



**STRENGTH OF  
CHARACTER**

ANNUAL REPORT 2019



LEUCROTТА  
EXPLORATION INC.

## Q4 2019 FINANCIAL AND OPERATING RESULTS

### FINANCIAL RESULTS

(\$000s, except per share amounts)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
<b>Oil and natural gas sales</b>	<b>6,870</b>	7,113	(3)	<b>27,645</b>	32,048	(14)
<b>Cash flow from operating activities</b>	<b>2,098</b>	3,764	(44)	<b>10,465</b>	16,249	(36)
Per share - basic and diluted	<b>0.01</b>	0.02	(50)	<b>0.05</b>	0.08	(38)
<b>Adjusted funds flow <sup>(1)</sup></b>	<b>2,316</b>	2,875	(19)	<b>10,266</b>	15,949	(36)
Per share - basic and diluted	<b>0.01</b>	0.01	-	<b>0.05</b>	0.08	(38)
<b>Net loss</b>	<b>6,140</b>	161	3,714	<b>5,529</b>	43	12,758
Per share - basic and diluted	<b>0.03</b>	-	100	<b>0.03</b>	-	100
<b>Capital expenditures and acquisitions</b>	<b>4,160</b>	10,665	(61)	<b>14,997</b>	36,680	(59)
<b>Proceeds on sale of equipment <sup>(2)</sup></b>	<b>-</b>	2,729	(100)	<b>4,767</b>	2,729	75
<b>Working capital</b>				<b>125</b>	2,102	(94)
<b>Common shares outstanding (000s)</b>						
Weighted average - basic and diluted	<b>200,525</b>	200,525	-	<b>200,525</b>	200,520	-
End of period - basic				<b>200,525</b>	200,525	-
End of period - fully diluted				<b>226,646</b>	227,082	-

(1) Adjusted funds flow and adjusted funds flow per share do not have any standardized meaning prescribed by International Financial Reporting Standards ("IFRS") and therefore may not be comparable to similar measures used by other companies. Please refer to the "Non-GAAP Measures" section in the MD&A for more details and the "Cash Flow from Operating Activities and Adjusted Funds Flow" section in the MD&A for a reconciliation from cash flow from operating activities.

(2) The sale of equipment for proceeds of \$4.8 million is exclusive of \$2.7 million deposit received in Q4 2018.

**OPERATING RESULTS <sup>(1)</sup>**

	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
<b>Daily production</b>						
Oil and NGLs (bbls/d)	765	850	(10)	820	954	(14)
Natural gas (mcf/d)	12,392	14,115	(12)	13,347	15,574	(14)
Oil equivalent (boe/d)	2,830	3,202	(12)	3,044	3,550	(14)
<b>Revenue</b>						
Oil and NGLs (\$/bbl)	51.26	44.78	14	51.80	59.46	(13)
Natural gas (\$/mcf)	2.86	2.78	3	2.49	2.00	25
Oil equivalent (\$/boe)	26.39	24.14	9	24.88	24.74	1
<b>Royalties</b>						
Oil and NGLs (\$/bbl)	-	(0.60)	(100)	-	1.45	(100)
Natural gas (\$/mcf)	-	-	-	-	-	-
Oil equivalent (\$/boe)	-	(0.16)	(100)	-	0.39	(100)
<b>Net operating expenses <sup>(2)</sup></b>						
Oil and NGLs (\$/bbl)	8.43	5.95	42	8.34	6.67	25
Natural gas (\$/mcf)	0.80	0.78	3	0.85	0.82	4
Oil equivalent (\$/boe)	5.77	5.00	15	5.95	5.40	10
<b>Net transportation and marketing expenses <sup>(2)</sup></b>						
Oil and NGLs (\$/bbl)	1.35	1.17	15	1.34	1.54	(13)
Natural gas (\$/mcf)	1.46	0.82	78	1.11	0.52	113
Oil equivalent (\$/boe)	6.74	3.92	72	5.25	2.69	95
<b>Operating netback <sup>(2)</sup></b>						
Oil and NGLs (\$/bbl)	41.48	38.26	8	42.12	49.80	(15)
Natural gas (\$/mcf)	0.60	1.18	(49)	0.53	0.66	(20)
Oil equivalent (\$/boe)	13.88	15.38	(10)	13.68	16.26	(16)
Depletion and depreciation (\$/boe)	(9.65)	(9.29)	4	(9.56)	(9.38)	2
Asset impairment (\$/boe)	(22.41)	-	100	(5.25)	-	100
General and administrative expenses (\$/boe)	(4.76)	(5.48)	(13)	(4.30)	(4.05)	6
Share based compensation (\$/boe)	(0.20)	(0.84)	(76)	(0.51)	(2.81)	(82)
Gain on sale of assets (\$/boe)	-	-	-	1.30	-	100
Finance expense (\$/boe)	(0.47)	(0.42)	12	(0.36)	(0.26)	38
Finance income (\$/boe)	0.04	0.10	(60)	0.03	0.21	(86)
<b>Net loss (\$/boe)</b>	<b>(23.57)</b>	<b>(0.55)</b>	<b>4,185</b>	<b>(4.97)</b>	<b>(0.03)</b>	<b>16,467</b>

(1) "bbls" refers to barrels, "mcf" refers to thousand cubic feet, and "boe" refers to barrel of oil equivalent. Disclosure provided herein in respect of a boe may be misleading, particularly if used in isolation. A boe conversion rate of six thousand cubic feet of natural gas to one barrel of oil equivalent has been used for the calculation of boe amounts in the MD&A. This boe conversion rate is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

(2) Net operating expenses, net transportation and marketing expenses and operating netback do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures used by other companies. Please refer to the "Non-GAAP Measures" section in the MD&A for more details and the "Net Operating Expenses", "Net Transportation and Marketing Expenses" and "Operating Netback" sections in the MD&A for reconciliations from operating expenses, transportation and marketing expenses, and net loss per boe, respectively.

## MANAGEMENT'S DISCUSSION AND ANALYSIS ("MD&A")

April 27, 2020

The MD&A should be read in conjunction with the audited financial statements and related notes for the years ended December 31, 2019 and 2018. The audited financial statements and financial data contained in the MD&A have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). All dollar amounts are expressed in Canadian currency, unless otherwise noted.

### DESCRIPTION OF BUSINESS

Leucrotta Exploration Inc. ("Leucrotta" or the "Company") is an oil and natural gas company, actively engaged in the acquisition, development, exploration, and production of oil and natural gas reserves in northeastern British Columbia, Canada. The Company trades on the TSX Venture Exchange ("TSXV") under the symbol "LXE".

### FREQUENTLY RECURRING TERMS

The Company uses the following frequently recurring industry terms in the MD&A: "bbls" refers to barrels, "mcf" refers to thousand cubic feet, and "boe" refers to barrel of oil equivalent. Disclosure provided herein in respect of a boe may be misleading, particularly if used in isolation. A boe conversion rate of six thousand cubic feet of natural gas to one barrel of oil equivalent has been used for the calculation of boe amounts in the MD&A. This boe conversion rate is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

### NON-GAAP MEASURES

This MD&A refers to certain financial measures that are not determined in accordance with IFRS (or "GAAP"). This MD&A contains the terms "adjusted funds flow", "adjusted funds flow per share", "operating netback", "net operating expenses", and "net transportation and marketing expenses" which do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures used by other companies. The Company uses these measures to help evaluate its performance.

On January 1, 2019, Leucrotta adopted IFRS 16, Leases using the modified retrospective approach and as such prior period comparatives were not restated. The impact of the adoption of IFRS 16 to the non-GAAP measures noted below was an increase of \$85 thousand (\$0.08/boe) for the year ended December 31, 2019, to adjusted funds flow representing the payment of lease obligations relating to the Company's office lease that were previously recorded as general and administrative expenses. The non-GAAP measures of operating netback, net operating expenses, and net transportation and marketing expenses were not impacted. Refer to the "Significant Accounting Policies" section of this MD&A for further details regarding the adoption of IFRS 16.

Management uses adjusted funds flow to analyze performance and considers it a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investments and abandonment obligations and to repay debt, if any. Adjusted funds flow is a non-GAAP measure and has been defined by the Company as cash flow from operating activities excluding the change in non-cash working capital related to operating activities and expenditures on decommissioning obligations. The Company also presents adjusted funds flow per share whereby amounts per share are calculated using weighted average shares outstanding, consistent with the calculation of net loss per share. Adjusted funds flow is reconciled from cash flow from operating activities under the heading "Cash Flow from Operating Activities and Adjusted Funds Flow".

Management considers operating netback an important measure as it demonstrates its profitability relative to current commodity prices. Operating netback, which is calculated as average unit sales price less royalties, net operating expenses, and net transportation and marketing expenses, represents the cash margin for every barrel of oil equivalent sold. Operating netback per boe is reconciled to net loss per boe under the heading "Operating Netback".

Net operating expenses is calculated as operating expenses less processing revenues. Management uses net operating expenses to determine the current periods' cash cost of operating expenses less processing revenue and net operating expenses per boe is used to measure operating efficiency on a comparative basis. The measure approximates the Company's operating expenses relative to its produced volumes by excluding third party operating costs.

Net transportation and marketing expenses is calculated as transportation expenses less marketing revenues. Management uses net transportation and marketing expenses to determine the current periods' cash cost of transportation expenses less marketing revenue and net transportation and marketing expenses per boe is used to measure transportation efficiency on a comparative basis as well as the Company's ability to mitigate the cost of excess committed capacity.

### UPDATE

In Q4 2019, Leucrotta's capital was spent predominantly on the upgrade of the recently acquired Two Rivers facility and related infrastructure. All other capital was restricted pending completion and start-up of the facility in March 2020.

Production remained relatively stable at 2,830 boe/d for the quarter as wells continue to outperform expectations and resulted in positive reserve revisions. Production increased in late March 2020 with the start-up of the Two Rivers facility and is estimated to average approximately 3,000 boe/d for 2020.

Leucrotta maintained positive net working capital at end of Q4 2019 but is estimated to have approximately \$5.0 million of debt at the end of Q1 2020. Capital spending will be limited on a go-forward basis until there is more clarity on commodity prices. Leucrotta will look to reduce debt through cash flow and sale of non-core properties and equipment.

We look forward to reporting on further business developments in the near future.

## SUMMARY OF FINANCIAL RESULTS

(\$000s, except per share amounts)	Three Months Ended December 31			Year Ended December 31		
	2019	2018		2019	2018	2017
<b>Oil and natural gas sales</b>	<b>6,870</b>	7,113		<b>27,645</b>	32,048	26,124
<b>Cash flow from operating activities</b>	<b>2,098</b>	3,764		<b>10,465</b>	16,249	8,311
Per share - basic and diluted	<b>0.01</b>	0.02		<b>0.05</b>	0.08	0.04
<b>Adjusted funds flow</b>	<b>2,316</b>	2,875		<b>10,266</b>	15,949	9,602
Per share - basic and diluted	<b>0.01</b>	0.01		<b>0.05</b>	0.08	0.05
<b>Net loss</b>	<b>6,140</b>	161		<b>5,529</b>	43	8,222
Per share - basic and diluted	<b>0.03</b>	-		<b>0.03</b>	-	0.04
<b>Total assets</b>				<b>309,452</b>	317,043	313,041
<b>Total long-term liabilities</b>				<b>12,273</b>	9,572	8,718
<b>Working capital</b>				<b>125</b>	2,102	18,660

The Company experienced a decrease in oil and natural gas sales, cash flow from operating activities, and adjusted funds flow and an increased net loss for the year ended December 31, 2019 compared to 2018. This was mainly due to lower oil and NGLs commodity prices and the decline of flush production from Q1 2018 resulting from successful drilling at Doe/Mica, BC.

The large net loss in Q4 2019 was due to the impairment of the non-Montney CGU of \$5.8 million.

The large net loss in 2017 was due to a \$6.2 million expense related to non-core exploration and evaluation ("E&E") assets.

PRODUCTION	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Average Daily Production						
Oil and NGLs (bbls/d)	<b>765</b>	850	(10)	<b>820</b>	954	(14)
Natural gas (mcf/d)	<b>12,392</b>	14,115	(12)	<b>13,347</b>	15,574	(14)
Combined (boe/d)	<b>2,830</b>	3,202	(12)	<b>3,044</b>	3,550	(14)

Daily production decreased to 2,830 boe/d and 3,044 boe/d for the three months and year ended December 31, 2019, respectively, from 3,202 boe/d and 3,550 boe/d for the comparative periods in 2018. The decrease in production was the result of natural declines of flush production in the first half of 2018 from successful drilling in 2017 at Doe/Mica, BC.

Leucrotta's production profile for the year ended December 31, 2019 remained consistent with 2018. The 2019 weighting was 73% natural gas (December 31, 2018 - 73%) and 27% oil and NGLs (December 31, 2018 - 27%). The Q4 2019 weighting was 73% natural gas (Q4 2018 - 73%) and 27% oil and NGLs (Q4 2018 - 27%).

OIL AND NATURAL GAS SALES (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Oil and NGLs	<b>3,606</b>	3,500	3	<b>15,495</b>	20,704	(25)
Natural gas	<b>3,264</b>	3,613	(10)	<b>12,150</b>	11,344	7
Total	<b>6,870</b>	7,113	(3)	<b>27,645</b>	32,048	(14)
Average Sales Price						
Oil and NGLs (\$/bbl)	<b>51.26</b>	44.78	14	<b>51.80</b>	59.46	(13)
Natural gas production sales and transportation revenue (\$/mcf)	<b>2.86</b>	2.78	3	<b>2.49</b>	2.00	25
Combined (\$/boe)	<b>26.39</b>	24.14	9	<b>24.88</b>	24.74	1

Revenue totaled \$6.9 million and \$27.6 million for the three months and year ended December 31, 2019, respectively, compared to \$7.1 million and \$32.0 million for the comparative periods in 2018. Production declines and lower oil and NGLs pricing throughout the year were partially offset by better natural gas pricing throughout 2019.

PROCESSING AND MARKETING REVENUE (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Sale of purchased natural gas	-	-	-	-	361	(100)
Processing revenue	115	277	(58)	525	884	(41)
Marketing revenue	35	51	(31)	213	507	(58)
<b>Total</b>	<b>150</b>	<b>328</b>	<b>(54)</b>	<b>738</b>	<b>1,752</b>	<b>(58)</b>

The purchase and sale of natural gas is done to optimize firm transportation capacity. See also "Net transportation and marketing expenses" section.

Processing revenue relates to fees received from third parties for gas processed through the Company's gas plant. Marketing revenue relates to unutilized firm transportation assigned to third parties for a contracted fee in which the Company receives a premium.

The following table outlines the Company's realized wellhead prices and industry benchmarks:

Commodity Pricing	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
<b>Oil and NGLs</b>						
Corporate price (\$CDN/bbl)	51.26	44.78	14	51.80	59.46	(13)
Canadian light sweet (\$CDN/bbl)	66.77	48.27	38	68.87	68.49	1
West Texas Intermediate ("WTI") (\$US/bbl)	56.96	58.81	(3)	57.02	64.77	(12)
<b>Natural gas</b>						
Corporate price (\$CDN/mcf)	2.86	2.78	3	2.49	2.00	25
AECO price (\$CDN/mcf)	2.48	1.62	53	1.80	1.53	18
Chicago City Gate (\$US/mmbtu)	2.21	3.69	(40)	2.42	3.01	(20)
<b>Exchange rate</b>						
\$US/\$CAD exchange rate	0.7577	0.7564	-	0.7537	0.7718	(2)

Differences between corporate and benchmark prices can be the result of quality differences (higher or lower API oil and higher or lower heat content natural gas), sour content, the mix of sales points and marketing contracts negotiated for products, the mix of oil and NGLs, and various other factors. Leucrotta's differences are mainly the result of a higher proportion of lower priced NGLs and higher heat content natural gas production that is priced higher than AECO reference prices as well as the diversification of sales points and marketing contracts for products.

The Company's corporate average oil and NGLs prices were 76.8% and 75.2% of Canadian light sweet prices for the three months and year ended December 31, 2019, respectively, down from 92.8% and 86.8% for the comparative periods in 2018 mainly due to significant declines in butane and propane prices that are not linked to the Canadian light sweet index price. Leucrotta's liquids mix during the fourth quarter of 2019 was approximately 65% oil, condensate and pentanes, 12% butane and 23% propane (Q4 2018 - 65% oil, condensate and pentanes, 11% butane and 24% propane).

Corporate average natural gas prices were 115.3% and 138.3% of AECO prices for the three months and year ended December 31, 2019, respectively, compared to 171.6% and 130.7% for the comparative periods in 2018. The large decrease in Q4 2019 from Q4 2018 was mainly due to the large spread between Chicago prices and AECO prices in Q4 2018 compared to Q4 2019. The Company received AECO pricing plus \$0.20/mcf on the first 10,000 mcf/d and ATP pricing on production above this in the Doe/Mica core area from January 2018 to October 2018. From November 2018 to October 2019, the Company received a Chicago indexed pricing on the first 7,000 mcf/d, AECO pricing plus \$0.31/mcf on the next 6,000 mcf/d, and ATP pricing on production above this in the Doe/Mica core area. From November 2019 to December 2019 the Company received Chicago indexed pricing on all its natural gas production.

Future prices received from the sale of the products may fluctuate as a result of market factors. In addition, the Company may enter into commodity price contracts to help manage future cash flows. The Company does not currently have any commodity price contracts outstanding.

ROYALTIES (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Oil and NGLs	-	(47)	(100)	-	506	(100)
Natural gas	-	-	-	-	-	-
<b>Total</b>	<b>-</b>	<b>(47)</b>	<b>(100)</b>	<b>-</b>	<b>506</b>	<b>(100)</b>
<b>Average Royalty Rate (% of sales)</b>						
Oil and NGLs	-	(1.3)	(100)	-	2.4	(100)
Natural gas	-	-	-	-	-	-
<b>Combined</b>	<b>-</b>	<b>(0.7)</b>	<b>(100)</b>	<b>-</b>	<b>1.6</b>	<b>(100)</b>

The Company pays royalties to provincial governments (Crown). Crown royalties are calculated on a sliding scale based on commodity prices and individual well production rates. Royalty rates can change due to commodity price fluctuations and changes in production volumes on a well-by-well basis, subject to a minimum and maximum rate restriction ascribed by the Crown. The provincial government

has also enacted various royalty incentive programs that are available for wells that meet certain criteria, such as natural gas deep drilling, which can result in fluctuations in royalty rates.

During the three months and year ended December 31, 2019, the Company realized credits of \$0.5 million (December 31, 2018 - \$0.4 million) and \$2.0 million (December 31, 2018 - \$1.8 million), respectively, to offset royalties otherwise payable. These credits stem from the British Columbia Government's Infrastructure Royalty Credit Program resulting from infrastructure built and wells drilled and tied-into the related infrastructure and the Company currently has \$0.6 million of credits remaining.

Further credits to reduce royalties are expected in the future as royalties continue to be payable on wells already tied-into completed and approved infrastructure projects and as new infrastructure is built and wells are drilled and tied-into related infrastructure that was approved for credits under the program and become royalty payable. The timing of receipt of future credits is dependent on commodity prices and production levels and thus cannot be readily forecast; correspondingly, royalty rates reported in future quarters will vary, likely materially, as these credits are recognized. This credit program is in addition to BC's Natural Gas Deep Well Royalty Credit Program where the Company currently has \$1.2 million in remaining royalty credits.

NET OPERATING EXPENSES (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Oil and NGLs	593	466	27	2,495	2,322	7
Natural gas	1,024	1,284	(20)	4,644	5,565	(17)
Operating expenses	1,617	1,750	(8)	7,139	7,887	(9)
Less: processing revenue	(115)	(277)	(58)	(525)	(884)	(41)
Net operating expenses (non-GAAP)	1,502	1,473	2	6,614	7,003	(6)
Average net operating expenses						
Oil and NGLs (\$/bbl)	8.43	5.95	42	8.34	6.67	25
Natural gas (\$/mcf)	0.80	0.78	3	0.85	0.82	4
Combined (\$/boe)	5.77	5.00	15	5.95	5.40	10

Per unit net operating expenses were \$5.77/boe and \$5.95/boe for the three months and year ended December 31, 2019, respectively, compared to \$5.00/boe and \$5.40/boe in the comparative periods in 2018. The increase for the three months and year ended December 31, 2019 from the comparative periods in 2018 in oil and NGLs net operating expenses per boe was the result of putting the Mica 13-07 light oil well back on production which has higher operating costs associated. The Company also faced increased maintenance costs and carbon taxes.

NET TRANSPORTATION AND MARKETING EXPENSES (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Oil and NGLs transportation	95	92	3	400	536	(25)
Natural gas transportation	1,696	1,116	52	5,643	3,544	59
Transportation expenses	1,791	1,208	48	6,043	4,080	48
Purchased natural gas	-	-	-	-	270	(100)
Transportation and marketing expenses	1,791	1,208	48	6,043	4,350	39
Less: sale of purchased natural gas	-	-	-	-	(361)	(100)
Less: marketing revenue	(35)	(51)	(31)	(213)	(507)	(58)
Net transportation and marketing expenses (non-GAAP)	1,756	1,157	52	5,830	3,482	67
Average net transportation and marketing expenses						
Oil and NGLs (\$/bbl)	1.35	1.17	15	1.34	1.54	(13)
Natural gas (\$/mcf)	1.46	0.82	78	1.11	0.52	113
Combined (\$/boe)	6.74	3.92	72	5.25	2.69	95

Net transportation and marketing expenses are mainly third-party pipeline tariffs from firm transportation agreements to deliver production to the purchasers at main hubs. Net transportation and marketing expenses increased to \$6.74/boe and \$5.25/boe for the three months and year ended December 31, 2019, respectively, compared to \$3.92/boe and \$2.69/boe for the comparative periods in 2018.

The significant increase in natural gas transportation during the three months and year ended December 31, 2019 compared to the same periods in 2018 was mainly due to the Company transporting natural gas to Chicago to receive higher Chicago indexed pricing on a portion of the Company's production. The fourth quarter of 2019 included \$0.4 million (\$0.35/mcf of gas production or \$1.54/boe of total production) of unutilized and unmitigated firm transportation costs (Q4 2018 - \$nil).



OPERATING NETBACK	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
<b>Oil and NGLs (\$/bbl)</b>						
Revenue	51.26	44.78	14	51.80	59.46	(13)
Royalties	-	0.60	(100)	-	(1.45)	(100)
Net operating expenses	(8.43)	(5.95)	42	(8.34)	(6.67)	25
Net transportation and marketing expenses	(1.35)	(1.17)	15	(1.34)	(1.54)	(13)
Operating netback	41.48	38.26	8	42.12	49.80	(15)
<b>Natural gas (\$/mcf)</b>						
Revenue	2.86	2.78	3	2.49	2.00	25
Royalties	-	-	-	-	-	-
Net operating expenses	(0.80)	(0.78)	3	(0.85)	(0.82)	4
Net transportation and marketing expenses	(1.46)	(0.82)	78	(1.11)	(0.52)	113
Operating netback	0.60	1.18	(49)	0.53	0.66	(20)
<b>Combined (\$/boe)</b>						
Revenue	26.39	24.14	9	24.88	24.74	1
Royalties	-	0.16	(100)	-	(0.39)	(100)
Net operating expenses	(5.77)	(5.00)	15	(5.95)	(5.40)	10
Net transportation and marketing expenses	(6.74)	(3.92)	72	(5.25)	(2.69)	95
Operating netback	13.88	15.38	(10)	13.68	16.26	(16)

During the three months and year ended December 31, 2019, Leucrotta generated an operating netback of \$13.88/boe and \$13.68/boe, respectively, compared to \$15.38/boe and \$16.26/boe for the comparative periods in 2018. The lower netbacks in 2019 compared to 2018 stem from higher net operating expenses and net transportation and marketing expenses partially offset by higher natural gas pricing.

The following is a reconciliation of operating netback per boe to loss per boe for the periods noted:

(\$/boe)	Three Months Ended December 31			Year Ended December 31		
	2019	2018 <sup>(1)</sup>	% Change	2019	2018 <sup>(1)</sup>	% Change
<b>Operating netback</b>	<b>13.88</b>	15.38	(10)	<b>13.68</b>	16.26	(16)
Depletion and depreciation	(9.65)	(9.29)	4	(9.56)	(9.38)	2
Asset impairment	(22.41)	-	100	(5.25)	-	100
General and administrative expenses	(4.76)	(5.48)	(13)	(4.30)	(4.05)	6
Share based compensation	(0.20)	(0.84)	(76)	(0.51)	(2.81)	(82)
Gain on sale of assets	-	-	-	1.30	-	100
Finance expense	(0.47)	(0.42)	12	(0.36)	(0.26)	38
Finance income	0.04	0.10	(60)	0.03	0.21	(86)
<b>Net loss</b>	<b>(23.57)</b>	(0.55)	4,185	<b>(4.97)</b>	(0.03)	16,467

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

DEPLETION AND DEPRECIATION	Three Months Ended December 31			Year Ended December 31		
	2019	2018 <sup>(1)</sup>	% Change	2019	2018 <sup>(1)</sup>	% Change
Depletion and depreciation (\$000s)	2,514	2,736	(8)	10,621	12,147	(13)
Depletion and depreciation (\$/boe)	9.65	9.29	4	9.56	9.38	2

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

The Company calculates depletion on property, plant, and equipment mainly based on proved plus probable reserves. Some facilities and certain gas plant equipment, where the production and reserves do not represent the useful life of the assets, are depreciated over ten years. Depletion and depreciation for the three months and year ended December 31, 2019 was \$9.65/boe and \$9.56/boe, respectively, consistent with \$9.29/boe and \$9.38/boe for the comparative periods in 2018.

Included in depletion and depreciation expense for the three months and year ended December 31, 2019, is \$22 thousand (December 31, 2018 - \$nil) and \$90 thousand (December 31, 2018 - \$nil), respectively, related to the right-of-use asset for the Company's head office lease and \$nil (December 31, 2018 - \$nil) and \$63 thousand (December 31, 2018 - \$nil), respectively, related to land lease expiries.

## IMPAIRMENT OF PROPERTY, PLANT, AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS

At December 31, 2019, the Company evaluated its property, plant, and equipment ("PP&E") CGUs for indicators of impairment or impairment reversals. Indicators of impairment were determined to exist in both of Leucrotta's CGUs primarily as a result of significant and sustained decline in forward commodity benchmark prices for natural gas and NGLs and a market capitalization deficiency relative to the book value of the Company's shareholders' equity. Performance issues were also identified in the non-Montney CGU. An impairment test was performed using commodity price estimates of three independent reserve evaluators. The impairment tests at December 31, 2019 were primarily based on the net present value of cash flows from oil and natural gas reserves at pre-tax discount rates ranging from 10 to 17.5 percent depending on the underlying composition and risk profile of the reserve category as well as third party sales offers on specific facility assets in the non-Montney CGU. The Company has determined that there was no impairment to its Montney CGU at December 31, 2019 and that there was an impairment of \$4.75 million to the non-Montney CGU.

At December 31, 2018, the Company evaluated its CGUs for indicators of impairment or impairment reversals. During the year ended December 31, 2018, there were indicators of impairment identified in the Company's Montney CGU as a result of significant and sustained declines in the forward commodity prices for natural gas. An impairment test was performed primarily based on the net present value of cash flows from oil and natural gas reserves at pre-tax discount rates ranging from 10 to 20 percent depending on the underlying composition and risk profile of the reserve category. The Company determined that there was no impairment to its Montney CGU at December 31, 2018.

At December 31, 2019, the Company evaluated its E&E assets for indicators of impairment or impairment reversals and as a result of this assessment management determined that an impairment test was required to be performed on the non-Montney CGU due to the Company determining only minimal capital would be spent in the area. The carrying value of the non-Montney E&E assets were written down to their estimated recoverable amount of \$0.5 million resulting in an impairment charge of \$1.1 million.

GENERAL AND ADMINISTRATIVE (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018 <sup>(1)</sup>	% Change	2019	2018 <sup>(1)</sup>	% Change
G&A expenses (gross)	1,284	1,813	(29)	5,027	5,834	(14)
G&A capitalized	(44)	(198)	(78)	(248)	(588)	(58)
G&A recoveries	-	(1)	(100)	(3)	(3)	-
G&A expenses (net)	1,240	1,614	(23)	4,776	5,243	(9)
G&A expenses (\$/boe)	4.76	5.48	(13)	4.30	4.05	6

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

General and administrative ("G&A") expenses were \$4.76/boe and \$4.30/boe for the three months and year ended December 31, 2019, respectively, compared to \$5.48/boe and \$4.05/boe for the comparative periods in 2018. G&A expenses during 2019 decreased from 2018 mainly due to lower employment costs.

SHARE BASED COMPENSATION	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Share based compensation (\$000s)	53	247	(79)	569	3,645	(84)
Share based compensation (\$/boe)	0.20	0.84	(76)	0.51	2.81	(82)

The Company accounts for its share based compensation plans using the fair value method. Under this method, compensation cost is charged to earnings over the vesting period for stock options and warrants granted to officers, directors, employees, and consultants with a corresponding increase to contributed surplus.

Share based compensation expense decreased to \$53 thousand and \$0.6 million for the three months and year ended December 31, 2019, respectively, compared to \$0.2 million and \$3.6 million for the comparative periods in 2018. In May 2018, the expiry term for previously granted stock options, performance warrants and purchase warrants was extended to 6 years from the original term of 4 or 5 years. The incremental fair value of the modifications was \$3.8 million and \$3.5 million was recognized during the year ended December 31, 2018 based on the percentage of modified awards that were vested as at May 30, 2018 with the remaining expense to be recognized ratably as the awards vest. The incremental fair value was estimated immediately before and as at the date of modification using a Black-Scholes-Merton option pricing model.

No stock options or warrants were granted during the year ended December 31, 2019.

FINANCE EXPENSE (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018 <sup>(1)</sup>	% Change	2019	2018 <sup>(1)</sup>	% Change
Interest expense	66	69	(4)	190	141	35
Accretion of decommissioning obligations	55	53	4	211	200	6
Finance expense	121	122	(1)	401	341	18
Finance expense (\$/boe)	0.47	0.42	12	0.36	0.26	38

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

Interest expense includes interest payments on the credit facility and the interest expense on lease obligations. Interest expense increased during the year ended December 31, 2019 compared to the same period in 2018 due to higher fees for maintaining the credit facility and letters of guarantee.

Accretion expense remained consistent for the three months and year ended December 31, 2019 compared to the same periods in 2018.

## FINANCE INCOME

Finance income relates to interest earned on cash in the bank. Finance income totaled \$10 thousand and \$31 thousand for the three months and year ended December 31, 2019, respectively, down from \$28 thousand and \$0.3 million in the comparative periods in 2018. The decrease corresponds to the decrease in the Company's cash balance over the comparative periods.

## DEFERRED INCOME TAXES

The Company has not realized the net deferred income tax asset based on the independently evaluated reserve report as cash flows are not expected to be sufficient to realize the deferred income tax asset at this time.

As the Company has not recognized its deferred income tax asset, there was no financial impact as a result of the Alberta corporate income tax rate reduction that is considered substantively enacted under IFRS for the period ending December 31, 2019.

Estimated tax pools at December 31, 2019 total approximately \$322.8 million (December 31, 2018 - \$325.3 million).

## CASH FLOW FROM OPERATIONS AND ADJUSTED FUNDS FLOW

The following is a reconciliation of cash flow from operating activities to adjusted funds flow for the periods noted:

(\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018 <sup>(1)</sup>	% Change	2019	2018 <sup>(1)</sup>	% Change
Cash flow from operating activities	2,098	3,764	(44)	10,465	16,249	(36)
Add (deduct):						
Decommissioning expenditures	163	-	100	256	176	45
Change in non-cash working capital	55	(889)	(106)	(455)	(476)	(4)
Adjusted funds flow (non-GAAP)	2,316	2,875	(19)	10,266	15,949	(36)

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

Adjusted funds flow decreased to \$2.3 million (\$0.01 per basic and diluted share) and \$10.3 million (\$0.05 per basic and diluted share) for the three months and year ended December 31, 2019, respectively, from \$2.9 million (\$0.01 per basic and diluted share) and \$15.9 million (\$0.08 per basic share and diluted share) for the comparative periods in 2018. The decrease was mainly the result of lower production and lower oil and NGLs pricing which was partially offset by higher natural gas pricing with increased net transportation and marketing expenses to transport the natural gas to Chicago. Q4 2019 was less affected than the full year as oil and NGLs pricing was higher than in Q4 2018.

Cash flow from operating activities decreased for the three months and year ended December 31, 2019 to \$2.1 million (\$0.01 per basic and diluted share) and \$10.5 million (\$0.05 per basic and diluted share), respectively, from \$3.8 million (\$0.02 per basic and diluted share) and \$16.2 million (\$0.08 per basic and diluted share) for the comparative periods in 2018. The decrease period over period is due to similar reasons as stated above for adjusted funds flow. Cash flow from operating activities differs from adjusted funds flow due to the inclusion of changes in non-cash working capital and expenditures on decommissioning obligations.

## NET LOSS

Net loss for three months and year ended December 31, 2019 was \$6.1 million (\$0.03 per basic and diluted share) and \$5.5 million (\$0.03 per basic and diluted share), respectively, compared to \$0.2 million (\$nil per basic and diluted share) and \$43 thousand (\$nil per basic and diluted share) for the comparative periods in 2018. The large increase in net loss for the three months and year ended December 31, 2019 was the result of the impairment of the non-Montney CGU of \$5.8 million.

CAPITAL EXPENDITURES (\$000s)	Three Months Ended December 31			Year Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Property acquisitions	-	-	-	1,543	-	100
Land	76	1,364	(94)	897	2,642	(66)
Drilling, completions, and workovers	376	7,744	(95)	4,203	26,736	(84)
Equipment	3,668	1,510	143	8,112	6,806	19
Geological and geophysical	40	47	(15)	242	434	(44)
Office equipment	-	-	-	-	62	(100)
Total expenditures	4,160	10,665	(61)	14,997	36,680	(59)

Capital expenditures decreased significantly during the three months and year ended December 31, 2019 compared to the same periods in 2018. The Company drilled an exploratory well in a zone below the Lower Montney zone in Mica, BC. The Company closed three property acquisitions in Two Rivers, BC during the year ended December 31, 2019, one being a strategic infrastructure acquisition and the other two undeveloped land acquisitions. During the second half of 2019, the Company began the expansion of acquired infrastructure in Two Rivers, BC.

The Company also completed its sale of certain equipment for proceeds of \$5.9 million (deposit of \$2.7 million was received in Q4 2018 and the remainder in Q1 2019) resulting in a gain on the sale of equipment of \$1.6 million. During the year ended December 31, 2019, the Company sold additional equipment for proceeds of \$1.6 million resulting in a marginal loss of \$0.1 million.

During the year ended December 31, 2018, the Company drilled and completed three Lower Montney delineation wells and one Upper Montney delineation well. One well was drilled in Alberta and three wells were drilled at Mica, BC (one drilled north of the Peace River). The Company also tied-in its Mica 12-06 and Mica 1-24 light oil Montney wells which commenced production during the year.

## LIQUIDITY AND CAPITAL RESOURCES

Management uses working capital as a measure to assess the Company's financial position and is reconciled as follows:

(\$000s)	December 31, 2019	December 31, 2018	% Change
Current assets	3,728	11,131	(67)
Less:			
Current liabilities	(3,603)	(9,029)	(60)
Working capital	125	2,102	(94)

At December 31, 2019, the Company had working capital of \$0.1 million and \$nil had been drawn on the credit facility.

The Company has a \$20.0 million operating demand loan credit facility with a Canadian chartered bank. To access the credit facility over \$15.0 million requires entering into and maintaining forward commodity price contracts of no less than 50% of production volumes for the first 12 months and no less than 25% of production volumes for the following 12 months thereafter. The credit facility bears interest at prime plus a range of 0.50% to 2.50% and is secured by a \$100 million fixed and floating charge debenture on the assets of the Company. The undrawn portion of the credit facility is subject to a standby fee in the range of 0.20% to 0.45%. At December 31, 2019, the Company had outstanding letters of guarantee of \$4.3 million which reduce the amount that can be borrowed under the credit facility. The next review of the credit facility by the bank is scheduled on or before May 31, 2020.

The Company has \$1.3 million in a restricted corporate account to cross-guarantee a margin account for the President of the Company. The President is charged a fee by the Company and the margin account is also restricted until the cross-guarantee is removed. The President's margin account holds \$2.4 million of securities of Leucrotta common shares and a margin payable of \$1.3 million. The cross-guarantee is not intended to be long-term in nature and will be removed as soon as practicable. The cross-guarantee has allowed the President to comply with corporate governance mandates. The \$1.3 million has been segregated on the statement of financial position as restricted cash at December 31, 2019 (December 31, 2018 - \$1.0 million).

Management anticipates that the Company will continue to have adequate liquidity to fund budgeted capital investments through a combination of its cash balance, cash flow, equity, and debt if required. Leucrotta's capital program is flexible and can be adjusted as needed based upon the current economic environment. The Company will continue to monitor the economic environment and the possible impact on its business and strategy and will make adjustments as necessary. Leucrotta is estimated to have approximately \$5.0 million of debt at the end of Q1 2020 as a result of capital expenditures predominantly on the upgrade of the recently acquired Two Rivers facility and related infrastructure. Capital spending will therefore be limited on a go-forward basis until there is more clarity on commodity prices. Leucrotta will look to reduce debt through cash flow and sale of non-core properties and equipment.

## CONTRACTUAL OBLIGATIONS

The following is a summary of the Company's contractual obligations and commitments at December 31, 2019:

(\$000s)	Total	Less than One Year	One to Three Years	After Three Years
Accounts payable and accrued liabilities	3,516	3,516	-	-
Lease obligations	169	87	82	-
Decommissioning obligations	12,191	-	-	12,191
Operating leases	410	224	186	-
Firm transportation agreements	30,806	10,160	17,504	3,142
Total contractual obligations	47,092	13,987	17,772	15,333

Transportation commitments include contracts to transport natural gas and NGLs through third-party owned pipeline systems. The Company currently has commitments of 27.0 mmcf/d escalating to 33.3 mmcf/d in November 2020 of firm transportation to deliver natural gas to the Alliance Trading Pool (ATP) through October 31, 2021. The Company has also committed to 14.2 mmcf/d of firm transportation to deliver natural gas to Chicago through October 31, 2024.

Operating leases include the non-lease variable components of the head office lease.

## OFF BALANCE SHEET ARRANGEMENTS

The Company has certain lease arrangements, all of which are reflected in the contractual obligations and commitments table, which were entered into in the normal course of operations. All leases other than the fixed payment component of the head office lease have been treated as operating leases whereby the lease payments are included in operating expenses or general and administrative expenses depending on the nature of the lease.

## OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of voting common shares, an unlimited number of non-voting common shares, Class A preferred shares, issuable in series, and Class B preferred shares, issuable in series. The voting common shares of the Company commenced trading on the TSXV on August 19, 2014 under the symbol "LXE". The following table summarizes the common shares outstanding and the number of shares exercisable into common shares from options, warrants, and other instruments:

(000s)	December 31, 2019	April 27, 2020
Voting common shares	200,525	200,525
Warrants	14,965	14,851
Stock options	11,156	11,004
Total	226,646	226,380

## SUMMARY OF QUARTERLY RESULTS

	Q4 2019	Q3 2019	Q2 2019	Q1 2019	Q4 2018 <sup>(1)</sup>	Q3 2018 <sup>(1)</sup>	Q2 2018 <sup>(1)</sup>	Q1 2018 <sup>(1)</sup>
Average Daily Production								
Oil and NGLs (bbls/d)	765	829	861	824	850	888	938	1,144
Natural gas (mcf/d)	12,392	13,414	13,550	14,049	14,115	14,724	15,297	18,216
Combined (boe/d)	2,830	3,065	3,119	3,166	3,202	3,342	3,487	4,180
(\$000s, except per share amounts)								
Oil and natural gas sales	6,870	6,113	6,560	8,102	7,113	7,182	7,327	10,426
Cash flow from operating activities	2,098	950	3,688	3,729	3,764	1,975	4,579	5,931
Per share - basic and diluted	0.01	-	0.02	0.02	0.02	0.01	0.02	0.03
Adjusted funds flow	2,316	1,825	2,017	4,108	2,875	3,339	3,348	6,387
Per share - basic and diluted	0.01	0.01	0.01	0.02	0.01	0.02	0.02	0.03
Net earnings (loss)	(6,140)	(1,181)	(882)	2,674	(161)	(148)	(2,280)	2,546
Per share - basic and diluted	(0.03)	(0.01)	(-)	0.01	(-)	(-)	(0.01)	0.01

(1) IFRS 16 was adopted January 1, 2019 using the modified retrospective approach; therefore, comparative information has not been restated. Refer to the "Significant Accounting Policies" section of this MD&A.

Production has decreased in each quarter of 2018 and 2019 due to natural declines. Oil and natural gas sales, cash flow from operating activities and adjusted funds flow generally followed the same trend as production with some exceptions based on volatility of commodity prices received. The increased loss in Q2 2018 from Q1 2018 was the result of non-cash share based compensation expense related to the expiry term extension of existing stock options, performance warrants and purchase warrants. The higher net earnings in Q1 2019 from Q4 2018 was mainly the result of a \$1.6 million gain on the sale of equipment and higher oil, NGLs and natural gas commodity pricing. The increased net loss in Q4 2019 from Q3 2019 was the result of impairment of the non-Montney CGU of \$5.8 million.

## CHANGES IN ACCOUNTING POLICIES AND NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

### IFRS 16, Leases

Effective January 1, 2019, the Company adopted IFRS 16, "Leases" ("IFRS 16") which provides a single recognition and measurement model for lessees to recognize assets and liabilities for contracts that are, or contain, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company recognizes a right-of-use ("ROU") asset and a lease liability at the lease commencement date. The ROU asset is initially measured at cost based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the ROU asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The Company includes ROU assets in property, plant, and equipment on the statement of financial position. The lease term includes periods covered by an option to extend if the Company is reasonably certain to exercise that option. In addition, the ROU asset is periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

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

against the lease obligation, with a portion reflected as interest expense using the effective interest rate method. The Company presents the lease liability as its own line item on the statement of financial position.

The Company has elected to use the modified retrospective approach upon adoption and therefore the comparative information has not been restated. The effect of initially applying the standard was a \$0.3 million increase to ROU assets, with a corresponding lease liability recorded. The ROU asset was measured at the amount equal to the lease liability on January 1, 2019 with no impact on opening deficit. The lease liability was measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The weighted average incremental borrowing rate used to determine the lease obligation on adoption was approximately 5.0%. The ROU assets and lease liabilities recognized relate to the Company's head office lease.

The Company has elected to apply the practical expedient of not recognizing right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as expenses on a straight-line basis over the lease term.

The difference in operating lease commitments disclosed as at December 31, 2018 and lease liabilities recognized on the statement of financial position at January 1, 2019 is primarily due to the impact of discounting using the Company's incremental borrowing rate at January 1, 2019 and a portion of the head office lease being variable and considered a non-lease component.

The following shows the impact of IFRS 16 implementation on the operating lease commitments previously disclosed:

	<b>January 1, 2019</b>
Office lease commitments	<b>907</b>
Non-lease component and variable payments included in the above	<b>(634)</b>
Lease component of lease commitment	<b>273</b>
Impact of discounting	<b>(19)</b>
Lease obligation recognized discounted using incremental borrowing rate	<b>254</b>

The adoption of IFRS 16 had the following impact on the Company's 2019 financial results, compared to what would have occurred had the new accounting policy not been adopted: cash flow used in financing activities for the year ended December 31, 2019 was \$85 thousand (\$0.08/boe) higher due to the deduction of the lease payments while cash flow from operating activities increased \$85 thousand (\$0.08/boe). For the year ended December 31, 2019, general and administrative expenses decreased by \$96 thousand (\$0.09/boe), offset by increases to depletion and depreciation expense of \$90 thousand (\$0.08/boe) and finance expense of \$11 thousand (\$0.01/boe).

#### ***Future standards and interpretations:***

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 "Business Combinations". The amendments are intended to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. IFRS 3 continues to adopt a market participant's perspective to determine whether an acquired set of activities and assets is a business. The amendments clarify the minimum requirements for a business; remove the assessment of whether market participants are capable of replacing any missing elements; add guidance to help entities assess whether an acquired process is substantive; narrow the definitions of a business and of outputs; and introduce an optional fair value concentration test. The concentration test is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The amendments to IFRS 3 are effective for annual reporting periods beginning on or after January 1, 2020 and apply prospectively.

#### **CRITICAL ACCOUNTING ESTIMATES**

Management is required to make estimates, judgments, and assumptions in the application of IFRS that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses for the period then ended. Certain of these estimates may change from period to period resulting in a material impact on the Company's results from operations and financial position (see note 2d in the notes to the Company's financial statements for full descriptions of the use of estimates and judgments).

#### **RISK ASSESSMENT**

The acquisition, exploration, and development of oil and natural gas properties involves many risks common to all participants in the oil and natural gas industry. Leucrotta's exploration and development activities are subject to various business risks such as unstable commodity prices, interest rate and foreign exchange fluctuations, the uncertainty of replacing production and reserves on an economic basis, government regulations, taxes, and safety and environmental concerns. While management realizes these risks cannot be eliminated, they are committed to monitoring and mitigating these risks.

#### **Reserves and reserve replacement**

The recovery and reserve estimates on Leucrotta's properties are estimates only and the actual reserves may be materially different from that estimated. The estimates of reserve values are based on a number of variables including price forecasts, projected production volumes and future production and capital costs. All of these factors may cause estimates to vary from actual results.

Leucrotta's future oil and natural gas reserves, production, and adjusted funds flow to be derived therefrom are highly dependent on the Company successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Leucrotta's reserves will depend on its abilities to acquire suitable prospects or properties and discover new reserves.

To mitigate this risk, Leucrotta has assembled a team of experienced technical professionals who have expertise operating and exploring in areas the Company has identified as being the most prospective for increasing reserves on an economic basis. To further mitigate reserve replacement risk, Leucrotta has targeted a majority of its prospects in areas which have multi-zone potential, year-round access, and lower drilling costs and employs advanced geological and geophysical techniques to increase the likelihood of finding additional reserves.

### **Operational risks**

Leucrotta's operations are subject to the risks normally incidental to the operation and development of oil and natural gas properties and the drilling of oil and natural gas wells. Continuing production from a property, and to some extent the marketing of production therefrom, are largely dependent upon the ability of the operator of the property.

### **Market risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of foreign currency risk, interest rate risk, and other price risk, such as commodity price risk. The objective of market risk management is to manage and control market price exposures within acceptable limits, while maximizing returns. The Company may use financial derivatives or physical delivery sales contracts to manage market risks. All such transactions are conducted within risk management tolerances that are reviewed by the Board of Directors. As required under the terms of the Company's credit facility, the Company is subject to an upper limit on fixed price contracts of 65% of its future production up to a three year period.

#### *Foreign exchange risk*

The prices received by the Company for the production of oil, natural gas, and NGLs are primarily determined in reference to US dollars, but are settled with the Company in Canadian dollars. The Company's cash flow from commodity sales will therefore be impacted by fluctuations in foreign exchange rates. The Company currently does not have any foreign exchange contracts in place.

#### *Interest rate risk*

The Company is exposed to interest rate risk when it borrows funds at floating interest rates. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations. The amount drawn on the Company's credit facility at December 31, 2019 was \$nil.

#### *Commodity price risk*

Oil and natural gas prices are impacted by not only the relationship between the Canadian and US dollar but also by world economic events that dictate the levels of supply and demand. The Company's oil, natural gas, and NGLs production is marketed and sold on the spot market to area aggregators based on daily spot prices that are adjusted for product quality and transportation costs. The Company's cash flow from product sales will therefore be impacted by fluctuations in commodity prices. In addition, the Company may enter into commodity price contracts to manage future cash flows. At December 31, 2019, the Company did not have any commodity price contracts outstanding.

### **Credit risk**

Credit risk represents the financial loss that the Company would suffer if the Company's counterparties to a financial asset fail to meet or discharge their obligation to the Company. A substantial portion of the Company's accounts receivable and deposits are with customers and joint interest partners in the oil and natural gas industry and are subject to normal industry credit risks. The Company generally grants unsecured credit but routinely assesses the financial strength of its customers and joint interest partners.

The Company sells the majority of its production to four petroleum and natural gas marketers and therefore is subject to concentration risk. Historically, the Company has not experienced any collection issues with its oil and natural gas marketers. Joint interest receivables are typically collected within one to three months of the joint interest billing being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval for significant capital expenditures prior to the expenditure being incurred. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however, in certain circumstances, the Company may cash call a partner in advance of expenditures being incurred.

The maximum exposure to credit risk is represented by the carrying amount of cash and cash equivalents, restricted cash, and accounts receivable on the statement of financial position. At December 31, 2019, \$1.8 million (97%) of the Company's outstanding accounts receivable were current and \$43 thousand (2%) were outstanding for more than 90 days. During the year ended December 31, 2019, the Company deemed \$37 thousand of outstanding accounts receivable to be uncollectable (December 31, 2018 - \$nil).

Cash and cash equivalents and restricted cash consist of bank balances placed with a financial institution with strong investment grade ratings which management believes the risk of loss to be remote.

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual, quarterly, and monthly capital expenditure budgets, which are monitored and updated as required, and requires authorizations for expenditures on projects to assist with the management of capital. In managing liquidity risk, the Company ensures that it has access to additional financing, including potential equity issuances and additional debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

The Company has a working capital balance of \$0.1 million including \$0.3 million of cash, and an available \$20.0 million credit facility. To access the credit facility over \$15.0 million requires entering into and maintaining forward commodity price contracts of no less than 50% of production volumes for the first 12 months and no less than 25% of production volumes for the following 12 months thereafter. Management anticipates that the Company will continue to have adequate liquidity to fund budgeted capital investments through a combination of its cash balance, cash flow, equity, and debt if required.

The global impact of COVID-19 as well as the recent declines in spot prices for oil have resulted in significant declines in financial markets and has forecasted a great deal of uncertainty. As a result, oil and gas companies are subject to liquidity risks in maintaining their revenues and earnings as well as ongoing and future development and operating expenditure requirements. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. Additionally, impairment indicators for property, plant, and equipment could exist in future periods, if current conditions persist. In light of the current volatility and difficulty in reliably estimating the length or severity of these developments, and hence their financial impact, the preparation of financial forecasts is challenging. At December 31, 2019, the Company remains in compliance with all terms of its credit facility and based on current available information, management expects to comply with all terms during the subsequent 12-month period.

### **Safety and Environmental Risks**

The oil and natural gas business is subject to extensive regulation pursuant to various municipal, provincial, national, and international conventions and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases, or emissions of various substances produced in association with oil and natural gas operations. Leucrotta is committed to meeting and exceeding its environmental and safety responsibilities. Leucrotta has implemented an environmental and safety policy that is designed, at a minimum, to comply with current governmental regulations set for the oil and natural gas industry. Changes to governmental regulations are monitored to ensure compliance. Environmental reviews are completed as part of the due diligence process when evaluating acquisitions. Environmental and safety updates are presented and discussed at each Board of Directors meeting. Leucrotta maintains adequate insurance commensurate with industry standards to cover reasonable risks and potential liabilities associated with its activities as well as insurance coverage for officers and directors executing their corporate duties. To the knowledge of management, there are no legal proceedings to which Leucrotta is a party or of which any of its property is the subject matter, nor are any such proceedings known to Leucrotta to be contemplated.

### **FORWARD-LOOKING INFORMATION**

This document contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "may", "will", "should", "believe", "intends", "forecast", "plans", "guidance" and similar expressions are intended to identify forward-looking statements or information.

More particularly and without limitation, this MD&A contains forward-looking statements and information relating to the Company's risk management program, oil, NGLs, and natural gas production, capital programs, and debt. The forward-looking statements and information are based on certain key expectations and assumptions made by the Company, including expectations and assumptions relating to prevailing commodity prices and exchange rates, applicable royalty rates and tax laws, future well production rates, the performance of existing wells, the success of drilling new wells, the availability of capital to undertake planned activities, and the availability and cost of labour and services.

Although the Company believes that the expectations reflected in such forward-looking statements and information are reasonable, it can give no assurance that such expectations will prove to be correct. Since forward-looking statements and information address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results may differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, the risks associated with the oil and gas industry in general such as operational risks in development, exploration and production, delays or changes in plans with respect to exploration or development projects or capital expenditures, the uncertainty of estimates and projections relating to production rates, costs, and expenses, commodity price and exchange rate fluctuations, marketing and transportation, environmental risks, competition, the ability to access sufficient capital from internal and external sources and changes in tax, royalty, and environmental legislation. The forward-looking statements and information contained in this document are made as of the date hereof for the purpose of providing the readers with the Company's expectations for the coming year. The forward-looking statements and information may not be appropriate for other purposes. The Company undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

### **ADDITIONAL INFORMATION**

Additional information related to the Company may be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).





KPMG LLP  
Suite 3100, 205 5th Avenue SW  
Calgary AB T2P 4B9  
Telephone 403-691-8000  
Fax 403-691-8008  
www.kpmg.ca

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Leucrotta Exploration Inc.

### **Opinion**

We have audited the financial statements of Leucrotta Exploration Inc. (the "Company"), which comprise:

- the statements of financial position as at December 31, 2019 and December 31, 2018
- the statements of operations and comprehensive loss for the years then ended
- the statements of shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the financial statements, including a summary of significant accounting policies

Hereinafter referred to as the "financial statements".

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2019 and December 31, 2018, 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.
- the information, other than the financial statements and the auditors' report thereon, included in the 2019 Annual Report.

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 and the 2019 Annual Report 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 John Waiand.

*KPMG LLP*

Chartered Professional Accountants  
Calgary, Canada  
April 27, 2020

**Leucrotta Exploration Inc.**  
**Statements of Financial Position**

(\$000s)	Note	December 31 2019	December 31 2018
<b>Assets</b>			
Current assets			
Cash and cash equivalents		295	2,729
Restricted cash	(4)	1,310	1,000
Accounts receivable		1,816	2,896
Prepaid expenses and deposits		307	192
Equipment held for sale	(5)	-	4,314
		<b>3,728</b>	<b>11,131</b>
Property, plant, and equipment	(6)	<b>182,742</b>	187,432
Exploration and evaluation assets	(7)	<b>122,982</b>	118,480
		<b>305,724</b>	<b>305,912</b>
		<b>309,452</b>	<b>317,043</b>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities		3,516	6,673
Current portion of lease obligations	(8)	87	-
Revolving credit facility	(9)	-	2,356
		<b>3,603</b>	<b>9,029</b>
Lease obligations	(8)	82	-
Decommissioning obligations	(10)	<b>12,191</b>	9,572
		<b>15,876</b>	<b>18,601</b>
<b>Shareholders' Equity</b>			
Shareholders' capital	(11)	<b>288,837</b>	288,837
Contributed surplus		<b>19,737</b>	19,074
Deficit		<b>(14,998)</b>	(9,469)
		<b>293,576</b>	<b>298,442</b>
		<b>309,452</b>	<b>317,043</b>
Commitments	(24)		

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

Approved on behalf of the Board of Directors



**Rob Zakresky**  
Director



**Tom Medvedic**  
Director

**Leucrotta Exploration Inc.**  
**Statements of Operations and Comprehensive Loss**

(\$000s, except per share amounts)	Note	Years Ended December 31	
		2019	2018
<b>Revenue</b>			
Oil and natural gas sales	(22)	27,645	32,048
Processing and marketing	(22)	738	1,752
Royalties	(22)	-	(506)
		<b>28,383</b>	<b>33,294</b>
<b>Expenses</b>			
Operating		7,139	7,887
Transportation and marketing	(23)	6,043	4,350
Depletion and depreciation	(6,7)	10,621	12,147
Asset impairment	(6,7)	5,834	-
General and administrative		4,776	5,243
Share based compensation	(12)	569	3,645
Gain on sale of assets	(5)	(1,440)	-
Finance income		(31)	(276)
Finance expense	(15)	401	341
		<b>33,912</b>	<b>33,337</b>
<b>Net loss and comprehensive loss</b>		<b>(5,529)</b>	<b>(43)</b>
Net loss per share			
Basic and diluted	(13)	(0.03)	(-)

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

**Leucrotta Exploration Inc.**  
**Statements of Shareholders' Equity**

(\$000s)	Shareholders' Capital	Contributed Surplus	Deficit	Total Equity
Balance, December 31, 2017	288,787	14,398	(9,426)	293,759
Net loss	-	-	(43)	(43)
Exercise of stock options	50	(15)	-	35
Share based compensation	-	4,691	-	4,691
<b>Balance, December 31, 2018</b>	<b>288,837</b>	<b>19,074</b>	<b>(9,469)</b>	<b>298,442</b>
Balance, December 31, 2018	288,837	19,074	(9,469)	298,442
Net loss	-	-	<b>(5,529)</b>	<b>(5,529)</b>
Share based compensation	-	<b>663</b>	-	<b>663</b>
<b>Balance, December 31, 2019</b>	<b>288,837</b>	<b>19,737</b>	<b>(14,998)</b>	<b>293,576</b>

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

**Leucrotta Exploration Inc.**  
**Statements of Cash Flows**

(\$000s)	Note	Years Ended December 31	
		2019	2018
<b>Operating Activities</b>			
Net loss		(5,529)	(43)
Depletion and depreciation	(6,7)	10,621	12,147
Asset impairment	(6,7)	5,834	-
Share based compensation	(12)	569	3,645
Finance expense	(15)	401	341
Interest paid	(15)	(190)	(141)
Gain on sale of assets	(5)	(1,440)	-
Decommissioning expenditures	(10)	(256)	(176)
Change in non-cash working capital	(21)	455	476
		<b>10,465</b>	<b>16,249</b>
<b>Financing Activities</b>			
Revolving credit facility	(9)	(2,356)	2,356
Payment of lease obligations	(8)	(85)	-
Exercise of stock options		-	35
		<b>(2,441)</b>	<b>2,391</b>
<b>Investing Activities</b>			
Capital expenditures - property, plant, and equipment	(6)	(8,932)	(9,284)
Capital expenditures - exploration and evaluation assets	(7)	(4,522)	(27,396)
Property acquisitions	(6,7)	(1,543)	-
Disposition of oil and natural gas properties and equipment	(5)	4,767	-
Deposit on equipment held for sale	(5)	-	2,729
Change in non-cash working capital	(21)	(228)	(5,707)
		<b>(10,458)</b>	<b>(39,658)</b>
Change in cash and cash equivalents		<b>(2,434)</b>	<b>(21,018)</b>
Cash and cash equivalents, beginning of year		<b>2,729</b>	<b>23,747</b>
Cash and cash equivalents, end of year		<b>295</b>	<b>2,729</b>

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

## **1. REPORTING ENTITY**

Leucrotta Exploration Inc. (“Leucrotta” or the “Company”) is an oil and natural gas company, actively engaged in the acquisition, development, exploration, and production of oil and natural gas reserves in northeastern British Columbia, Canada. Leucrotta was incorporated in Alberta, Canada under the Business Corporations Act (Alberta) on June 10, 2014 under the name of 1828073 Alberta Ltd., and subsequently changed its name to Leucrotta Exploration Inc. on July 15, 2014. The Company commenced trading on the TSX Venture Exchange (“TSXV”) on August 19, 2014 under the symbol “LXE”.

The Company conducts many of its activities jointly with others and these financial statements reflect only the Company’s proportionate interest in such activities.

The Company’s place of business is located at 700, 639 – 5<sup>th</sup> Avenue SW, Calgary, Alberta, Canada, T2P 0M9.

## **2. BASIS OF PRESENTATION**

### **(a) Statement of compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The financial statements were authorized for issuance by the Board of Directors on April 27, 2020.

### **(b) Basis of measurement**

The financial statements have been prepared on the historical cost basis.

### **(c) Functional and presentation currency**

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

### **(d) Use of estimates and judgments**

The preparation of financial statements in conformity with IFRS requires management to make estimates and use judgment regarding the reported amounts of assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the period. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future periods could require a material change in the financial statements. Accordingly, actual results may differ from the estimated amounts as future confirming events occur.

Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

#### *Business combinations*

Business combinations are accounted for using the acquisition method. Under this method, the consideration transferred is allocated to the assets acquired and the liabilities assumed based on the fair values at the time of acquisition. In determining the fair value of the assets and liabilities, the Company is often required to make assumptions and estimates, such as reserves, future commodity prices, fair value of undeveloped land, discount rates, decommissioning obligations and possible outcome of any assumed contingencies.

#### *Cash-generating units (“CGU”)*

The Company’s assets are aggregated into CGUs for the purposes of calculating impairment. CGUs are determined based on the smallest group of assets that generate cash inflows independent of other assets or groups of assets. Determination of CGUs is subject to the Company’s judgment and is based on geographical proximity, shared infrastructure, similar exposure to market risk, materiality, and the way in which management monitors the Company’s operations. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

#### *Impairment*

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 costs, discount rates, market value of land, and other relevant assumptions.

- (i) Reserves – Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, operating costs, or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
- (ii) Oil and natural gas prices – Forward price estimates are used in the cash flow model. Commodity prices can fluctuate for a variety of reasons including supply and demand fundamentals, inventory levels, exchange rates, weather, and economic and geopolitical factors.



- (iii) Discount rate – The discount rate used to calculate the net present value of cash flows is based on estimates of a discount rate specific to the risk of the CGU being assessed for impairment. Changes in the general economic environment could result in significant changes to this estimate.

*Exploration and evaluation assets*

The application of the Company's accounting policy for exploration and evaluation assets requires the Company 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.

*Depletion and depreciation*

Amounts recorded for depletion and depreciation are based on estimates of total proved and probable oil and natural gas reserves and future development capital. By their nature, the estimates of reserves, including the estimates of future prices, costs, and future cash flows, are subject to measurement uncertainty. Accordingly, the impact to the financial statements in future periods could be material.

*Decommissioning obligations*

Amounts recorded for decommissioning obligations requires the use of estimates with respect to the amount and timing of decommissioning expenditures. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology. Other provisions are recognized in the period when it becomes probable that there will be a future cash outflow.

*Share based compensation*

Compensation costs recognized for share based compensation plans are subject to the estimation of what the ultimate value will be using pricing models such as the Black-Scholes-Merton model and Monte Carlo simulations, both of which are based on significant assumptions such as volatility, expected term, and forfeiture rate.

*Deferred taxes*

Deferred taxes are based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates, and the likelihood of assets being realized. Tax interpretations, regulations, and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Judgments are also required to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

*Leases*

The incremental borrowing rates are based on judgments including economic environment, term, currency, security and the underlying risk inherent to the asset. The carrying balance of the right-of-use assets, lease obligations, and the resulting interest and depreciation expense, may differ due to changes in the market conditions and lease term. In determining the lease term, management considers the non-cancellable period along with extension terms that allow for operational flexibility taking into consideration future market conditions and other facts and circumstances.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently by the Company to all periods presented in these financial statements, other than as described below.

**(a) Joint arrangements**

Joint arrangements represent activities where the Company has joint control established by a contractual agreement. Joint control requires unanimous consent for financial and operational decisions (being those that significantly affect the returns of the arrangement). A joint arrangement is either a joint operation, whereby the parties have rights to the assets and obligations for the liabilities, or a joint venture, whereby the parties have rights to the net assets. For a joint operation the financial statements include the Company's proportionate share of the assets, liabilities, revenues, expenses and cash flows of the arrangement with items of a similar nature on a line-by-line basis, from the date that joint control commences until the date that joint control ceases. Joint ventures are accounted for using the equity method of accounting and recognized at cost and adjusted thereafter for the post-acquisition change in the Company's share of the joint venture's net assets. Many of the Company's oil and natural gas activities involve joint operations. The Company has no arrangements classified as joint ventures.

**(b) Financial instruments**

**Non-derivative financial instruments**

Financial instruments are recognized initially at fair value. Measurement in subsequent periods is dependent on the financial instrument's classification. The initial classification of a financial asset into one of the following three categories depends on the Company's business model for managing its financial assets and the contractual terms of the cash flows.

**Amortized cost**

Includes assets that are held within a business model whose objective is to hold assets to collect contractual cash flows and its contractual terms give rise on specified dates to cash flows that represent solely payments of principal and interest. Financial assets designated at amortized cost are initially recognized at fair value, net of directly attributable transaction costs, and are subsequently measured at amortized cost using the effective interest rate method, net of any impairment.

**Fair value through other comprehensive income ("FVOCI")**

Includes assets that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets, where its contractual terms give rise on specified dates to cash flows that represent solely payments

of principal and interest. Financial assets designated at FVOCI are measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

#### Fair value through profit or loss ("FVTPL")

Includes assets that do not meet the criteria for amortized cost or FVOCI and are measured at fair value through profit or loss, including all derivative financial assets. Financial assets designated at FVTPL are initially recognized and subsequently measured at fair value with subsequent changes in fair value charged to earnings.

Financial liabilities are classified and measured at amortized cost or FVTPL. A financial liability is classified as FVTPL if it is held-for-trading, a derivative, or designated as FVTPL on initial recognition. The classification of a financial liability is irrevocable. Financial liabilities at FVTPL (other than financial liabilities designated at FVTPL) are measured at fair value with changes in fair value, along with any interest expense, recognized in earnings. Other financial liabilities are initially measured at fair value less attributable transaction costs and are subsequently measured at amortized cost using the effective interest method.

The Company derecognizes financial assets only when the contractual rights to cash flows from the financial assets expire, or when it transfers the financial assets and substantially all the associated risks and rewards of ownership to another entity. Gains and losses on derecognition are generally recognized in earnings. However, gains and losses on derecognition of financial assets classified as FVOCI remain within accumulated other comprehensive income.

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in earnings.

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts, and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

The Company's financial instruments comprise cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, and credit facility, all of which are classified and measured at amortized cost.

#### Derivative financial instruments

From time to time, the Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company does not designate financial derivative contracts as effective accounting hedges, and thus does not apply hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are measured at fair value, with changes therein recognized in profit or loss. Transaction costs are recognized in profit or loss when incurred.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in earnings. Derivatives embedded in hybrid contracts that contain financial asset hosts within the scope of IFRS 9 are not separated and the entire contract is measured at either FVTPL or amortized cost, as appropriate.

#### Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

### (c) Property, plant, and equipment and exploration and evaluation assets

#### Recognition and measurement

##### *Exploration and evaluation expenditures*

Pre-license costs are recognized in profit or loss as incurred.

Exploration and evaluation costs, including the costs of acquiring undeveloped land and drilling costs, are initially capitalized until the drilling of the well is complete and the results have been evaluated. The costs are accumulated in cost centers by well, field, or exploration area pending determination of technical feasibility and commercial viability. The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved or probable reserves are determined to exist. If proved or probable reserves are found, the accumulated costs and associated undeveloped land are transferred to property, plant, and equipment. The exploration and evaluation costs are reviewed for impairment prior to any such transfer.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and are transferred to property, plant, and equipment, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to their respective CGUs.

##### *Development and production costs*

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

production assets includes: transfers from exploration and evaluation assets, which generally include the cost to drill the well and the cost of the associated land upon determination of technical feasibility and commercial viability; the cost to complete and tie-in the well; facility costs; the cost of recognizing provisions for future restoration and decommissioning obligations; geological and geophysical costs; and directly attributable overhead.

Development and production assets are grouped into CGUs for impairment testing. The Company currently has two CGUs both being located in Northeast BC, one being the Company's Montney assets and the other being its non-Montney assets.

When significant parts of an item of property, plant, and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant, and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant, and equipment and are recognized in profit or loss. The carrying amount of any replaced or disposed item of property, plant, and equipment is derecognized.

#### **Subsequent costs**

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant, and equipment are recognized as property, plant, and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. Capitalized property, plant, and equipment generally represent costs incurred in developing proved or probable reserves and bringing in or enhancing production from such reserves and are accumulated on a field or geotechnical area basis. The costs of the day-to-day servicing of property, plant, and equipment are recognized in operating expenses as incurred.

#### **Non-monetary asset swaps**

Exchanges or swaps of property, plant, and equipment are measured at fair value unless the exchange transaction lacks commercial substance or neither the fair value of the assets given up nor the assets received can be reliably estimated. The cost of the acquired asset is measured at the fair value of the asset given up, unless the fair value of the asset received is more clearly evident. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gain or loss on derecognition of the asset given up is included in profit or loss. Exchanges or parts of exchanges that involve principally exploration and evaluation assets are measured at the carrying amount of the asset exchanged, reduced by the amount of any cash consideration received. No gain or loss is recognized unless the cash consideration received exceeds the carrying value of the asset held.

#### **Depletion and depreciation**

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account the estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives. Future development costs are estimated taking into account the level of development required to produce the reserves.

Proved plus probable reserves are estimated at least annually by independent qualified reserve evaluators and represent the estimated quantities of 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.

The Company has determined the estimated useful lives for most gas processing plants, pipeline facilities, and compression facilities to be consistent with the reserve lives of the areas for which they serve. As such, the Company includes the cost of these assets within their associated CGU for the purpose of depletion using the unit of production method. Some facilities, where the production and reserves do not represent the useful life of the assets, are depreciated over an estimated useful life of ten years.

The cost of office and other equipment is depreciated using the straight-line method over the estimated useful life of three years.

Depreciation methods, useful lives, and residual values are reviewed at each reporting date and, if necessary, changes are accounted for prospectively.

#### **Assets held for sale**

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as held for sale if their carrying amount will be recovered primarily through a sale transaction rather than through continuing use. Assets and liabilities qualifying as held for sale must be available for immediate sale in their present condition, subject only to terms that are usual and customary for sales of such assets, and their sale must be highly probable. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale.

Non-current assets, or disposal groups, are measured at the lower of their carrying amount and fair value less costs of disposal, with gains or losses recognized in income or loss. Non-current assets or disposal groups held for sale are presented in current assets and liabilities within the statement of financial position. Assets held for sale are not subject to depletion and depreciation.

**(d) Leases**

*Policy applicable from January 1, 2019:*

The Company assesses whether a contract is a lease based on whether the contract conveys the right to control the use of an underlying asset for a period of time in exchange for consideration.

The Company recognizes a right-of-use ("ROU") asset and a lease liability at the lease commencement date. The ROU asset is initially measured at cost based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the ROU asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The Company includes ROU assets in property, plant, and equipment on the statement of financial position. The lease term includes periods covered by an option to extend if the Company is reasonably certain to exercise that option. In addition, the ROU asset is periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

The lease liability is measured at amortized cost using the effective interest method. It is re-measured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option. When the lease liability is re-measured in this way, a corresponding adjustment is made to the carrying amount of the ROU asset, or is recorded in earnings if the carrying amount of the ROU asset has been reduced to zero. Lease payments are applied against the lease obligation, with a portion reflected as interest expense using the effective interest rate method. The Company presents the lease liability as its own line item on the statement of financial position.

*Policy applicable before January 1, 2019:*

Leases wherein the Company assumes substantially all the risks and rewards of ownership are classified as finance leases, when applicable. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the 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 classified as operating leases, which are not recognized on the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

**(e) Impairment**

**Financial assets**

The Company has elected to measure loss allowances for its financial assets measured at amortized cost at an amount equal to lifetime expected credit losses ("ECLs") as its accounts receivable are due within a period of less than one year and are not considered to have a significant financing component. The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk. ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e., the difference between the cash flows due to the Company in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

**Non-financial assets**

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Exploration and evaluation assets are assessed for impairment when they are transferred to property, plant, and equipment or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. ROU assets may be tested as part of a cash-generating unit, as a separate cash-generating unit or as an individual asset.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (a cash-generating unit or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs of disposal.

Fair value less costs of disposal is determined to be the amount for which the asset could be sold in an arm's length transaction. In determining fair value less costs of disposal, discounted cash flows and recent market transactions are taken into account. These calculations are corroborated by valuation multiples or other available fair value indicators.

Value in use is determined as the net present value of the estimated future cash flows expected to arise from the continued use of the asset in its present form and its eventual disposal. Value in use is determined by applying assumptions specific to the Company's continued use and can only take into account approved future development costs. Estimates of future cash flows used in the evaluation of impairment of assets are made using management's forecasts of commodity prices and expected

production volumes. The latter takes into account assessments of field reservoir performance and includes expectations about proved and unproved volumes, which are risk-weighted using geological, production, recovery, and economic projections.

An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated to the assets in the CGUs on a pro rata basis. Impairment losses recognized in prior periods are assessed each reporting date if facts or circumstances indicate that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

**(f) Business combinations**

Transactions for the purchase of assets, where the assets acquired are deemed to constitute a business, are accounted for as business combinations. Using the acquisition method, identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. Transaction costs related to the acquisition are expensed as incurred.

**(g) Share based compensation**

The Company uses the fair value method for valuing share based compensation. Under this method, the compensation cost attributed to stock options and warrants is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Upon the settlement of the stock options or warrants, the previously recognized value in contributed surplus is recorded as an increase to share capital.

**(h) Provisions**

Provisions are recognized when the Company has a present obligation as a result of a past event that can be estimated with reasonable certainty. Provisions are measured by estimating the cash flows that the Company would pay to be relieved of the obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the estimated future cash flows at a risk-free pre-tax rate. Provisions are not recognized for future operating losses.

*Decommissioning obligations*

The Company's activities give rise to dismantling, decommissioning, and site disturbance remediation activities. A provision is made for the estimated cost of abandonment and site restoration and capitalized in the relevant asset category. The capitalized amount is depreciated on a unit of production basis over the life of the associated proved plus probable reserves. Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time, changes in the estimated future cash flows underlying the obligation, and changes in the risk-free rate. The increase in the provision due to the passage of time is recognized as accretion (within finance expenses) whereas increases or decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

**(i) Revenue**

The Company earns revenue from its production and sale of oil, natural gas and natural gas liquids ("NGLs") and from fees charged to third parties for processing and other services provided at facilities where the Company has an ownership interest.

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

The Company evaluates its arrangements with third parties and partners to determine if the Company is acting as the principal or as an agent. 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 revenue is recognized on a net basis, only reflecting the fee, if any, realized by the Company from the transaction.

Tariffs, tolls and fees charged to other entities for use of pipelines and facilities owned by the Company are evaluated by management to determine if these originate from contracts with customers or from incidental or collaborative arrangements. Tariffs, tolls and fees charged to other entities that are from contracts with customers are recognized in revenue when the related services are provided.

When allocating the transaction price realized in contracts with multiple performance obligations, management is required to make estimates of the prices at which the Company would sell the product separately to customers.

**(j) Finance income and expense**

Finance income and expense comprises interest expense, including interest on the credit facility and lease obligations, accretion on decommissioning obligations, and interest income earned on cash in the bank.

**(k) Income tax**

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

Current 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 on the 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. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. 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 by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, 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 earnings 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.

**(l) Per share amounts**

Basic per share amounts are calculated by dividing the net earnings or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted per share amounts are determined by adjusting the weighted average number of common shares outstanding during the period for the effects of dilutive instruments such as stock options, performance warrants and purchase warrants granted.

**(m) Flow-through shares**

The Company, from time to time, may issue flow-through shares to finance a portion of its exploration capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the exploration expenditures are renounced to the subscribers. On issuance of flow-through shares, the premium received on such shares, being the difference between the fair value ascribed to flow-through shares issued and the fair value that would have been received for common shares with no tax attributes, is recognized as a liability on the statement of financial position. When the exploration expenditures are incurred, the liability is drawn down, a deferred tax liability is recorded equal to the estimated amount of deferred income tax payable by the Company as a result of the foregone tax benefits, and the difference is recognized in profit or loss.

**(n) Government grants**

Government grants are recognized when there is reasonable assurance that the Company will comply with the conditions attached to them and the grants will be received. When the conditions of a grant relate to income or expenses, it is recognized in the statement of operations in the period in which the expenditures are incurred or income is earned. When the conditions of a grant relate to an underlying asset, it is recognized as a reduction to the carrying amount of the related asset and amortized into earnings on a systematic basis over the expected useful life of the underlying asset through reduced depletion and depreciation expense.

**(o) Changes in accounting policies and new standards and interpretations not yet adopted**

**IFRS 16, Leases**

Effective January 1, 2019, the Company adopted IFRS 16, "Leases" ("IFRS 16") which provides a single recognition and measurement model for lessees to recognize assets and liabilities for contracts that are, or contain, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company has elected to use the modified retrospective approach upon adoption and therefore the comparative information has not been restated. The effect of initially applying the standard was a \$0.3 million increase to ROU assets, with a corresponding lease liability recorded. The ROU asset was measured at the amount equal to the lease liability on January 1, 2019 with no impact on opening deficit. The lease liability was measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The weighted average incremental borrowing rate used to determine the lease obligation on adoption was approximately 5.0%. The ROU assets and lease liabilities recognized relate to the Company's head office lease. The average depreciation term of the ROU asset at January 1, 2019 was 2.8 years.

The Company has elected to apply the practical expedient of not recognizing right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as expenses on a straight-line basis over the lease term.

The difference in operating lease commitments disclosed as at December 31, 2018 and lease liabilities recognized on the statement of financial position at January 1, 2019 is primarily due to the impact of discounting using the Company's incremental borrowing rate at January 1, 2019 and a portion of the head office lease being variable and considered a non-lease component.

The following shows the impact of IFRS 16 implementation on the operating lease commitments previously disclosed:

	January 1, 2019
Office lease commitments	907
Non-lease component and variable payments included in the above	(634)
Lease component of lease commitment	273
Impact of discounting	(19)
Lease obligation recognized discounted using incremental borrowing rate (note 6 and 8)	254

***Future standards and interpretations:***

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 "Business Combinations". The amendments are intended to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. IFRS 3 continues to adopt a market participant's perspective to determine whether an acquired set of activities and assets is a business. The amendments clarify the minimum requirements for a business; remove the assessment of whether market participants are capable of replacing any missing elements; add guidance to help entities assess whether an acquired process is substantive; narrow the definitions of a business and of outputs; and introduce an optional fair value concentration test. The concentration test is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The amendments to IFRS 3 are effective for annual reporting periods beginning on or after January 1, 2020 and apply prospectively.

**4. RESTRICTED CASH**

At December 31, 2019, the Company has \$1.3 million (December 31, 2018 - \$1.0 million) in a restricted corporate account to cross-guarantee a margin account for the President of the Company. The President is charged a fee by the Company and the margin account is also restricted until the cross-guarantee is removed. The President's margin account holds \$2.4 million of securities of Leucrotta common shares and a margin payable of \$1.3 million. The cross-guarantee is intended to be temporary in nature and will be removed as soon as practicable. The cross-guarantee has allowed the President to comply with corporate governance mandates.

**5. EQUIPMENT HELD FOR SALE**

	Net Book Value
Balance, December 31, 2017	-
Cost transferred from property, plant, and equipment	4,794
Accumulated depreciation transferred from property, plant, and equipment	(480)
Balance, December 31, 2018	4,314
Sale of equipment	(4,314)
Balance, December 31, 2019	-

During the year ended December 31, 2019, the Company sold certain equipment for proceeds of \$5.9 million (USD \$4.4 million) resulting in a gain of \$1.6 million. During the fourth quarter of 2018, the Company received deposits totaling \$2.7 million (USD \$2.0 million) relating to the sale with the remaining balance of \$3.1 million (USD \$2.4 million) received in the first quarter of 2019. The \$2.7 million deposit was recognized in cash with an offsetting amount recognized in accounts payable as at December 31, 2018 and upon the sale closing the deposit was applied to the proceeds and the accounts payable was reversed.

During the year ended December 31, 2019, the Company sold additional equipment for proceeds of \$1.6 million resulting in a loss of \$0.1 million.

## 6. PROPERTY, PLANT, AND EQUIPMENT

<b>Cost</b>	<b>Total</b>
Balance, December 31, 2017	192,078
Additions	9,284
Transfer from exploration and evaluation assets	37,167
Transfer to equipment held for sale	(4,794)
Change in decommissioning obligations	830
Capitalized share based compensation	217
Balance, December 31, 2018	234,782
Property acquisition	1,556
Additions	8,932
Dispositions	(2,000)
Change in decommissioning obligations	1,566
Initial recognition of right-of-use assets (note 3o)	254
Capitalized share based compensation	52
<b>Balance, December 31, 2019</b>	<b>245,142</b>
<b>Accumulated Depletion, Depreciation, and Impairment</b>	<b>Total</b>
Balance, December 31, 2017	35,683
Transfer to equipment held for sale	(480)
Depletion and depreciation	12,147
Balance, December 31, 2018	47,350
Dispositions	(258)
Depletion and depreciation	10,558
Impairment	4,750
<b>Balance, December 31, 2019</b>	<b>62,400</b>
<b>Net Book Value</b>	<b>Total</b>
December 31, 2018	187,432
<b>December 31, 2019</b>	<b>182,742</b>

The Company closed a property acquisition during the year ended December 31, 2019 for cash consideration of \$0.5 million. Net assets acquired consisted of strategic pipeline and facility infrastructure in the Company's core Montney area less decommissioning obligations acquired of \$1.1 million. There are no producing wells and no reserves assigned to the wells acquired through the transaction.

During the year ended December 31, 2019, approximately \$0.1 million (December 31, 2018 - \$0.3 million) of directly attributable general and administrative costs were capitalized as expenditures on property, plant, and equipment.

### Depletion and depreciation

The calculation of depletion and depreciation expense for the year ended December 31, 2019 included an estimated \$324.4 million (December 31, 2018 - \$329.6 million) for future development costs associated with proved plus probable undeveloped reserves and excluded approximately \$3.8 million (December 31, 2018 - \$3.8 million) for the estimated salvage value of production equipment and facilities.

Included in depletion and depreciation expense for the year ended December 31, 2019, is \$90 thousand (December 31, 2018 - \$nil) related to the right-of-use asset for the Company's head office lease. At December 31, 2019, the net book value of this right-of-use asset is \$0.2 million.

### Impairment

At December 31, 2019, the Company evaluated its property, plant, and equipment ("PP&E") CGUs for indicators of impairment or impairment reversals. Indicators of impairment were determined to exist in both of the Company's CGUs primarily as a result of significant and sustained decline in forward commodity benchmark prices for natural gas and NGLs and a market capitalization deficiency relative to the book value of the Company's shareholders' equity. Performance issues were also identified in the non-Montney CGU.

The recoverable amount of the Montney CGU, comprised of primarily natural gas and natural gas liquids reserves, was determined using the value in use methodology based on the net present value of cash flows from oil and natural gas reserves at pre-tax discount rates ranging from 10 to 17.5 percent depending on the underlying composition and risk profile of the reserve category. The Company has determined that there was no impairment to its Montney CGU at December 31, 2019.

The recoverable amount of the non-Montney CGU, comprised primarily of light oil reserves and associated facilities infrastructure, was determined using the fair value less costs of disposal methodology which is designated as Level 3 on the fair value hierarchy. The recoverable amount of the CGU was based on the net present value of cash flows from oil and natural gas reserves at pre-tax discount rates ranging from 10 to 15 percent in addition to third party sales offers on specific facility assets in the CGU. At December



31, 2019, the Company determined that the carrying amount of the non-Montney CGU exceeded the recoverable amount, net of associated decommissioning obligations, of \$1.7 million and accordingly, an impairment charge of \$4.75 million was recorded.

Commodity price estimates based on an average of three independent reserve evaluators used in the impairment calculations as at December 31, 2019 were as follows:

Year	West Texas Intermediate Oil (\$US/bbl)	Foreign Exchange Rate (USD/CDN)	Edmonton Light, Sweet Oil (\$CDN/bbl)	AECO Gas Price (\$CDN/mmbtu)	Chicago Gas Price (\$USD/mmbtu)
2020	61.00	0.760	72.64	2.04	2.53
2021	63.75	0.770	76.06	2.32	2.78
2022	66.18	0.785	78.35	2.62	2.96
2023	67.91	0.785	80.71	2.71	3.07
2024	69.48	0.785	82.64	2.81	3.15
2025	71.07	0.785	84.60	2.89	3.23
2026	72.68	0.785	86.57	2.96	3.30
2027	74.24	0.785	88.49	3.03	3.36
2028	75.73	0.785	90.31	3.10	3.43
2029	77.24	0.785	92.17	3.17	3.50
Escalate Thereafter	2.0% per year		2.0% per year	2.0% per year	2.0% per year

The results of impairment tests are sensitive to changes in any of the key estimates of which changes could decrease or increase the recoverable amounts of assets and result in additional impairment charges or recovery of impairment charges. Key input estimates used in the determination of cash flows from oil and gas reserves include: quantities of reserves and future production, forward commodity pricing, development costs, operating costs, royalty obligations, abandonment costs, and discount rates. As at December 31, 2019, if pre-tax discount rates used in the calculation of impairment changed by 1% with all other variables held constant, the recoverable amount of the Montney CGU would change by approximately \$14.5 million. As at December 31, 2019, if commodity price estimates changed by \$1.00/bbl for oil and NGLs and \$0.10/mcf for natural gas with all other variables held constant, the recoverable amount of the Montney CGU would change by approximately \$15.0 million. No sensitivity analysis has been provided for the non-Montney CGU as the fair value less costs of disposal was determined with reference to third party sales offers.

At December 31, 2018, the Company evaluated its CGUs for indicators of impairment or impairment reversals. During the year ended December 31, 2018, there were indicators of impairment identified in the Company's Montney CGU as a result of significant and sustained declines in the forward commodity prices for natural gas. A value in use impairment test was performed primarily based on the net present value of cash flows from oil and natural gas reserves at pre-tax discount rates ranging from 10 to 20 percent depending on the underlying composition and risk profile of the reserve category. The Company determined that there was no impairment to its Montney CGU at December 31, 2018.

## 7. EXPLORATION AND EVALUATION ASSETS

	<b>Total</b>
Balance, December 31, 2017	127,422
Additions	27,396
Transfer to property, plant, and equipment	(37,167)
Capitalized share based compensation	829
Balance, December 31, 2018	118,480
Property acquisitions	<b>1,085</b>
Additions	<b>4,522</b>
Impairment	<b>(1,084)</b>
Land lease expiries	<b>(63)</b>
Capitalized share based compensation	<b>42</b>
<b>Balance, December 31, 2019</b>	<b>122,982</b>

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proved or probable reserves. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period, consisting primarily of undeveloped land and drilling costs until the drilling of the well is complete and the results have been evaluated. The Company closed two property acquisitions during the year ended December 31, 2019 for cash consideration of \$1.1 million. Net assets acquired consisted of undeveloped land in the Company's core Montney area.

During the year ended December 31, 2019, approximately \$0.1 million (December 31, 2018 - \$0.3 million) of directly attributable general and administrative costs were capitalized as expenditures on exploration and evaluation assets.

Land lease expiries for the year ended December 31, 2019 were \$63 thousand (December 31, 2018 - \$nil) and have been included in depletion and depreciation expense.

## Impairment

At December 31, 2019, the Company evaluated its E&E assets for indicators of impairment or impairment reversals and as a result of this assessment management determined that an impairment test was required to be performed on the non-Montney CGU due to the Company determining only minimal capital would be spent in the area. The carrying value of the non-Montney E&E assets were written down to their estimated recoverable amount of \$0.5 million resulting in an impairment charge of \$1.1 million at December 31, 2019.

## 8. LEASE OBLIGATIONS

Effective January 1, 2019, the Company applied the IFRS 16 accounting policy and recognized its office lease contract as a right-of-use asset. Lease obligations are discounted with an effective interest rate of 5.0% and right-of-use asset is amortized based on the lease term. The Company's office lease expires October 31, 2021 and has no renewal option in the lease agreement.

	<b>Total</b>
Balance, December 31, 2018	-
Liabilities recognized on adoption of IFRS 16 (note 3o)	<b>254</b>
Lease payments	<b>(96)</b>
Interest expense	<b>11</b>
<b>Balance, December 31, 2019</b>	<b>169</b>
Current	<b>87</b>
Long-term	<b>82</b>
	<b>169</b>

The total undiscounted amount of the estimated future cash flows to settle the lease obligations over the remaining lease term is \$0.2 million. The Company's minimum lease payments are as follows:

	<b>December 31, 2019</b>
Within one year	92
Later than one year but not later than two years	84
Later than two years	-
Minimum lease payments	176
Amount representing interest expense	<b>(7)</b>
Present value of net lease payments	<b>169</b>

The expense recognized relating to short-term leases and leases of low-value assets for the year ended December 31, 2019 was \$0.3 million and has been included in operating expenses.

For the year ended December 31, 2019, \$0.2 million of non-lease variable expenses relating to the head office lease have been included within general and administrative expenses.

## 9. CREDIT FACILITY

The Company has a \$20.0 million revolving operating demand loan credit facility with a Canadian chartered bank. To access the credit facility over \$15.0 million requires entering into and maintaining forward commodity price contracts of no less than 50% of production volumes for the first 12 months and no less than 25% of production volumes for the following 12 months thereafter. The revolving credit facility bears interest at prime plus a range of 0.50% to 2.50% and is secured by a \$100 million fixed and floating charge debenture on the assets of the Company. The undrawn portion of the credit facility is subject to a standby fee in the range of 0.20% to 0.45%. At December 31, 2019, \$nil had been drawn on the revolving credit facility (December 31, 2018 - \$2.4 million). At December 31, 2019, the Company had outstanding letters of guarantee of \$4.3 million which reduce the amount that can be borrowed under the credit facility. The next review of the revolving credit facility by the bank is scheduled on or before May 31, 2020.

The Company's credit facility includes a covenant requiring the Company to maintain an adjusted working capital ratio of not less than one-to-one. The working capital ratio, as defined by its creditor, is calculated as current assets plus any undrawn amounts available on its credit facility less current liabilities excluding any current portion drawn on the credit facility. The Company was compliant with this covenant at December 31, 2019.

## 10. DECOMMISSIONING OBLIGATIONS

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to abandon and reclaim the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The total undiscounted amount of the estimated cash flows, adjusted for inflation at 1.35% per year (December 31, 2018 - 2.0%), required to settle the decommissioning obligations is approximately \$17.1 million (December 31, 2018 - \$15.7 million) which is estimated to be incurred over the next 30 years. At December 31, 2019, a risk-free rate of 1.67% (December 31, 2018 - 2.12%) was used to calculate the net present value of the decommissioning obligations.

	Year Ended December 31, 2019	Year Ended December 31, 2018
Balance, beginning of year	9,572	8,718
Provisions incurred	65	458
Provisions settled	(256)	(176)
Property acquisitions (note 6)	1,098	-
Revisions in estimated cash flows	188	301
Revisions due to change of rates	1,313	71
Accretion	211	200
<b>Balance, end of year</b>	<b>12,191</b>	<b>9,572</b>

Included in revisions due to change of rates is \$2.3 million resulting from the difference between the fair value discount rate on the acquisition date and the subsequent revaluation using the risk-free rate.

## 11. SHAREHOLDERS' CAPITAL

The Company is authorized to issue an unlimited number of voting common shares, an unlimited number of non-voting common shares, Class A preferred shares, issuable in series, and Class B preferred shares, issuable in series. No non-voting common shares or preferred shares have been issued.

Voting Common Shares	Number	Amount
Balance, December 31, 2017	200,497	288,787
Exercise of stock options	28	50
<b>Balance, December 31, 2018 and December 31, 2019</b>	<b>200,525</b>	<b>288,837</b>

## 12. SHARE BASED COMPENSATION PLANS

### Stock options

The Company has authorized and reserved for issuance 20.1 million common shares under a stock option plan enabling certain officers, directors, employees, and consultants to purchase common shares. The Company will not issue options exceeding 10% of the shares outstanding at the time of the option grants (the performance warrants described below are aggregated with any options for the 10% limit). Under the plan, the exercise price of each option equals the market price of the Company's shares on the date of the grant and an option's maximum term is ten years. At December 31, 2019, 11.2 million options were outstanding at an average exercise price of \$1.25 per share.

	Number of Options	Weighted Average Exercise Price (\$)
Balance, December 31, 2017	11,470	1.25
Granted	25	1.70
Exercised	(28)	1.24
Forfeited	(45)	1.47
Balance, December 31, 2018	11,422	1.25
Forfeited	(266)	1.28
<b>Balance, December 31, 2019</b>	<b>11,156</b>	<b>1.25</b>
<b>Exercisable, December 31, 2019</b>	<b>10,294</b>	<b>1.20</b>

The following table summarizes the stock options outstanding and exercisable at December 31, 2019:

Exercise Price	Options Outstanding		Options Exercisable	
	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Exercise Price
\$0.80 to \$1.00	4,097	1.9	4,097	0.87
\$1.01 to \$1.30	4,480	1.0	4,480	1.29
\$1.31 to \$1.78	2,579	3.7	1,717	1.78
	11,156	1.9	10,294	1.20

The Company accounts for its share based compensation plans using the fair value method. Under this method, compensation cost is charged to earnings over the vesting period for stock options and warrants granted to officers, directors, employees, and consultants with a corresponding increase to contributed surplus.

The fair value of the stock options granted were estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	December 31, 2019	December 31, 2018
Risk-free interest rate (%)	-	1.9
Expected life (years)	-	4.0
Expected volatility (%)	-	51.3
Expected dividend yield (%)	-	-
Forfeiture rate (%)	-	0.2
Weighted average fair value of options granted (\$ per option)	-	0.71

During the year ended December 31, 2019, the Company recognized \$0.5 million (December 31, 2018 - \$2.6 million) of share based compensation related to the stock options (including the stock option modification, see below). At December 31, 2019 there was \$0.2 million remaining as unrecognized share based compensation related to both the original stock option grants and the modification incremental fair value.

#### Stock option modification

In May 2018, the expiry term for previously granted stock options was extended to 6 years from the original term of 4 or 5 years. The incremental fair value of the stock option modification was \$1.5 million and \$1.4 million was recognized during the year ended December 31, 2018 based on the percentage of modified options that were vested. The incremental fair value was estimated immediately before and as at the date of modification using a Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Prior to modification	Post modification
Risk-free interest rate (%)	1.9	2.0
Expected life (years)	1.8	3.5
Expected volatility (%)	39.4	45.5
Expected dividend yield (%)	-	-
Forfeiture rate (%)	-	-
Weighted average fair value of options granted (\$ per option)	0.86	0.99

#### Performance Warrants

The Company has 7.3 million performance warrants outstanding to certain officers, directors, employees, and consultants to purchase common shares at an exercise price of \$1.70. The performance warrants expire on August 15, 2020 and are subject to both time vesting, which has been met, and performance vesting as follows:

	30 day Volume Weighted Average Trading Price of the Common Shares (\$)	Percentage of Warrants Vested
	1.87	20%
	2.04	40%
	2.21	60%
	2.38	80%
	2.55	100%

	Number of Warrants	Exercise Price
Balance, December 31, 2017	7,491	1.70
Forfeited	(6)	1.70
Balance, December 31, 2018	7,485	1.70
Forfeited	(170)	1.70
<b>Balance, December 31, 2019</b>	<b>7,315</b>	<b>1.70</b>
<b>Exercisable, December 31, 2019</b>	<b>4,389</b>	<b>1.70</b>

During the year ended December 31, 2019, the Company recognized \$0.2 million (December 31, 2018 - \$0.8 million) of share based compensation related to the performance warrants (including the performance warrant modification, see below). At December 31, 2019 there was \$nil remaining as unrecognized share based compensation related to the performance warrants. No new performance warrants were granted during the year ended December 31, 2019. The remaining life of the performance warrants at December 31, 2019 is 0.6 years (December 31, 2018 - 1.6 years).

#### Performance warrant modification

In May 2018, the expiry term for previously granted performance warrants was extended to 6 years from the original term of 5 years. The incremental fair value of the performance warrant modification was \$1.0 million and \$0.8 million was recognized during the year ended December 31, 2018 based on the percentage of modified performance warrants that were vested. The incremental fair value

was estimated immediately before and as at the date of modification using a Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Prior to modification	Post modification
Risk-free interest rate (%)	1.9	1.9
Expected life (years)	1.2	2.2
Expected volatility (%)	36.0	38.0
Expected dividend yield (%)	-	-
Forfeiture rate (%)	-	-
Weighted average fair value of warrants granted (\$ per warrant)	0.32	0.45

#### Purchase Warrants

The Company has 7.65 million purchase warrants outstanding to certain officers, directors, employees, and consultants to purchase common shares at an exercise price of \$2.04 expiring on September 12, 2020 that are fully vested.

	Number of Warrants	Exercise Price
<b>Balance, December 31, 2017 and 2018 and 2019</b>	<b>7,650</b>	<b>2.04</b>
<b>Exercisable, December 31, 2019</b>	<b>7,650</b>	<b>2.04</b>

During the year ended December 31, 2019, the Company recognized \$nil (December 31, 2018 - \$1.3 million) of share based compensation related to the purchase warrants (including the purchase warrant modification, see below). At December 31, 2019 there was \$nil remaining as unrecognized share based compensation related to the purchase warrants. No new purchase warrants were granted during the year ended December 31, 2019. The remaining life of the purchase warrants at December 31, 2019 is 0.7 years (December 31, 2018 - 1.7 years).

#### Purchase warrant modification

In May 2018, the expiry term for previously granted purchase warrants was extended to 6 years from the original term of 5 years. The incremental fair value of the purchase warrant modification was \$1.3 million and \$1.3 million was recognized during the year ended December 31, 2018 based on the percentage of modified purchase warrants that were vested. The incremental fair value was estimated immediately before and as at the date of modification using a Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Prior to modification	Post modification
Risk-free interest rate (%)	1.9	1.9
Expected life (years)	1.3	2.3
Expected volatility (%)	35.3	39.7
Expected dividend yield (%)	-	-
Forfeiture rate (%)	-	-
Weighted average fair value of warrants granted (\$ per warrant)	0.28	0.44

### 13. PER SHARE AMOUNTS

The following table summarizes the weighted average number of shares used in the basic and diluted net loss per share calculations:

	December 31, 2019	December 31, 2018
Weighted average number of shares - basic and diluted	200,525	200,520

For the year ended December 31, 2019, 11.2 million stock options, 7.7 million purchase warrants and 7.3 million performance warrants (December 31, 2018 - 11.4 million stock options, 7.7 million purchase warrants and 7.5 million performance warrants) were excluded from the weighted-average share calculations because they were anti-dilutive due to the net loss.

#### 14. KEY MANAGEMENT PERSONNEL

The Company considers its directors and executives to be key management personnel. The key management personnel compensation is comprised of the following:

	December 31, 2019	December 31, 2018
Short-term wages and benefits	1,846	2,219
Share based compensation <sup>(1)</sup>	479	3,619
Total <sup>(2,3)</sup>	2,325	5,838

(1) Represents the amortization of share based compensation expense associated with the Company's share based compensation plans granted to key management personnel inclusive of any capitalized portion.

(2) Balances outstanding and payable at December 31, 2019 were \$nil (December 31, 2018 - \$nil).

(3) At December 31, 2019, key management personnel included 12 individuals (December 31, 2018 – 12 individuals).

#### 15. FINANCE EXPENSE

Finance expense includes the following:

	December 31, 2019	December 31, 2018
Interest expense	190	141
Accretion of decommissioning obligations	211	200
Finance expense	401	341

#### 16. INCOME TAXES

The provision for income taxes in the statements of operations and comprehensive loss reflects an effective tax rate which differs from the expected statutory tax rate. The differences were accounted for as follows:

	December 31, 2019	December 31, 2018
Loss before taxes	5,529	43
Statutory income tax rate	26.75%	27.0%
Expected income tax recovery	1,479	12
Increase (decrease) in income tax recovery resulting from:		
Share based compensation and other non-deductible amounts	(171)	(1,017)
Change in statutory income tax rate	(639)	-
Change in unrecognized deferred income tax asset	(669)	1,005
Deferred income tax recovery	-	-

The tax rate consists of the combined federal and provincial statutory tax rates for the Company for the years ended December 31, 2019 and December 31, 2018. In the second quarter of 2019, the Alberta government enacted a decrease in the Alberta corporate income tax rate from 12% to 11% effective July 1, 2019, with a further reduction of 1% on January 1 for each of the years 2020, 2021 and 2022 bringing the provincial rate to 8%.

At December 31, 2019 and 2018, the Company has an unrecognized net deferred income tax asset based on the independently evaluated reserve report as cash flows are not expected to be sufficient to realize the deferred income tax asset at this time.

At December 31, 2019, the Company has estimated tax pools of \$322.8 million (December 31, 2018 - \$325.3 million) available for deduction against future taxable income.

Unrecognized deductible temporary differences are as follows:

	December 31, 2019	December 31, 2018
Oil and natural gas properties and equipment	13,526	10,230
Lease obligations	169	-
Decommissioning obligations	12,191	9,572
Share issue costs	2,197	3,393
Non-capital losses	4,446	4,446
Unrecognized deductible temporary differences	32,529	27,641

Non-capital losses of \$4.4 million will expire between 2035 and 2036.

## 17. FAIR VALUE OF FINANCIAL INSTRUMENTS

### **Cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, and credit facility**

The fair value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, and credit facility at December 31, 2019 and December 31, 2018 approximated their carrying value due to their short term to maturity and the credit facility bears interest at floating rates where the premium charged is indicative of the Company's current credit spreads.

The Company classified the fair value of its financial instruments at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument:

- Level 1 – observable inputs, such as quoted market prices in active markets
- Level 2 – inputs, other than the quoted market prices in active markets, which are observable, either directly or indirectly
- Level 3 – unobservable inputs for the asset or liability in which little or no market data exists, therefore requiring an entity to develop its own assumptions

During the years ended December 31, 2019 and 2018, there were no transfers between level 1, level 2, and level 3 classified assets and liabilities.

## 18. FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities. The Company employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. Risk management is ultimately established by the Board of Directors and is implemented by management. As required under the terms of the Company's credit facility, the Company is subject to an upper limit on fixed price contracts of 65% of its future production up to a three year period.

### **Market risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of foreign currency risk, interest rate risk, and other price risk, such as commodity price risk. The objective of market risk management is to manage and control market price exposures within acceptable limits, while maximizing returns. The Company may use financial derivatives or physical delivery sales contracts to manage market risks. All such transactions are conducted within risk management tolerances that are reviewed by the Board of Directors.

#### *Foreign exchange risk*

The prices received by the Company for the production of oil, natural gas, and NGLs are primarily determined in reference to US dollars, but are settled with the Company in Canadian dollars. The Company's cash flow from commodity sales will therefore be impacted by fluctuations in foreign exchange rates. The Company does not currently have any foreign exchange contracts in place.

#### *Interest rate risk*

The Company is exposed to interest rate risk when it borrows funds at floating interest rates. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations. The amount drawn on the Company's credit facility at December 31, 2019 was \$nil.

#### *Commodity price risk*

Oil and natural gas prices are impacted by not only the relationship between the Canadian and US dollar but also by world economic events that dictate the levels of supply and demand. The Company's oil, natural gas, and NGLs production is marketed and sold on the spot market to area aggregators based on daily spot prices that are adjusted for product quality and transportation costs. The Company's cash flow from product sales will therefore be impacted by fluctuations in commodity prices. A \$1.00/boe increase or decrease in commodity prices would have impacted the net loss by approximately \$1.1 million for the year ended December 31, 2019 (December 31, 2018 - \$1.3 million).

The Company did not enter into commodity price contracts to manage future cash flows as at December 31, 2019.

### **Credit risk**

Credit risk represents the financial loss that the Company would suffer if the Company's counterparties to a financial asset fail to meet or discharge their obligation to the Company. A substantial portion of the Company's accounts receivable and deposits are with customers and joint interest partners in the oil and natural gas industry and are subject to normal industry credit risks. The Company generally grants unsecured credit but routinely assesses the financial strength of its customers and joint interest partners.

The Company sells the majority of its production to four petroleum and natural gas marketers and therefore is subject to concentration risk. Historically, the Company has not experienced any collection issues with its oil and natural gas marketers. Joint interest receivables are typically collected within one to three months of the joint interest billing being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval for significant capital expenditures prior to the expenditure being incurred. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however, in certain circumstances, the Company may cash call a partner in advance of expenditures being incurred.

The maximum exposure to credit risk is represented by the carrying amount of cash and cash equivalents, restricted cash, and accounts receivable on the statement of financial position. At December 31, 2019, \$1.8 million (97%) of the Company's outstanding accounts receivable were current and \$43 thousand (2%) were outstanding for more than 90 days. During the year ended December 31, 2019, the Company deemed \$37 thousand of outstanding accounts receivable to be uncollectable (December 31, 2018 - \$nil).

Cash and cash equivalents and restricted cash consist of bank balances placed with a financial institution with strong investment grade ratings which management believes the risk of loss to be remote.

### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual, quarterly, and monthly capital expenditure budgets, which are monitored and updated as required, and requires authorizations for expenditures on projects to assist with the management of capital. In managing liquidity risk, the Company ensures that it has access to additional financing, including potential equity issuances and additional debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

The global impact of COVID-19 as well as the recent declines in spot prices for oil have resulted in significant declines in financial markets and has forecasted a great deal of uncertainty. As a result, oil and gas companies are subject to liquidity risks in maintaining their revenues and earnings as well as ongoing and future development and operating expenditure requirements. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. Additionally, impairment indicators for property, plant, and equipment could exist in future periods, if current conditions persist. In light of the current volatility and difficulty in reliably estimating the length or severity of these developments, and hence their financial impact, the preparation of financial forecasts is challenging. At December 31, 2019, the Company remains in compliance with all terms of its credit facility and based on current available information, management expects to comply with all terms during the subsequent 12-month period.

See note 24 for a summary of contractual commitments at December 31, 2019. The Company's accounts payable and accrued liabilities are due within the current operating period.

## 19. CAPITAL MANAGEMENT

The Company's objectives when managing capital are to maintain a flexible capital structure, which optimizes the cost of capital at an acceptable risk, and to maintain investor, creditor, and market confidence to sustain future development of the business.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company considers its capital structure to include shareholders' equity and working capital (current assets less current liabilities). To maintain or adjust the capital structure, the Company may, from time to time, issue shares, raise debt, or adjust its capital spending to manage its current and projected debt levels.

	December 31, 2019	December 31, 2018
Shareholders' equity	293,576	298,442
Working capital	125	2,102

In addition, management prepares annual, quarterly, and monthly budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. The Company's share capital is not subject to external restrictions, however, the Company's credit facility includes a covenant requiring the Company to maintain a working capital ratio of not less than one-to-one (see note 9). There were no changes in the Company's approach to capital management from the previous year.

## 20. SUPPLEMENTAL DISCLOSURES

### Presentation of expenses

The Company's statements of operations and comprehensive loss is prepared primarily by nature of expense, with the exception of employee compensation costs which are included in general and administrative expenses. Included in general and administrative expenses for the year ended December 31, 2019 are \$3.3 million of wages and benefits (December 31, 2018 - \$4.0 million).



## 21. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31, 2019	December 31, 2018
Restricted cash	(310)	-
Accounts receivable	1,080	1,208
Prepaid expenses and deposits	(115)	181
Accounts payable and accrued liabilities	(3,157)	(3,891)
Deposit on equipment held for sale	2,729	(2,729)
Change in non-cash working capital	227	(5,231)
Relating to:		
Investing	(228)	(5,707)
Operating	455	476
Change in non-cash working capital	227	(5,231)

## 22. REVENUE

The Company sells its production pursuant to fixed or 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. Under the contracts, the Company is required to deliver variable volumes of oil, natural gas liquids or natural gas to the contract counterparty. Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

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 presents the Company's oil and natural gas revenues disaggregated by revenue source:

	December 31, 2019	December 31, 2018
Oil and condensate	12,961	16,436
Other natural gas liquids	2,534	4,268
Natural gas	12,150	11,344
Oil and natural gas sales	27,645	32,048

Under certain marketing arrangements the Company will transfer title of its natural gas production to a third-party marketing company who will subsequently redeliver the natural gas production to an end customer by utilizing the Company's pipeline capacity. This portion representing the sale of transportation services is presented within natural gas revenue which is disaggregated in the below table by type:

	December 31, 2019	December 31, 2018
Natural gas production sales	7,284	8,034
Transportation revenue	4,866	3,310
Natural gas sales	12,150	11,344

The following table presents the Company's processing and marketing revenues disaggregated by revenue source:

	December 31, 2019	December 31, 2018
Sale of purchased natural gas	-	361
Processing revenue	525	884
Marketing revenue	213	507
Processing and marketing revenue	738	1,752

The Company's revenue was generated entirely in the province of British Columbia. The majority of revenue resulted from sales whereby the transaction price was based on index prices. Of total oil and natural gas sales, four customers represented combined sales of 100% for the year ended December 31, 2019 (December 31, 2018 – three customers represented combined sales of 94%).

During the year ended December 31, 2019, the Company realized credits of \$2.0 million (December 31, 2018 - \$1.8 million) to offset royalties otherwise payable. These credits stem from the British Columbia Government's Infrastructure Royalty Credit Program resulting from infrastructure built and wells drilled and tied-into the related infrastructure and the Company currently has \$0.6 million of credits remaining.

## 23. TRANSPORTATION AND MARKETING EXPENSES

	December 31, 2019	December 31, 2018
Pipeline tariffs from firm transportation agreements	6,043	4,080
Purchased natural gas	-	270
Transportation and marketing expenses	6,043	4,350

## 24. COMMITMENTS

The following is a summary of the Company's contractual obligations and commitments at December 31, 2019:

	2020	2021	2022	2023	2024	Thereafter	Total
Operating leases	224	186	-	-	-	-	410
Firm transportation agreements	10,160	9,963	3,771	3,770	3,142	-	30,806
	10,384	10,149	3,771	3,770	3,142	-	31,216

Transportation commitments include contracts to transport natural gas and NGLs through third-party owned pipeline systems. The Company currently has commitments of 27.0 mmcf/d escalating to 33.3 mmcf/d in November 2020 of firm transportation to deliver natural gas to the Alliance Trading Pool (ATP) through October 31, 2021. The Company has also committed to 14.2 mmcf/d of firm transportation to deliver natural gas to Chicago through October 31, 2024.

Operating leases include the non-lease variable components of the head office lease.

# CORPORATE INFORMATION

## OFFICERS AND DIRECTORS

**Robert J. Zakresky, CA**  
President, CEO & Director

**Nolan Chicoine, MPAcc, CA**  
VP Finance & CFO

**Terry L. Trudeau, P.Eng.**  
VP Operations & COO

**R.D. (Rick) Sereda, M.Sc., P.Geol.**  
VP Exploration

**Helmut R. Eckert, P.Land**  
VP Land

**Peter Cochrane, P.Eng.**  
VP Engineering

**Daryl H. Gilbert, P.Eng.**  
Chairman of the Board

**John A. Brussa, B.A., LL.B.**  
Director

**Don Cowie**  
Director

**Kelvin B. Johnston**  
Director

**Brian Krausert, B.Sc.**  
Director

**Tom J. Medvedic, CA**  
Director

## BANK

National Bank of Canada  
1800, 311 – 6th Avenue SW  
Calgary, Alberta T2P 3H2

## TRANSFER AGENT

Computershare  
100 University Avenue, 8th Floor  
Toronto, Ontario M5J 2Y1

## LEGAL COUNSEL

Gowling WLG (Canada) LLP  
1600, 421 – 7th Avenue SW  
Calgary, Alberta T2P 4K9

## AUDITORS

KPMG LLP  
3100, 205 – 5th Avenue SW  
Calgary, Alberta T2P 4B9

## INDEPENDENT ENGINEERS

GLJ Petroleum Consultants Ltd.  
4100, 400 – 3rd Avenue SW  
Calgary, Alberta T2P 4H2

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For further information,  
please visit our website at  
[www.leucrotta.ca](http://www.leucrotta.ca) or contact:

**Robert J. Zakresky**  
President & CEO  
P 403.705.4525

**Nolan Chicoine**  
VP Finance & CFO  
P 403.705.4525

**Leucrotta Exploration Inc.**  
Suite 700, 639 – 5th Avenue SW  
Calgary, Alberta T2P 0M9  
P 403.705.4525  
F 403.705.4526



**LEUCROTТА EXPLORATION INC.**

700, 639 – 5th Avenue SW Calgary, Alberta T2P 0M9

**P** 403.705.4525 **E** [info@leucrotta.ca](mailto:info@leucrotta.ca)