaluator:

| Year | Canadian Light Sweet Crude ($/Bbl) | Western Canada Select ($/Bbl) | Alberta AECO - C Spot ($/MMBtu) | Edmonton Pentanes Plus ($/Bbl) | Edmonton Butane ($/Bbl) | Edmonton Propane ($/Bbl) | Exchange Rate ($US/$CAD) |
|---|---|---|---|---|---|---|---|
| 2019 | 75.27 | 59.47 | 1.95 | 75.32 | 40.91 | 30.27 | 0.77 |
| 2020 | 77.89 | 62.31 | 2.44 | 80.00 | 50.25 | 34.51 | 0.80 |
| 2021 | 82.25 | 67.45 | 3.00 | 83.75 | 56.88 | 38.15 | 0.80 |
| 2022 | 84.79 | 69.53 | 3.21 | 85.50 | 58.01 | 39.64 | 0.80 |
| 2023 | 87.39 | 71.66 | 3.30 | 87.29 | 59.17 | 40.62 | 0.80 |
| 2024 | 89.14 | 73.10 | 3.39 | 89.11 | 60.36 | 41.62 | 0.80 |
| 2025 | 90.92 | 74.56 | 3.49 | 90.96 | 61.56 | 42.64 | 0.80 |
| 2026 | 92.74 | 76.05 | 3.58 | 92.86 | 62.79 | 43.68 | 0.80 |
| 2027 | 94.60 | 77.57 | 3.68 | 94.79 | 64.05 | 44.75 | 0.80 |
| 2028 | 96.49 | 79.12 | 3.78 | 96.76 | 65.33 | 45.83 | 0.80 |
| 2029 | 98.42 | 80.70 | 3.88 | 98.77 | 66.64 | 46.94 | 0.80 |

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 13. Decommissioning obligations

| | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|
| Balance, beginning of year | **$324,640** | $289,493 |
| Obligations incurred | **7,060** | 4,680 |
| Obligations acquired | **15,384** | 9,042 |
| Obligations disposed | **-** | (6,596) |
| Obligations settled | **(3,724)** | (801) |
| Change in discount rate, pursuant to acquisitions | **27,232** | 17,815 |
| Change in estimates | **6,279** | 4,138 |
| Accretion | **8,171** | 6,869 |
| Balance, end of year | **$385,042** | $324,640 |

The total future decommissioning obligations are based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated an undiscounted and uninflated total future liability of $396.0 million as at December 31, 2018 (at December 31, 2017: $340.3 million) to be incurred on average in 25 years.

For the year ended December 31, 2018, the Company used a risk free rate of 2.18 percent and an inflation rate of 1.8 percent to calculate the net present value of the decommissioning obligations, compared to the year ended December 31, 2017 when the risk free rate was 2.26 percent and the inflation rate was 1.8 percent, resulting in a change in estimate of $6.3 million. Actual costs may differ from estimated costs due to changes in laws and regulations, timing of costs, changes in technology and market conditions.

The decommissioning obligations acquired pursuant to the June Acquisition and Privateco Acquisition, during the year ended December 31, 2018, were initially recognized using a fair value interest rate of 7 percent. They were subsequently revalued using the respective risk free rates at the time of the acquisition, resulting in a combined change of $27.2 million.

### 14. Taxes

Tax recovery

The combined provision for taxes in the statement of income and comprehensive income reflects an effective tax rate which differs from the expected statutory rate. The reasons for the difference are as follows:

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Income (loss) before taxes | **$25,631** | ($12,326) |
| Statutory income tax rate | **27.0%** | 27.0% |
| Expected income tax expense (recovery) | **6,920** | (3,328) |
| Add (deduct): | | |
| Non-deductible stock-based compensation | **2,082** | 815 |
| Permanent depletion | **551** | 584 |
| Rate adjustments | **-** | 59 |
| Other | **(816)** | 34 |
| Deferred income tax expense (recovery) | **$8,737** | ($1,836) |

*(continued)*

# TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

Deferred tax asset

The following table summarizes the continuity of the deferred tax liability (asset):

| | As at Dec 31, 2016 | Recognized in profit or loss | Recognized in equity | Acquisitions (note 8) | As at Dec 31, 2017 |
|---|---|---|---|---|---|
| E&E and PP&E | $178,124 | $21,422 | - | $9,508 | $209,054 |
| Decommissioning obligations | (78,108) | (7,104) | - | (2,441) | (87,653) |
| Loss carryforwards | (112,034) | (15,898) | - | - | (127,932) |
| Stock based compensation | (86) | (2,714) | - | - | (2,800) |
| Financial derivatives | (300) | 216 | - | - | (84) |
| Share issue costs | (4,789) | 2,242 | - | - | (2,547) |
| | ($17,193) | ($1,836) | - | $7,067 | ($11,962) |

| | As at Dec 31, 2017 | Recognized in profit or loss | Recognized in equity | Acquisitions (note 6) | As at Dec 31, 2018 |
|---|---|---|---|---|---|
| E&E and PP&E | $209,054 | $28,406 | - | (4,880) | $232,580 |
| Decommissioning obligations | (87,653) | (14,886) | - | (518) | (103,057) |
| Loss carryforwards | (127,932) | (6,944) | - | - | (134,876) |
| Stock based compensation | (2,800) | 960 | - | - | (1,840) |
| Financial derivatives | (84) | 84 | - | - | - |
| Share issue costs | (2,547) | 1,117 | - | - | (1,430) |
| | ($11,962) | $8,737 | - | ($5,398) | ($8,623) |

As at December 31, 2018, the Company has tax deductions of approximately $1.9 billion (2017: $1.6 billion) available to shelter future taxable income.

| | **As at December 31, 2018** | As at December 31, 2017 |
|---|---|---|
| CEE | **$60,990** | $48,673 |
| CDE | **212,174** | 155,003 |
| COGPE | **852,997** | 748,877 |
| UCC | **246,043** | 207,759 |
| Share issue costs | **5,297** | 9,433 |
| Loss carry forwards (expiring between 2026 to 2037) | **499,533** | 473,823 |
| | **$1,877,034** | $1,643,568 |

**TORC Oil & Gas Ltd.**
**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

## 15. Share capital

Share capital - authorized

At December 31, 2018, the Company was authorized to issue an unlimited number of Class A voting common shares, an unlimited number of Class B non-voting common shares and an unlimited number of preferred shares. The Company has not issued any Class B non-voting common shares nor any preferred shares.

Share capital - issued

During the year ended December 31, 2018, the Company closed the Privateco Acquisition (note 6) and the June Acquisition (note 7). Related to these acquisitions, TORC issued 15.6 million common shares valued at $7.17 (weighted average) per common share on the acquisition closing dates.

During the year ended December 31, 2017, the Company closed various acquisitions (the 2017 Asset Acquisitions). Related to the 2017 Asset Acquisitions, TORC issued 8.6 million common shares valued at $6.99 (weighted average) per common share on the acquisition closing dates.

Significant investor

The Company has a significant investor, the Canada Pension Plan Investment Board ("CPPIB"), with approximately 28% ownership in the outstanding common shares of the Company. As long as CPPIB owns greater than 10% of the outstanding common shares of the Company, it has the right to participate in future offerings of securities by the Company, whether by way of public offering or private placement. This includes any offering of common shares and securities convertible or exchangeable into common shares, up to its pro rata ownership interest immediately prior to such offering in the case of a public offering or a private placement to five or more investors, in order to maintain its pro rata percentage ownership interest in the Company, and up to all of the offering in the case of a private placement to less than five investors.

## 16. Dividends

| *(thousands, except per share amounts)* | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Dividends declared per share | **$0.256** | $0.240 |
| Cash dividends paid | **$35,402** | $28,963 |
| Dollar value of common shares issued under the Share Dividend Program | **16,850** | 15,847 |
| Total dividends | **$52,252** | $44,810 |

In 2016, the Company's dividend plan enabled common shareholders to elect to receive dividends in common shares rather than cash (the "Share Dividend Program"), calculated at 95% of the weighted average trading price for the five days immediately prior to the payment date (the "SDP Discount"). On December 15, 2016, TORC announced the elimination of the SDP Discount, beginning with the January 2017 dividend, which was paid in February 2017.

During the period between January 1, 2019 and February 25, 2019, $9.6 million of dividends have been declared.

# TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

## 17. Revenue

The Company sells its production pursuant to variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Commodity prices are based on market indices that are determined on a monthly or daily basis.

The contracts generally have a term of one year or less, whereby delivery takes place throughout the contract period. Revenues are typically collected on the 25th day of the month following production.

The following table details the Company's sales by product:

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Crude oil | **$518,482** | $377,327 |
| NGL | **14,425** | 6,922 |
| Natural gas | **8,100** | 9,591 |
| | **$541,007** | $393,840 |

Included in accounts receivable at December 31, 2018 is $27.2 million (December 31, 2017: $40.6 million) of accrued petroleum and natural gas revenues.

## 18. Stock-based compensation

In September 2013, the Company's shareholders approved an award plan (the ‘‘Share Award Plan’’) whereby restricted awards and performance awards (collectively, ‘‘Share Awards’’) may be granted to the directors, officers and employees of the Company. The maximum number of common shares issuable under the Share Award Plan, combined with the Company's existing stock option and incentive share plans, cannot exceed ten percent of the outstanding common shares. In addition, the combined number of restricted and performance awards cannot exceed 3.75 percent of the outstanding common shares. Share Awards are earned over various periods, generally up to three years from the date of grant. Upon being earned, a holder of restricted awards is entitled to a notional payment equal to the equivalent number of common shares (plus accrued dividend equivalents). A holder of performance awards is entitled to a similar payment equal to the equivalent number of common shares, converted using a multiplier between zero and two (plus accrued dividend equivalents), dependent on the Company's performance on a set criteria as determined by the Board of Directors. The Corporation has the discretion to settle the awards in common shares, cash or a combination thereof.

*Stock options*

Stock options granted have a term of five years to expiry and have various vesting periods up to three years. The following table summarizes the Company's stock option activity:

| *(thousands, except exercise prices)* | Number of stock options | Weighted average exercise price |
|---|---|---|
| Balance at December 31, 2016 | 502 | $14.22 |
| Expired | (366) | 15.31 |
| Forfeited | (25) | 13.05 |
| **Balance at December 31, 2017** | **111** | **$10.91** |
| Expired | (111) | 10.91 |
| **Balance and exercisable at December 31, 2018** | **-** | **-** |

As at December 31, 2018, all outstanding stock options have expired.

*(continued)*

**(in $000's of Canadian dollars, unless otherwise noted)**

*Restricted awards*

The following table summarizes restricted award activity:

| *(thousands)* | Number of restricted awards |
|---|---|
| Balance at December 31, 2016 | 1,003 |
| Granted | 582 |
| Adjustment for payment of dividends | 46 |
| Forfeited | (32) |
| Vested | (550) |
| Balance at December 31, 2017 | 1,049 |
| Granted | 708 |
| Adjustment for payment of dividends | 55 |
| Forfeited | (38) |
| Vested | (517) |
| **Balance at December 31, 2018** | **1,257** |

Restricted awards are earned over various periods, generally up to three years from the date of grant. Upon being earned, a holder of restricted awards is entitled to a notional payment equal to the equivalent number of common shares (plus accrued dividend equivalents). The Corporation has the discretion to settle the awards in common shares, cash or a combination thereof. The fair value of restricted awards is deemed to equal the stock price on the date of grant. For the year ended December 31, 2018, the weighted average fair value of restricted awards granted was $6.28 (year ended December 31, 2017: $6.73) per restricted award. There is no forfeiture rate included in the calculation of fair values of restricted awards granted.

*Performance awards*

The following table summarizes performance award activity:

| *(thousands)* | Number of performance awards |
|---|---|
| Balance at December 31, 2016 | 1,667 |
| Granted | 1,084 |
| Granted pursuant to performance multiplier [1] | 335 |
| Adjustment for payment of dividends | 89 |
| Forfeited | (35) |
| Vested | (1,272) |
| Balance at December 31, 2017 | 1,868 |
| Granted | 1,353 |
| Granted pursuant to performance multiplier [1] | 837 |
| Adjustment for payment of dividends | 107 |
| Forfeited | (84) |
| Vested | (1,793) |
| **Balance at December 31, 2018** | **2,288** |

(1) Performance awards granted pursuant to performance multipliers are not further increased or decreased by future performance multipliers.

*(continued)*

# TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

Performance awards are earned over various periods, generally up to three years from the date of grant. Upon being earned, a holder of performance awards is entitled to a notional payment equal to the equivalent number of common shares, converted using a multiplier between zero and two (plus accrued dividend equivalents), dependent on the Company's performance on a set criteria as determined by the Board of Directors. The Corporation has the discretion to settle the awards in common shares, cash or a combination thereof. The multiplier, which was determined during the earning period, is considered to have been applied at the grant date. As performance multipliers are known, past grants are adjusted to reflect the multiplier. The fair value of performance awards is deemed to equal the stock price on the date of grant. For the year ended December 31, 2018, the weighted average fair value of performance awards granted was $6.52 (year ended December 31, 2017: $7.12) per performance award. There is no forfeiture rate included in the calculation of fair values of performance awards granted.

*Stock-based compensation*

The following table summarizes the stock-based compensation:

| | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Stock-based compensation on performance awards | **$12,735** | $11,234 |
| Stock-based compensation on restricted awards | **3,993** | 4,215 |
| Capitalized stock-based compensation | **(7,868)** | (7,254) |
| Total stock-based compensation | **$8,860** | $8,195 |

## 19. Earnings (loss) per share

Earnings (loss) per share amounts are calculated by dividing the net income (loss) for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period.

| *(thousands, except number of common shares and per share amounts)* | **Year ended Dec 31, 2018** | Year ended Dec 31, 2017 |
|---|---|---|
| Income (loss) for the year | **$16,894** | ($10,490) |
| Basic weighted average number of common shares | **205,793,386** | 187,416,719 |
| Diluted weighted average number of common shares | **208,487,806** | 187,416,719 |
| Basic and diluted income (loss) per common share | **$0.08** | ($0.06) |

In computing diluted earnings per share for the year ended December 31, 2018, 2,069,431 performance awards and 624,989 restricted awards were added to the basic weighted average common shares outstanding.

For the year ended December 31, 2017, the diluted number of shares is equivalent to the basic number of shares due to antidilutive stock options, incentive shares, performance and restricted awards. Therefore, the diluted per share amounts for net loss are equivalent to the basic per share amounts.

## TORC Oil & Gas Ltd.

**Notes to the Financial Statements**
**As at and for the years ended December 31, 2018 and December 31, 2017**
**(in $000's of Canadian dollars, unless otherwise noted)**

### 20. Bank debt

At December 31, 2018, the Company had a reserves-based revolving credit facility of $500 million with a syndicate of banks (the "Credit Facility"), comprised of a $55 million operating facility from the operating lender (the "Operating Facility") and a $445 million syndicated facility with a syndicate of banks (the "Syndicated Facility"). As at December 31, 2018 the amount drawn from the Credit Facility was $335.5 million. On October 31, 2018, the Credit Facility was renewed at $500 million, comprised of a $55 million operating facility and a $445 million syndicated facility. Advances under the Credit Facility are available by way of direct advances, bankers' acceptances and standby letters of credit/guarantees. Direct advances bear interest at the prime rate, U.S. base rate or LIBOR rate, as applicable, plus a margin which is dependent on the Company's debt to trailing funds flow ratio. The bankers' acceptances bear interest at the applicable bankers' acceptance rate plus a stamping fee, based on the Company's debt to trailing funds flow ratio.

Both the Syndicated Facility and the Operating Facility are available on a revolving basis until April 27, 2019. On or before April 27, 2019, at TORC's request and subject to the approval of the lending syndicate, the Credit Facility may be extended for an additional 364 day period. In the event of non-extension, the undrawn portion of the Credit Facility will be cancelled and the amount outstanding will convert to a 364 day non-revolving term facility with repayment of the Credit Facility due on April 28, 2020. The Credit Facility is secured by a fixed and floating charge debenture on all of the Company's assets.

The borrowing base is primarily based on reserves and commodity prices estimated by the lenders. The borrowing base of the Company's Credit Facility is subject to review and redetermination by the lenders on a semi-annual basis and in the event of a change in the Company's borrowing base properties (including due to a disposition of assets beyond certain defined limits or a change which results in a material adverse effect, as determined by the lenders). In the normal course, the Company's next credit facility evaluation is due to be completed by April 27, 2019.

### 21. Financial derivatives

The following table presents a reconciliation of the change in the unrealized amounts for the years ended December 31, 2018 and December 31, 2017:

| | Fair value |
|---|---|
| Financial derivative liability at December 31, 2016 | ($1,112) |
| Unrealized gain on financial derivatives | 803 |
| Financial derivative liability at December 31, 2017 | (309) |
| Unrealized gain on financial derivatives | 309 |
| Financial derivative liability at December 31, 2018 | - |

As at December 31, 2018, there were no commodity contracts outstanding.

Subsequent to December 31, 2018, the Company entered into the following commodity contract:

| Term | Type | Volume (Bbl/d) | Price (per Bbl in Canadian dollars) | Reference |
|---|---|---|---|---|
| Mar 1, 2019 - Dec 31, 2019 | Costless Collar | 500 | $60.00 - $92.00 | C$WTI |

### 22. Commitment

Future minimum lease payments for the Company's office space as at December 31, 2018 are as follows:

| | |
|---|---|
| 2019 | $2,018 |
| 2020 | 1,193 |
| Total | $3,211 |