yangarra resources ltd.

Yangarra Resources Ltd.

Consolidated Financial Statements

December 31, 2017 and 2016

Management's Responsibility

To the Shareholders of Yangarra Resources Ltd.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Professional Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

March 8, 2018

"James G. Evaskevich" (signed)	*"James A. Glessing" (signed)*
James G. Evaskevich	James A. Glessing
Chief Executive Officer	Chief Financial Officer

Independent Auditors Report

To the Shareholders of Yangarra Resources Ltd.

We have audited the accompanying consolidated financial statements of Yangarra Resources Ltd., which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016 and the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Yangarra Resources Ltd. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Calgary, Alberta

March 8, 2018

MNP LLP

Chartered Professional Accountants

Yangarra Resources Ltd.
Consolidated Statements of Financial Position
As at:

		December 31, 2017		December 31, 2016
Assets				
Current				
Accounts receivable *(note 13)*	$	**26,413,976**	$	11,225,201
Prepaid expenses and inventory		**3,360,583**		3,364,770
Interest rate contracts *(note 13c i)*		**37,116**		–
Total current assets		**29,811,675**		14,589,971
Non-current				
Property and equipment *(note 3)*		**342,099,959**		277,693,631
Exploration and evaluation assets *(note 4)*		**6,032,865**		6,762,465
Interest rate contracts *(note 13c i)*		**286,914**		–
Total assets	$	**378,231,413**	$	299,046,067
Liabilities				
Current				
Current portion of bank debt *(note 5)*	$	–	$	65,140,999
Accounts payable and accrued liabilities *(note 13)*		**38,421,687**		14,454,777
Commodity contracts *(note 13c iii)*		**2,532,196**		934,561
Interest rate contracts *(note 13c i)*		**68,037**		244,851
Total current liabilities		**41,021,920**		80,775,188
Non-current				
Bank debt *(note 5)*		**84,886,124**		–
Other long-term liabilities *(note 12)*		**169,799**		211,962
Commodity contracts *(note 13c iii)*		**975,665**		199,671
Interest rate contract *(note 13c i)*		–		363,727
Decommissioning liability *(note 6)*		**10,076,055**		8,096,560
Deferred tax liability *(note 11)*		**33,145,227**		25,285,001
Total liabilities		**170,274,790**		114,932,109
Shareholders' Equity				
Share capital *(note 7b)*		**166,386,242**		163,052,797
Contributed surplus		**14,603,528**		13,579,635
Retained earnings		**26,966,853**		7,481,526
Total shareholders' equity		**207,956,623**		184,113,958
Total liabilities and shareholders' equity	$	**378,231,413**	$	299,046,067

Contingency (note 16), Commitments (note 17)

Approved on behalf of the Board of Directors

"James G. Evaskevich" (signed)
James G. Evaskevich

"Gordon A. Bowerman" (signed)
Gordon A. Bowerman

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

		2017		2016
Revenue				
Petroleum and natural gas sales	$	**77,913,091**	$	29,213,872
Royalties		**(6,411,927)**		(979,164)
		71,501,164		28,234,708
Commodity price risk contracts *(note 13c iii)*				
Realized gain on commodity contract settlement		**2,773,986**		2,102,795
Change in fair value of commodity contracts		**(2,373,629)**		(3,446,142)
		71,901,521		26,891,361
Expenses				
Production		**14,115,307**		7,730,777
Transportation		**2,159,708**		1,418,695
General and administrative		**1,986,774**		2,034,731
Finance *(note 15)*		**2,844,427**		2,579,885
Share-based compensation *(note 8)*		**1,506,329**		1,041,717
Depletion, depreciation and impairment *(note 3)*		**21,943,423**		14,983,585
		44,555,968		29,789,390
Other income				
Gain on settlement of lawsuit *(note 3)*		–		13,082,687
Income before tax		**27,345,553**		10,184,658
Deferred tax expense *(note 11)*		**7,860,226**		15,907
Net income and total comprehensive income	$	**19,485,327**	$	10,168,751
Earnings per share *(note 9)*				
Basic	$	**0.24**	$	0.14
Diluted	$	**0.23**	$	0.14
Weighted average number of shares *(note 9)*				
Basic		**80,719,934**		74,635,948
Diluted		**84,156,682**		75,123,266

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

		2017		2016
Share Capital				
Balance, beginning of year	$	**163,052,797**	$	151,345,752
Issued		–		11,500,000
Share issue costs		–		(804,461)
Tax effect of share issue costs		–		217,205
Exercise of options *(note 7)*		**2,179,593**		523,071
Contributed surplus transferred on exercise of stock options *(note 7)*		**1,153,852**		271,230
Balance, end of year		**166,386,242**		163,052,797
Contributed Surplus				
Balance, beginning of year		**13,579,635**		12,474,614
Share-based compensation		**2,177,746**		1,376,251
Exercise of options		**(1,153,853)**		(271,230)
Balance, end of year		**14,603,528**		13,579,635
Retained Earnings (deficit)				
Balance, beginning of year		**7,481,526**		(2,687,225)
Net income		**19,485,327**		10,168,751
Balance, end of year		**26,966,853**		7,481,526
Total Shareholder' Equity	$	**207,956,623**	$	184,113,958

		2017		2016
Operating				
Net income for the year	$	**19,485,327**	$	10,168,751
Add back non-cash items:				
Change in fair value of commodity contracts		**2,373,629**		3,446,142
Change in fair value of interest rate contracts *(note 15)*		**(864,571)**		(64,444)
Share-based compensation *(note 8)*		**1,506,329**		1,041,717
Depletion and depreciation *(note 3)*		**21,943,423**		14,983,585
Accretion *(note 6)*		**598,287**		182,357
Gain on settlement of lawsuit *(note 3)*		–		(13,082,687)
Deferred tax expense *(note 11)*		**7,860,226**		15,907
Gain on abandonment costs incurred		–		(427,601)
Decommissioning costs incurred *(note 6)*		**(95,433)**		(180,862)
Change in non-cash working capital *(note 10)*		**(1,032,343)**		582,625
Net cash flow from operating activities		**51,774,874**		16,665,490
Financing				
Issue of equity instruments, net of costs *(note 7)*		**2,179,593**		11,218,610
Bank debt advance *(note 5)*		**19,745,125**		3,009,741
Other long-term liabilities repayment		**(42,163)**		(40,265)
Change in non-cash working capital *(note 10)*		–		–
Net cash from financing activities		**21,882,555**		14,188,086
Investing				
Additions to property and equipment *(note 3)*		**(83,472,094)**		(27,672,766)
Property acquisitions		–		(1,400,000)
Change in non-cash working capital *(note 10)*		**9,814,665**		(1,780,810)
Net cash flow used in investing activities		**(73,657,429)**		(30,858,576)
Change in cash and cash equivalents		–		–
Cash, beginning of the year		–		–
Cash, end of the year	$	–	$	–

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

1. Basis of preparation, adoption of IFRS and statement of compliance

Yangarra Resources Ltd. (the "Company") is a publicly traded company involved in the production, exploration and development of resource properties in Western Canada. The address of the registered office is 1530, 715 – 5 Avenue SW, Calgary Alberta, T2P 2X6.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC"), after the elimination of intercompany transactions and balances.

Statement of compliance and authorization:

These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These consolidated financial statements are presented in Canadian dollars, which is the functional currency of the Company and its subsidiary. The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 8, 2018.

2. Summary of significant accounting policies

a) Basis of measurement

The consolidated financial statements have been prepared under the historical cost method, except for certain instruments which were recognized at fair value (note 13 d).

b) Inventory

Inventory is carried at the lower of cost and net realizable value on a weighted average cost basis. Inventory is primarily comprised of pipe, compressors and production equipment that will be utilized in future drilling activity. The cost of inventory includes all cost incurred in the normal course of business to bring each product to its present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less any expected selling costs. If the carrying amount exceeds net realizable value, a write-down is recognized. The write-down may be reversed in a subsequent period if circumstances which caused it no longer exist and the inventory is still on hand.

c) Property and equipment and exploration and evaluation assets

(i) Exploration and evaluation assets

Exploration and evaluation ("E&E") costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as either tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated pending determination of technical feasibility and commercial viability. Costs incurred prior to acquiring the legal rights to explore an area are charged directly to net income as exploration and evaluation expense. Assets classified as E&E are not depleted or depreciated.

The Company assesses the recoverability of the E&E assets, before and at the moment of reclassification, to property and equipment. E&E assets are assessed for impairment if (a) sufficient data exists to determine technical feasibility and commercial viability and (b) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. The impairment of E&E assets, and any eventual reversal thereof, is recognized in profit or loss.

The technical feasibility and commercial viability of extracting a mineral resource is determinable when proved or probable reserves are determined to exist. A review of each license or field is carried out, at least annually, to ascertain whether proved or probable reserves have been discovered. Upon determination of proved or probable reserves, intangible E&E assets attributable to these reserves are first tested for impairment and then reclassified from E&E assets to property and equipment. The costs of undeveloped land that expires is recognized in profit or loss.

2. Summary of significant accounting policies (continued)

c) Property and equipment and exploration and evaluation assets (continued)

(ii) Property and equipment

Property and equipment ("P&E") is carried at cost, less accumulated depletion, depreciation and accumulated impairment losses. The cost of an item of P&E consists of the purchase price, any costs directly attributable to bringing the asset into the location and condition necessary for its intended use, a discounted current estimate of the decommissioning costs and borrowing costs for qualifying assets.

Accumulated costs are depleted using the unit-of-production method. Depletion is calculated using the ratio of production in the year to the remaining total proved and probable reserves before royalties, taking into account future development costs necessary to bring those reserves into production. These estimates are evaluated and reported on by independent reserve engineers annually. Proven and probable reserves are estimated using independent reserve engineer reports. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proved and probable and a 50 percent statistical probability that is will be less. The equivalent statistical probabilities for proved reserve components are 90 percent and 10 percent, respectively.

Where an item of P&E comprises major components with different useful lives, the components are accounted for as separate items of P&E. The expected useful lives of P&E, residual values and methods of depreciation are reviewed at each reporting period and, if necessary, changes are accounted for prospectively.

Changes in estimates such as quantities of proved and probable reserves that affect unit-of-production calculations are applied on a prospective basis.

An item of P&E is derecognized upon disposal or is impaired when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss on disposal of the asset, determined as the difference between the net proceeds and the carrying amount of the asset, is recognized in the statement of comprehensive income in the period incurred.

Other assets are recorded at cost less accumulated amortization, which is calculated using the declining balance method at rates of 20 percent to 30 percent per annum.

(iii) Impairment of non-financial assets

At each financial reporting date, the carrying amounts of P&E are reviewed to determine whether there is any indication that those assets are impaired. If such indication exists, an estimate of the recoverable amount of the asset is calculated.

Individual assets are grouped together for impairment assessment purposes into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash generating unit or CGU). The carrying amount of P&E assets within a CGU are compared to the recoverable amount of the CGU. Goodwill is allocated to CGUs that are expected to benefit from synergies of the combination. E&E assets are allocated to CGUs when they are assessed for impairment if indicators of impairment exist as well as upon their reclassification into P&E.

2. Summary of significant accounting policies (continued)

c) Property and equipment and exploration and evaluation assets (continued)

(iii) Impairment of non-financial assets (continued)

A CGU's recoverable amount is the higher of its fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pretax discount rate that reflects current market assessments of the time value of money to the Company and the risks specific to the asset. Fair value less cost to sell is derived by estimating the discounted after-tax future net cash flows less estimated cost to sell. Discounted future net cash flows are based on forecasted commodity prices and costs over the expected economic life of the reserves and discounted market-based rates to reflect a market participant's view of the risks associated with the assets.

Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. The impairment loss is charged to the statement of income and comprehensive income. A previously recognized impairment loss is reversed or partially reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The new carrying amount cannot exceed the carrying amount that would have been determined, net of depletion and depreciation, had no impairment loss been recognized for the asset in prior periods.

(iv) Decommissioning liability

The Company recognizes a decommissioning liability in the period it arose with a corresponding increase to the carrying amount of the related asset. Measurement occurs when a legal or constructive obligation arises. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation discounted using the risk-free rate, updated at each reporting date. The increase in the provision due to the passage of time (accretion) is recognized as a finance expense whereas increases or decreases due to changes in the estimated cost to decommission the asset are capitalized as P&E or E&E. Actual costs incurred upon settlement of the decommissioning liability reduce the liability to the extent the provision was established and differences between actual costs incurred and estimated costs will be recorded as a gain or loss. The related decommissioning asset is depreciated or depleted on the same basis as the P&E to which it relates.

d) Leases

Leases that transfer substantively all the benefits, risks and rewards of ownership to the Company are recorded as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased asset and the present value of the minimum lease payments with a corresponding increase to obligations under finance leases. Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the obligation outstanding. The finance charge is included in the statement of comprehensive income over the lease period.

Leases that do not transfer the risks and rewards of ownership to the Company are classified as operating leases under which leasing costs are expensed in the period incurred.

2. Summary of significant accounting policies (continued)

e) Joint operations

A portion of the Company's petroleum and natural gas exploration and production activities are conducted jointly with others, and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

f) Revenue recognition

Revenue is recognized when the significant risks and rewards of ownership have been transferred to the customer, the revenue can be reliably measured, and it is probable that the economic benefits will flow to the Company. This takes place once delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured. Risk and rewards of ownership have been transferred to the customer at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product, when contractually required, has been obtained. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts, sales taxes, excise duties and similar levies based on the price specified in the sales contract.

g) Taxes

Tax expense represents the sum of current tax expense and deferred tax expense. Current tax expense is based on the taxable profits for the year. Income tax expense is recognized in the statement of comprehensive income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

Deferred tax assets and liabilities are recognized based on differences in the financial statement carrying amount for assets and liabilities and the associated tax balance. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences, unused tax credits carried forward and unused tax losses to the extent that it is probable that there will be taxable profits against which deductible temporary differences can be utilized. 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 difference arising in the initial recognition of goodwill.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the tax benefit will be realized.

Deferred taxes are measured based on enacted or substantively enacted tax rates for the period in which the temporary differences are expected to be realized or settled and are presented as non-current.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities, when they relate to income taxes levied by the same taxation authority and when the Company intends to settle its current tax assets and liabilities on a net basis.

h) Flow-through shares

Expenditure deductions for income tax purposes related to exploratory activities funded by flow-through equity instruments are renounced to investors in accordance with income tax legislation. The proceeds from issuance are allocated between the offering of shares and the sale of tax benefits. The allocation is made based on the difference between the quoted price of the existing shares and the amount the investor pays for the shares. A flow through share premium liability is recognized for this difference. The liability is reversed when eligible capital expenditures are incurred, and a deferred tax liability is recognized at that time. Income tax expense is the difference between the amount of the deferred tax liability and the liability recognized on issuance.

2. Summary of significant accounting policies (continued)

i) Share-based compensation plans

Periodically, the Company will grant stock options in exchange for the provision of services from certain employees, directors, officers and consultants. The Company follows the fair value method of valuing stock option grants using the Black-Scholes pricing model. Stock-based compensation expense is determined based on the estimated fair value of shares on the date of grant. Forfeitures are estimated at the grant date and are subsequently adjusted to reflect actual forfeitures. The expense is recognized over the service period, with a corresponding increase to contributed surplus. The Company capitalizes the qualifying portion of the stock-based compensation directly attributable to the development activities of exploration and evaluation and property, plant and equipment assets with a corresponding decrease to stock-based compensation expense. At the time the stock options are exercised, the issuance of common shares is recorded as an increase to shareholders' capital and a corresponding decrease to contributed surplus.

j) Per share amounts

Basic earnings per share ("EPS") is calculated by dividing the net income for the year attributable to equity owners of the Company by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments using the treasury stock method. The Company's potentially dilutive instruments are comprised of stock options granted.

k) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantively all the risks and rewards of ownership.

Financial statements are initially measured at fair value on the statement of financial position. Subsequent measurement of financial instruments is based on their initial classification.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instrument was acquired.

(i) Fair value through profit or loss

A financial asset can be classified as fair value asset through profit or loss only if it is designated at fair value through profit or loss or held-for-trading. Held-for-trading assets are comprised of derivatives or assets acquired or incurred principally for the purpose of selling or repurchasing in the near term. The Company's commodity contracts and interest rate contracts are derivatives and are recorded at fair value with changes in fair value included in the statement of income and comprehensive income. The Company does not apply hedge accounting to its derivative instruments.

(ii) Held-to-maturity

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company has the positive intention and ability to hold until maturity. These assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, impairment losses are included in the statement of income and comprehensive income. The Company has no held-to-maturity financial assets.

2. Summary of significant accounting policies (continued)

k) Financial instruments (continued)

(iii) Loans and receivables

These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These assets are measured at amortized cost using the effective interest method. Any gains or losses on the realization of receivables are included in the statement of income and comprehensive income. The financial assets that are categorized as loans and receivables include accounts receivable.

iv) Other financial liabilities

Other financial liabilities are measured at amortized cost using the effective interest method. Any gains or losses in the realization of other financial liabilities are included in profit or loss. The financial liabilities that are categorized as other financial liabilities include bank debt, accounts payable and accrued liabilities and other long-term liabilities.

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.

Risk management contracts

The Company enters into risk management contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These risk management contracts are not used for trading or speculative purposes. The Company has not designated its risk management contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Company considers all risk management contracts to be economic hedges. As a result, all risk management contracts are recorded at fair value at each reporting period with the change in fair value being recognized as an unrealized gain or loss on the statement of comprehensive income or loss.

Derivative assets and liabilities

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 contract 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 separate embedded derivatives are recognized immediately in the statement of income and comprehensive income.

The Company accounts for forward physical delivery contracts, which are entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements, as executory contracts. As such these contracts are not considered to be derivative financial instruments and are not recorded at fair value on the statement of financial position. Settlements on physical sales contracts are recognized in oil and natural gas revenues.

Impairment of financial assets

The Company will assess at each reporting period whether there is any objective evidence that a financial asset, other than those measured at fair value, is impaired. A financial asset is deemed to be impaired if there is objective evidence of impairment as a result of one or more events that has occurred since the initial recognition of the asset that has a negative impact on the estimated future cash flows of the financial asset. When assessing impairment of the Company’s financial assets carried at amortized cost, the carrying value of the financial assets is compared to the present value of estimated future cash flows, discounted using the instrument’s original effective interest rate. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in the statement of income and comprehensive income.

2. Summary of significant accounting policies (continued)

k) Financial instruments (continued)

Borrowing costs

Borrowing costs that are directly related to the issuance of new debt are recorded net of the associated debt and recognized into income using the effective interest rate method over the life of the debt.

Discounts or transaction costs on issuance of new debt

Discounts, where proceeds received are less than the par value of the debt or transaction costs related to the issuance of debt, are recorded as a reduction to long-term debt. Discounts or transactions costs would be amortized using the effective interest method over the life of the debt and included in finance expense.

Share capital

Common shares are classified as equity on the statement of financial position. Transaction costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

l) Provisions

Provisions and liabilities for legal and other contingent matters are recognized in the period when it becomes probable a future cash outflow resulting from past operations or events will occur and the amount of the cash outflow can be reasonably estimated. The timing of recognition and measurement of the provision requires the application of judgment to existing facts and circumstances, which can be subject to change, and the carrying amounts of provisions and liabilities are reviewed regularly and adjusted accordingly. The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine that the loss can be reasonably estimated. When a loss is recognized, it is charged to the statement of income and comprehensive income. The Company continually monitors known and potential contingent matters and makes appropriate provisions when warranted by the circumstances present.

m) Business combinations

Business combinations are accounted for using the acquisition method under IFRS 3 Business Combinations. management's determination of whether a transaction constitutes a business combination or an asset acquisition is based on the criteria in IFRS 3. The identifiable assets acquired and liabilities assumed in a business combination are measured at their fair values at the acquisition date. The decommissioning liability associated with the acquired property is subsequently re-measured at the end of the reporting period using a risk-free discount rate, with any changes recognized in decommissioning liability and property, plant and equipment ("PP&E") on the balance sheet. The cost of an acquisition is measured as the fair value of the assets transferred, equity instruments issued, and liabilities incurred or assumed at the acquisition date. The excess of the acquisition cost over the fair value of the net assets acquired is recognized as goodwill. If the cost of the acquisition is less than the fair value of the net assets acquired, a gain on business combination is recognized immediately in the statement of loss and comprehensive loss. A deferred tax asset or liability arising from the acquired net assets is also recognized in a business combination. Any resulting goodwill or a gain resulting from a bargain purchase is not considered to be taxable. Transaction costs associated with a business combination are expensed as incurred.

2. Summary of significant accounting policies (continued)

n) Significant accounting estimates judgments and estimates

The preparation of the consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect reported amounts and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Such estimates primarily relate to unsettled transactions and events at the statement of financial position date which are based on information available to management at each financial statement date. Actual results could differ from those estimated. Judgments, estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

<u>Critical judgments in applying accounting policies</u>

Business combinations

Determination of the fair value of acquired assets and liabilities in a business combination requires management to make assumptions and estimates about future events. The fair value of crude oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from crude oil and natural gas production. These assumptions and estimates generally require judgment and include estimates of reserves acquired, liabilities assumed, forecast commodity prices, expected production volumes, future development and operating costs, income taxes, and discount rates. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to the net assets acquired, goodwill or gain on business combination.

Cash-generating-units ("CGU") determination

The Company's assets are aggregated into cash-generating-units ("CGUs") based on their ability to generate largely independent cash flows and are used for impairment testing. CGUs are determined by similar geological structure, similar exposure to market risk, shared infrastructure and geographical proximity.

Impairment indicator assessment

The Company assesses its P&E and E&E assets for possible impairment if there are events or changes in circumstances that indicate the carrying values of the assets may not be recoverable. Such indicators include changes in the Company's business plans, changes in commodity prices, evidence of physical damage and significant downward revisions to estimated recoverable volumes or increases in estimated future development expenditures.

Contingencies

By their nature, contingencies will only be resolved when one or more of the future events occur or fail to occur. The recognition of contingencies inherently involves the estimates of the outcome of future events.

2. Summary of significant accounting policies (continued)

n) Significant accounting judgments and estimates (continued)

Key sources of estimation uncertainty

Reserves

Reserves are used in the unit of production calculation for depletion and depreciation as well as impairment analysis. The quantity of reserves is subject to a number of estimates and projections including assessment of engineering data, projected future rates of production, commodity prices, regulatory changes, operating costs and sustaining capital expenditures. However, all reserve and associated financial information is evaluated and reported on by a firm of qualified independent reserve evaluators in accordance with the standards prescribed by applicable securities regulators. The calculation of future cash flows based on these reserves is dependent on a number of estimates including: production volumes, facility performance, commodity prices, and royalties, operating costs, sustaining capital and tax rates. The price used in the Company's assessment of future cash flows is based on the Company's independent evaluator's estimate of future prices and evaluated for reasonability by the Company against other available information.

Decommissioning liabilities

The Company measures decommissioning liabilities at each financial statement date. The estimate is based on the Company's share of costs to reclaim the assets and certain facilities. To determine the future value of the liability, estimates of the amount, timing and inflation of the associated abandonment costs are made. The present value of the cost is recorded as the decommissioning liability using a risk-free discount rate. Due to the long-term nature of current and future project developments, abandonment costs will be incurred many years in the future. Because of these factors, different estimates could be used for such abandonment costs and the associated timing. Assumptions of higher future abandonment costs, regulatory changes, higher inflation, lower risk-free rates or an assumption of earlier or specified timing of abandonment would cause the decommissioning liability of the corresponding asset to increase. These changes would also cause future accretion expenses to increase.

Impairment Estimate

The assessment for impairment for P&E and E&E assets involves comparing the carrying value of the CGU with the higher of value in use calculations and fair value less costs of disposal. Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation on operating expenses, discount rates, production profiles and the outlook for regional supply-and-demand conditions for crude oil, natural gas and liquids. Impairment is recognized in the statement of income and comprehensive income in the period in which carrying amount exceeded the recoverable amount. Impairment reversals are recognized to the extent of the original impairment but are limited to the net book value that would have existed had the original impairment never been recorded, including estimates for depletion. In determining the appropriate discount rate the Company considers the acquisition metrics of recent transactions completed on similar assets to those in the specific CGU.

Accounts Receivable

Significant estimates are included in accounts receivable in terms of collectability as a significant portion of the balance is in dispute, the outcome for which is uncertain and could result in a material adjustment to the financial statements.

2. Summary of significant accounting policies (continued)

Key sources of estimation uncertainty (continued)

Deferred taxes

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. Deferred tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

Contingencies

When recognized, management makes its best estimate with respect to future cash outflow.

Other areas of estimates

The recognition of amounts in relation to stock-based compensation requires estimates related to valuation of stock options at the time of issuance including share price, risk free rate, volatility, expected life and dividend yield.

The fair value of commodity and interest rate contracts is calculated using valuation models that require estimates as to future market prices expected interest rates and expected volatility in these variables. By their nature, these estimates are subject to measurement uncertainty and the effect of changes in such estimates on the financial statements for current and future periods could be significant.

o) Pending Accounting standards

IFRS 16 Leases issued on January 13, 2016 by the IASB replaces IAS 17 Leases. The new standard introduces a single recognition and measurement model for leases, which would require the recognition of assets and liabilities for most leases with a term of more than twelve months. The new standard is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for entities that apply IFRS 15 "Revenue from Contracts with Customers" at or before the initial adoption date of January 1, 2018. Management is currently assessing any potential impact of the adoption of IFRS 16.

In April 2016, the IASB issued its final amendments to IFRS 15 Revenue from Contracts with Customers, which replaces IAS 18 Revenue, IAS 11 Construction Contracts, and related interpretations. The standard is required to be adopted either retrospectively or using a modified retrospective approach for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by Yangarra on January 1, 2018. The Company expects no material impact on net income or the statements of financial position and the Company will add the required note disclosure.

In July 2014, the IASB completed the final elements of IFRS 9 "Financial Instruments." The Standard supersedes earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 "Financial Instruments: Recognition and Measurement." IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. The Standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied by the Company on January 1, 2018. The Company expects no material impact on net income or the statements of financial position and the Company will add the required note disclosure.

3. Property and equipment

	Oil and Natural Gas Interests	Well and Plant Equipment	Other Assets	Total
Cost				
Balance at December 31, 2015	$ 265,301,069	$ 51,939,916	$ 1,824,464	$ 319,065,449
Cash additions	23,468,574	4,085,067	119,125	27,672,766
Property acquisition	22,323,000	–	–	22,323,000
Capitalized share-based compensation	334,533	–	–	334,533
Decommissioning liability	(1,362,468)	–	–	(1,362,468)
Balance at December 31, 2016	310,064,708	56,024,983	1,943,589	368,033,280
Cash additions	**72,298,450**	**10,853,654**	**319,990**	**83,472,094**
Capitalized share-based compensation	**671,416**	–	–	**671,416**
Decommissioning liability	**1,381,208**	–	–	**1,381,208**
Decommissioning costs incurred	**95,433**	–	–	**95,433**
Transfer from E&E	**729,600**	–	–	**729,600**
Balance at December 31, 2017	**$ 385,240,815**	**$ 66,878,637**	**$ 2,263,579**	**$ 454,383,031**
Depletion, depreciation and impairment				
Balance at December 31, 2015	$ 66,978,371	$ 7,367,300	$ 1,010,393	$ 75,356,064
Depletion and depreciation	13,212,900	716,400	297,440	14,226,740
Asset impairment	756,845	–	–	756,845
Balance at December 31, 2016	80,948,116	8,083,700	1,307,833	90,339,649
Depletion and depreciation	**20,516,400**	**1,167,600**	**259,423**	**21,943,423**
Balance at December 31, 2017	**$ 101,464,516**	**$ 9,251,300**	**$ 1,567,256**	**$ 112,283,072**
At December 31, 2016	$ 229,116,592	$ 47,941,283	$ 635,756	$ 277,693,631
At December 31, 2017	**$ 283,776,299**	**$ 57,627,337**	**$ 696,323**	**$ 342,099,959**

The depletion, depreciation and impairment of property and equipment, and any eventual reversal thereof, are recognized in the consolidated statement of income and comprehensive income. At December 31, 2017, all of the Company's properties are pledged as security for the bank debt (see note 5). The calculation of depletion for the year ended December 31, 2017 included estimated future development costs of $553 million (2016 – $366 million) associated with the development of the Company's proved plus probable reserves.

During the year ended December 31, 2017, the Company capitalized $1,381,208 (2016 – ($1,362,468)) related to the decommissioning liability of property and equipment and $671,416 (2016 – $334,533) of share-based compensation. The Company also capitalized $1,017,628 (2016 - $472,730) of recoveries related to the Company's working interest in operated capital expenditure programs on which overhead has been charged in accordance with standard industry operating agreements. During the year ended December 31, 2017, the Company capitalized $639,946 (2016 – $549,354) of salaries and consulting expenses directly related to geological services, drilling and completions.

At December 31, 2017, the Company performed a review of each of our CGUs for any indicators of impairment. The Company has two CGU's (2016 – three), one for Ferrier and one for Medicine Hat. There were no impairment indicators in the year ended December 31, 2017 (2016 - $756,845 - Jaslan CGU).

3. Property and equipment (continued)

On January 1, 2016, Yangarra closed the acquisition of certain strategic light oil assets in Yangarra's Central Alberta core area. The property acquisition was accounted for as a business combination under IFRS 3. The acquisition included a cash component, forgiveness of accounts receivable balances and the settlement of a lawsuit between the two parties. The fair value of the petroleum and natural gas properties acquired was determined using the total proved ("1P") value as at January 1, 2016, discounted at 10%, prepared by an independent reserve evaluator.

Net Assets Acquired		
Petroleum and natural gas properties	$	**22,323,000**
Decommissioning liability		**(693,818)**
Deferred tax liability		**(4,838,802)**
	$	**16,790,380**
Consideration		
Cash	$	**1,400,000**
Working capital		**2,307,693**
Gain on settlement of lawsuit		**13,082,687**
	$	**16,790,380**

4. Exploration and evaluation assets

Cost		
Balance at December 31, 2016	$	16,538,299
Transfer to Property and Equipment		**(729,600)**
Balance at December 31, 2017	$	**15,808,699**
Impairment losses		
Balance at December 31, 2016	$	9,775,834
Impairment		**–**
Balance at December 31, 2017	$	**9,775,834**
Net book value		
At December 31, 2016	$	6,762,465
At December 31, 2017	$	**6,032,865**

Exploration and evaluation ("E&E") assets consist of the Company's undeveloped land which is pending the determination of proven or probable reserves.

5. Bank debt

As at December 31, 2016, the Company had a $80 million revolving operating demand loan in place with Alberta Treasury Branches with $65 million drawn.

On May 12, 2017, Yangarra repaid the $72 million drawn on the revolving operating demand loan and entered into a $100 million syndicated credit facility. The banking syndicate was led by Alberta Treasury Branches and included Canadian Imperial Bank of Commerce. On November 16, 2017 the syndicated credit facility was increased to $120 million and National Bank of Canada was added.

5. Bank debt (continued)

As at December 31, 2017, the maximum amount available under the syndicated credit facility was $120 million comprised of a $110 million extendible revolving term credit facility and a $10 million operating facility. The amount available under these facilities is re-determined at least twice a year and is primarily based on the Company's oil and gas reserves, the lending institution's forecast commodity prices, the current economic environment and other factors as determined by the syndicate of lending institutions (the "Borrowing Base"). If the total advances made under the credit facilities are greater than the re-determined Borrowing Base, the Company has 60 days to repay any shortfall. The initial maturity date of the facility is May 31, 2019 (the "Initial Maturity Date") and the next Borrowing Base review is scheduled for May 31, 2018. The Initial Maturity Date may be extended for 364 day periods pursuant to delivery of a request for extension by the Company within certain time periods specified in the syndicated credit facility agreement.

As at December 31, 2017, the $84,886,124 (2016 – $65,140,999) reported amount of bank debt was comprised of $412,132 drawn on the operating facility, $84,821,111 drawn on the extendible revolving term credit facility in bankers' acceptance and net of unamortized transaction costs of $347,119.

The Company is subject to a single financial covenant requiring an adjusted working capital ratio above 1:1 (current assets plus the undrawn availability under the revolving facility, divided by the current liabilities less the drawn portion of the revolving facility, excluding unrealized commodity contracts and flow-through share premium obligation). The Company was in compliance with this covenant as at December 31, 2017. The facility is secured by a general security agreement over all assets of the Company.

The total stamping fees range, depending on the debt to EBITDA ratio, between 100 bps to 250 bps on bank prime borrowings and between 200 bps and 350 bps on bankers' acceptances. The undrawn portion of the credit facility is subject to a standby fee in the range of 50 bps to 87.5 bps. During the year ended December 31, 2017, the weighted average effective interest rate for the bank debt was 3.19% (2016 – 3.31%).

6. Decommissioning liability

The following table presents the reconciliation of the carrying amount of the liability associated with the decommissioning of the Company's property and equipment:

	December 31, 2017	*December 31, 2016*
Balance, beginning of year	**$ 8,096,560**	$ 9,191,316
Liabilities incurred	**1,690,870**	383,193
Property acquisition	**–**	693,818
Decommissioning costs incurred	**(95,433)**	(608,463)
Effect of change in estimates	**(214,229)**	(1,745,661)
Accretion	**598,287**	182,357
Balance, end of year	**$ 10,076,055**	$ 8,096,560

The following significant assumptions were used to estimate the decommissioning liability:

	December 31, 2017	*December 31, 2016*
Undiscounted cash flows	**$ 12,175,616**	$ 10,178,407
Discount rate	**1.31% - 2.47%**	0.76% - 2.31%
Inflation rate	**2%**	2%
Weighted average expected timing of cash flows	**10 years**	10 years

7. Share capital

a. Authorized

Unlimited number of common shares, without nominal or par value
Unlimited number of preferred shares, without nominal or par value

b. Common shares issued

	Number of shares		*Amount ($)*
Balance, December 31, 2015	67,681,804	$	151,345,752
Equity financing *(i)*	11,500,000		11,500,000
Share issue costs (net of $217,205 in tax)	–		(587,256)
Exercise of stock options	634,007		523,071
Contributed surplus transferred on exercise of stock options	–		271,230
Balance, December 31, 2016	79,815,811		163,052,797
Exercise of stock options	**1,562,679**		**2,179,593**
Contributed surplus transferred on exercise of stock options	**–**		**1,153,852**
Balance, December 31, 2017	**81,378,490**	**$**	**166,386,242**

i) On May 25, 2016 the Company closed a "bought deal" financing, completed by way of a short form prospectus. 11,500,000 common shares were issued at a price of $1.00 per common share for gross proceeds of $11,500,000.

8. Share-based compensation

The Company has an equity settled stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. The purpose of the plan is to advance the interests of the Company by encouraging these individuals to acquire shares in the Company and thereby remain associated with, and seek to maximize the value of, the Company. Under the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 10% of the issued and outstanding common shares on a non-diluted basis at any time. The options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and vest over terms determined at the time of grant.

During the year ended December 31, 2017, the Company granted options to purchase 1,558,342 common shares, the options will vest equally over three years with the first tranche vesting one year after the grant date. The fair value of the options was estimated at $2,561,675 ($1.64 per option) using the Black-Scholes pricing model.

During the year ended December 31, 2017 the Company recognized $1,506,329 (2016 – $1,041,717) of stock-based compensation on the income statement and capitalized $671,416 (2016 - $334,533) related to property and equipment.

8. Share-based compensation (continued)

The following tables summarize information about stock options outstanding as at:

	December 31, 2017		*December 31, 2016*	
	Options	***Weighted – average exercise price***	*Options*	*Weighted – average exercise price*
Opening	**7,888,198**	**$1.50**	6,749,700	$1.59
Granted	**1,558,342**	**2.60**	2,524,176	1.24
Exercised	**(1,562,679)**	**1.40**	(634,007)	0.83
Expired	**–**	**–**	(683,337)	2.14
Forfeited	**(20,000)**	**2.71**	(68,334)	0.94
Closing	**7,863,861**	**$1.85**	7,888,198	$1.50

The following provides a summary of the stock option plan as at December 31, 2017:

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.50 – $ 1.00	**1,481,555**	**2.72**	**$ 0.74**	**714,554**
$ 1.01 – $ 1.50	**1,747,227**	**3.87**	**1.32**	**1,035,557**
$ 1.51 – $ 2.00	**2,285,064**	**2.49**	**1.81**	**1,486,004**
$ 2.01 – $ 2.50	**166,667**	**1.15**	**2.28**	**166,667**
$ 2.51 – $ 3.00	**1,359,842**	**2.83**	**2.71**	**640,006**
$ 3.01 – $ 3.50	**613,228**	**4.57**	**3.28**	**–**
$ 3.51 – $ 4.00	**17,778**	**4.74**	**3.79**	**–**
$ 4.01 – $ 4.50	**117,500**	**4.92**	**4.22**	**–**
$ 4.51 – $ 5.00	**75,000**	**4.93**	**4.80**	**–**
	7,863,861	**3.10**	**$ 1.85**	**4,042,788**

The following provides a summary of the stock option plan as at December 31, 2016:

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.50 – $ 1.00	1,807,669	3.56	$ 0.74	435,009
$ 1.01 – $ 1.50	2,385,847	3.86	1.29	573,342
$ 1.51 – $ 2.00	2,713,008	3.27	1.80	1,001,002
$ 2.01 – $ 2.50	333,334	2.15	2.28	333,334
$ 2.51 – $ 3.00	648,340	2.25	2.70	432,227
	7,888,198	3.38	$ 1.50	2,774,914

8. Share-based compensation (continued)

The Black-Scholes pricing model was used to estimate the fair value of options granted based on the following significant assumptions:

	2017	*2016*
Weighted average exercise per option	**$3.17**	$1.24
Risk-free interest rate	**0.91% - 1.80%**	0.57% - 0.71%
Expected volatility	**63% - 68%**	68%
Weighted average expected life	**4.87 years**	5 years
Forfeiture rate	**5%**	5%
Weighted average fair value per option	**$1.64**	$0.66

9. Earnings per common share

	2017	2016
Net income for the period	$ **19,485,327**	$ 10,168,751
Weighted average number of shares (basic)		
Issued common shares at beginning of year	**79,815,811**	67,681,804
Effect of shares issued	**–**	6,912,568
Stock options exercised	**904,123**	41,576
Weighted average number of common shares - basic	**80,719,934**	74,635,948

Diluted earnings per share was calculated as follows:

Weighted average number of shares (diluted)		
Weighted average number of shares (basic)	**80,719,934**	74,635,948
Effect of outstanding options	**3,436,748**	487,318
Weighted average number of common shares - diluted	**84,156,682**	75,123,266

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding. For the year ended December 31, 2017, 686,838 (2016 – 6,047,195) options are excluded as they are out of the money based on an average share price of $3.24 (2016 – $1.04) for the year.

10. Change in non-cash working capital

		2017		2016
Accounts receivable	$	**(15,188,775)**	$	(3,250,977)
Prepaid expenses and deposits		**4,187**		(79,453)
Accounts payable and accrued liabilities		**23,966,910**		2,132,245
	$	**8,782,322**	$	(1,198,185)

The changes in non-cash working capital has been allocated to the following activities:

Operating	$	**(1,032,343)**	$	582,625
Financing		**–**		–
Investing		**9,814,665**		(1,780,810)
	$	**8,782,322**	$	(1,198,185)

11. Taxes

The provision for income taxes differs from the amount computed by applying the combined federal and provincial tax rates to the income before income tax. The difference results from the following:

		2017		*2016*
Income before income taxes	$	**27,345,553**	$	10,184,658
Combined federal and provincial statutory income tax rate		**27.0%**		27.0%
Expected income tax expense	$	**7,383,299**	$	2,749,858
Stock-based compensation		**425,328**		281,264
Impact of change in effective rate		–		–
Settlement of flow-through share obligation		–		394,615
Gain on settlement of lawsuit		–		(3,532,325)
Other		**51,598**		122,495
	$	**7,860,226**	$	15,907

The 2017 corporate tax rate was 27.0% (2016 – 27.0%).

The components of the net deferred tax asset (liability) are:

	Balance December 31, 2016	*Recognized in Income*	*Balance December 31, 2017*
Decommissioning liability	2,186,071	**534,464**	**2,720,535**
Non-capital loss carry-forwards	278,251	–	**278,251**
Share issue costs	653,189	**(257,171)**	**396,018**
Commodity price risk contracts	306,243	**640,879**	**947,122**
Interest rate contracts	164,316	**(233,434)**	**(69,118)**
Property and equipment	(28,873,071)	**(8,544,964)**	**(37,418,035)**
	(25,285,001)	**(7,860,226)**	**(33,145,227)**

11. Taxes (continued)

	Balance December 31, 2015	*Recognized in Income*	*Flow Through Share Premium*	*Recognized in Equity*	*Balance December 31, 2016*
Decommissioning liability	2,481,655	(295,584)	–	–	2,186,071
Non-capital loss carry-forwards	278,251	–	–	–	278,251
Share issue costs	693,156	(257,172)	–	217,205	653,189
Commodity price risk contracts	(624,216)	930,459	–	–	306,243
Interest rate contracts	181,716	(17,400)	–	–	164,316
Property and equipment	(23,026,423)	(376,210)	(5,470,438)	–	(28,873,071)
	(20,015,861)	(15,907)	(5,470,438)	217,205	(25,285,001)

As at December 31, 2017, the Company has approximately $210 million of tax pools available for deduction against future taxable income.

12. Related party disclosure

The consolidated financial statements include the financial statements of the Company and the subsidiary listed below:

Name	*Country of Incorporation*	*% equity interest* *2017*	*2016*
Yangarra Resources Corp.	Canada	100%	100%

Balances between the Company and its subsidiary have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Company and other related parties are disclosed below.

During the year ended December 31, 2017 and 2016, the Company was charged or invoiced the following amounts by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors:

		2017		2016
Administration and consulting fees	$	**557,917**	$	308,785
Production and capital expenditures		**364,175**		504,380
	$	**922,092**	$	813,165

Compensation of key management personal (Directors and Officers):

		2017		2016
Compensation	$	**1,525,000**	$	1,322,000
Share-based payments		**1,628,002**		903,783
	$	**3,153,002**	$	2,225,783

Included in accounts payable and accrued liabilities at December 31, 2017 is $23,193 (December 31, 2016 - $6,986) relating to the above transactions. These transactions were in the normal course of operations and were measured at fair value. Other long-term liabilities include a mortgage for $169,799 (December 31, 2016 - $211,962) held in the name of an officer of the Company for a property that is used as a field office. The Company is the beneficial owner through a trust agreement of the property against which the mortgage is secured. All mortgage payments are made by the Company.

13. Financial instruments and financial risk management

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has implemented and monitors compliance with the risk management policies as set out herein:

a. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and partners on joint operations in the oil and gas industry and are subject to normal industry credit risks.

Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at December 31, 2017, the maximum credit exposure is the carrying amount of the accounts receivable of $26,413,976 (December 31, 2016 – $11,225,201). The maximum exposure to credit risk for accounts receivable as at December 31, 2017 and December 31, 2016 by type of customer was:

		December 31, 2017		December 31, 2016
Natural gas and liquids marketers	$	**12,737,640**	$	3,479,225
Partners on joint operations		**11,159,533**		6,781,799
Realized commodity contracts		**67,093**		16,033
Other		**2,449,710**		948,144
	$	**26,413,976**	$	11,225,201

Receivables from natural gas and liquids marketers are typically collected on the 25th day of the month following production. The Company has mitigated the credit risk associated with the natural gas and liquids marketer through a security arrangement with Computershare. The Company historically has not experienced any significant collection issues with its natural gas and liquids marketers. All the revenue accruals and receivables from natural gas and liquids marketers were received in January 2018.

Receivables from partners on joint operations are typically collected within one to three months of the bill being issued to the partner. The Company mitigates the risk from receivables from partners on joint operations by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with partners on joint operations as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from partners on joint operations who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to partners on joint operations from which it can net receivable balances.

13. Financial instruments and financial risk management (continued)

As at December 31, 2017 and December 31, 2016, the Company considers its receivables to be aged as follows:

		December 31, 2017		December 31, 2016
Under 30 days	$	**17,449,229**	$	4,979,900
30 to 60 days		**2,003,025**		116,009
60 to 90 days		**168,871**		85,308
Over 90 days		**6,792,851**		6,043,984
	$	**26,413,976**	$	11,225,201

90% of the over 90-day receivables are made up of two industry partners. The Company has performed an analysis of each partner's financial situation and have determined they have the ability to pay. Included in the over 90-day receivables are balances with a significant portion in dispute with two of the industry partners (see note 16). The Company did not provide for any doubtful accounts nor write-off any accounts receivable during the year ended December 31, 2017.

Risk management assets and liabilities consist of commodity contracts used to manage the Company's exposure to fluctuations in commodity prices. The Company manages the credit risk exposure related to risk management contracts by selecting investment grade counterparties and by not entering into contracts for trading or speculative purposes. During 2017 and 2016, the Company did not experience any collection issues with risk management contracts. The Company typically does not obtain or post collateral or security from its oil and natural gas marketers or financial institution counterparties. The carrying amounts of accounts receivable represent the maximum credit exposure

b. Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation. The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

To facilitate the capital expenditure program, the Company has a credit facility agreement which is regularly reviewed by the lender. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows and availability on bank facilities. The Company's financial liabilities are comprised of accounts payable and accrued liabilities, interest rate contracts, commodity contracts, other long-term liabilities and bank debt, which are classified as current or non-current on the consolidated statement of financial position based on their maturity dates.

The Company has been funding the 2018 budget with cash flow from operations and the $35 million available on credit facility (see note 5).

13. Financial instruments and financial risk management (continued)

As at December 31, 2017, the contractual maturities of the Company's obligations are as follows:

	Carrying Amount	Contractual Cash Flows	Less than 1 year	1-2 Years	2-5 Years	More than 5 years
Accounts payable and accrued liabilities	38,421,687	38,421,687	38,421,687	-	-	-
Bank debt	84,886,124	84,886,124	-	84,886,124	-	-
Other long-term liabilities	169,798	169,798	43,488	45,431	80,879	-
Commodity contracts	3,507,861	3,507,861	2,532,196	975,665	-	-
Interest rate contract	68,037	68,037	68,037	-	-	-
	127,053,507	127,053,507	41,065,408	85,907,220	80,879	-

c. Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy as set out herein:

i. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears interest at a floating rate and to mitigate this risk, the Company has entered into interest rate contracts. For the year ended December 31, 2017, if interest rates (including the effect of the interest rate contract) had been 1% lower with all other variables held constant, income for the period would have been $855,766 (2016 - $643,881) higher, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amount.

The Company had the following interest rate contracts in place at December 31, 2017:

Contracts		**Fair Value**
Pay a floating rate to receive a 2.35% (plus a 2.50% credit spread) fixed rate on $10 million (January 2018-June 2018)	$	(40,565)
Pay a floating rate to receive a 2.15% (plus a 2.50% credit spread) fixed rate on $10 million (January 2018-May 2018)	$	(27,472)
Pay a floating rate to receive a 1.945% (plus a 2.50% credit spread) fixed rate on $10 million (June 2018-November 2023)	$	159,811
Pay a floating rate to receive a 1.935% (plus a 2.50% credit spread) fixed rate on $10 million (May 2018-November 2023)	$	164,219
	$	255,993

13. Financial instruments and financial risk management (continued)

ii. Currency risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars, however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at December 31, 2017.

iii. Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above.

As at December 31, 2017, the Company was committed to the following commodity price risk contracts:

Year	Volume	Term	Reference	Type	Strike Price		Fair Value
Oil							
2018	200 bbl/d	Jan to Dec	CDN$ WTI	Collar	CDN$ 62.50/bbl-75.90/bbl	$	(125,992)
2018	300 bbl/d	Jan to Jun	CDN$ WTI	Collar	CDN$ 62.50/bbl-76.10/bbl	$	(111,172)
2018	300 bbl/d	Jan to Dec	CDN$ WTI	Swap	CDN$ 71.60/bbl	$	(304,721)
2018	300 bbl/d	Jan to Jun	CDN$ WTI	Swap	CDN$ 75.17/bbl	$	(21,784)
2018	300 bbl/d	Jan to Jun	US$ WTI	Swap	US$ 49.10/bbl	$	(855,005)
2018	300 bbl/d	Jan to Jun	US$ WTI	Swap	US$ 52.15/bbl	$	(537,352)
2018	300 bbl/d	Jan to Jun	US$ WTI	Swap	US$ 56.75/bbl	$	(212,590)
2018	200 bbl/d	Jan to Dec	US$ WTI	Sold Call	US$ 70.00/bbl	$	(41,894)
2018	300 bbl/d	Jul to Dec	CDN$ WTI	Sold Call	CDN$ 75.17/bbl	$	(141,396)
2019	500 bbl/d	Jan to Dec	US$ WTI	Sold Call	US$ 60.00/bbl	$	(793,742)
2019	200 bbl/d	Jan to Dec	US$ WTI	Sold Call	US$ 65.00/bbl	$	(181,923)
Propane							
2018	200 bbl/d	Jan to Dec	Conway - C3	Swap	USD$32.34	$	(180,290)
Total						**$**	**(3,507,861)**

The following contracts were entered into after December 31, 2017:

Year	Volume	Term	Reference	Type	Strike Price
Oil					
2018	200 bbl/d	Jul to Dec	US$ WTI	Collar	US$ 55.00/bbl-64.40/bbl
2018	300 bbl/d	Feb to Jun	US$ WTI	Swap	US$61.00
2018	300 bbl/d	Jul to Dec	CDN$ WTI	Swap	CDN$ 75.40/bbl
2018	300 bbl/d	Jul to Dec	CDN$ WTI	Swap	CDN$ 75.40/bbl
2018	300 bbl/d	Jul to Dec	CDN$ WTI	Swap	CDN$ 76.00/bbl
2018	300 bbl/d	Mar to Dec	CDN$ WTI	Swap	CDN$ 78.20/bbl

13. Financial instruments and financial risk management (continued)

The following table summarizes the sensitivity of the fair value of the Company's derivative positions as at December 31, 2017 to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, the Company believes 10 percent volatility in commodity prices is a reasonable measure ($5.96/bbl for oil). Fluctuations in commodity prices potentially could have resulted in unrealized gains (losses) impacting income before tax as follows:

	Impact on Income Before Tax	
	Increase 10%	Decrease 10%
Crude oil	$ (2,685,873)	$ 1,785,772

d. Fair value of financial instruments

The fair value of accounts receivable, deposits and accounts payable and accrued liabilities approximate their carrying amount due to the short-term nature of the instruments. The fair value of the Company's long-term debt approximates its carrying value as the interest rates charged on this debt are comparable to current market rates. The fair values of the Company's risk management contracts are determined by discounting the difference between the contracted prices and published forward price curves as at the balance sheet date, using the remaining contracted oil volumes and a risk-free interest rate (based on published government rates).

The following table summarizes the carrying value and fair value of the Company's risk management assets and liabilities.

		December 31, 2017		December 31, 2016	
	Measurement Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets					
Financial assets at fair value through profit or loss:					
Risk management assets	2	$ 324,030	$ 324,030	$ -	$ -
Financial Liabilities					
Financial Liabilities at fair value through profit or loss:					
Risk management Liabilities	2	$ 3,575,898	$ 3,575,898	$ 1,742,810	$ 1,742,810

The fair values of financial instruments have been determined by various valuation methods as defined below:

- Level 1: fair value is based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: fair value is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: fair value is based on inputs for the asset or liability that are not based on observable market data (unobservable inputs).

14. Capital disclosures

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include shareholders equity and debt:

		December 31, 2017		*December 31, 2016*
Shareholders' equity	$	**207,956,623**	$	184,113,958
Bank debt	$	**84,886,124**	$	65,140,999

The Company monitors capital based on annual cash from operations before changes in non-cash working capital and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company considers its forecasted cash from operations before changes in non-cash working capital while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank debt available from the Company's lender, the level of bank debt that may be attainable from its lender as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms. At December 31, 2017, the Company's capital structure was subject to the banking covenants disclosed in note 5. No changes were made to the capital policy in 2017.

15. Finance expenses

During the year ended December 31, 2017 and 2016, the following items were included in the finance expense on the consolidated statements of income and comprehensive income:

		2017		2016
Interest & finance costs	$	**2,728,223**	$	2,186,954
Realized loss on interest rate contracts		**242,744**		275,018
Change in fair value of interest rate contracts *(note 13)*		**(864,571)**		(64,444)
Accretion of decommissioning liability *(note 6)*		**598,287**		182,357
Accretion of debt transaction costs		**139,744**		–
	$	**2,844,427**	$	2,579,885

16. Contingency

In 2016, the Company served an industry partner with a Statement of Claim issued from The Court of Queen's Bench of Alberta, by which the Company claims production was misallocated on a number of wells the industry partner was operating. The industry partner has filed a Statement of Defense. The potential outcome of the lawsuit and claims are uncertain; however, they could be material.

In the normal conduct of operations, there are other pending claims by and against the Company. Litigation is subject to many uncertainties, and the outcome of individual matters is not predictable with assurance. In the opinion of management, based on the advice and information provided by its legal counsel, the final determination of these other litigations will not materially affect the Company's financial position or results of operations.

17. Commitments

The Company has entered into lease agreements for office premises and Company vehicles with payments as follows:

2018	$	543,503
2019	$	512,187
2020	$	480,965
2021	$	232,716
Thereafter	$	72,616