

**BLACKSTEEL ENERGY INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the three and six months ended**  
**OCTOBER 31, 2018**

**Report Date: December 28, 2018**

# BLACKSTEEL ENERGY INC.

## Corporate Information

---

This Management's Discussion and Analysis ("**MD&A**") of the financial condition and results of operations of Blacksteel Energy Inc. (the "**Corporation**" or "**Blacksteel**") is dated December 28, 2018 and should be read in conjunction with the condensed interim financial statements including notes to the financial statements for the three and six months ended October 31, 2018 (the "**Financial Statements**").

The condensed interim financial statements have been prepared by management in accordance with International Financial Reporting Standards ("**IFRS**") and this MD&A should be read in conjunction with these condensed interim financial statements. The preparation of the condensed interim financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, at the date of the condensed interim financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

Blacksteel's Audit Committee and Board of Directors have reviewed and, on December 28, 2018, approved this MD&A and the accompanying condensed interim financial statements.

## FORWARD-LOOKING INFORMATION

This MD&A may include forward-looking statements including opinions, assumptions, estimates and management's assessment of future plans and operations, expected accretion expenses, expectations as to the non-taxability of the Corporation and capital expenditures and the timing and funding thereof. When used in this document, the words "anticipate," "believe," "estimate," "expect," "intent," "may," "project," "plan", "should" and similar expressions are intended to be among the statements that identify forward-looking statements. Forward-looking statements are subject to a wide range of risks and uncertainties, and although the Corporation believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will be realized. Any number of important factors could cause actual results to differ materially from those in the forward-looking statements including, but not limited to, risks associated with petroleum and natural gas exploration, development, exploitation, production, marketing and transportation, the volatility of petroleum and natural gas prices, currency fluctuations, the ability to implement corporate strategies, the state of domestic capital markets, the ability to obtain financing, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, changes in petroleum and natural gas acquisition and drilling programs, delays resulting from inability to obtain required regulatory approvals, delays resulting from inability to obtain drilling rigs and other services, labour supply risks, environmental risks, competition from other producers, imprecision of reserve estimates, changes in general economic conditions, whether farm-in and farm-out opportunities result in agreements and other factors more fully described from time to time in the reports and filings made by the Corporation with securities regulatory authorities.

Statements relating to "reserves" or "resources" are deemed to be forwardlooking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. Readers are cautioned not to place undue reliance on forward-looking statements, as no assurances can be given as to future results, levels of activity or achievements.

The Corporation's policy for updating forward-looking information is to discuss significant variances from previously reported material forward-looking information in future MD&A's.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

### HIGHLIGHTS

#### Operational

- Corporation's current light oil production from three wells is approximately 25 barrels per day.
- The Corporation, together with the operator of the Girouville, property continues to look for ways to optimize production and reduce operating costs in order to maximize operating cash flow.

#### Financial

- Working capital of \$316,740 at October 31, 2018.
- Net loss for the three and six months period ended October 31, 2018, was \$122,270 and \$202,586 compared to a net loss of \$152,411 and \$248,405 for the comparative periods last year.
- The Corporation continues to work toward completing the proposed Drakkar Energy Ltd. transaction announced in its July 5, 2018 press release. Updates on the transaction will be made in due course.

### CORPORATE OVERVIEW

Blacksteel, incorporated under *the Business Corporations Act (Alberta)*, is a public early stage oil and gas company whose principal business activity is in the exploration, exploitation, development and production of petroleum and natural gas resources in the Western Canadian Sedimentary Basin.

#### Share Capital

Since its inception, the Corporation has raised capital several times. The details of share capital transactions during the period ended October 31, 2018 and the year ended April 30, 2018 are as follows:

<b>Class A common shares issued and outstanding</b>	<b>Number of shares</b>	<b>Stated Value</b>
<b>Balance, April 30, 2017</b>	36,108,451	\$ 15,166,660
Common shares cancellation <sup>(1)</sup>	(1,058,000)	(444,640)
Warrants exercised	550,965	215,609
<b>Balance, April 30, 2018</b>	<b>35,601,416</b>	<b>\$ 14,937,629</b>
Warrants exercised	626,000	244,954
<b>Balance, October 31, 2018</b>	<b>36,227,416</b>	<b>\$ 15,182,583</b>

- (1) On August 4, 2017, the Corporation entered into a securities exchange agreement with TERIC and the Corporation's directors. The agreement resulted in the redemption of 1,058,000 common shares held by TERIC (note 5). The excess of the stated value of the redeemed shares of \$444,640 over the consideration paid of \$132,333, through the forgiveness of the loan receivable, was credited to contributed surplus.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

### SELECTED FINANCIAL INFORMATION

Below is a table comparing relevant financial information of the years ended April 30, 2018, 2017 and 2016.

	April 30, 2018	April 30, 2017	April 30, 2016
Petroleum and natural gas revenue, gross	\$ 535,700	\$ 98,800	\$ -
Net loss	547,654	814,478	438,659
Loss per share, basic and diluted	0.02	0.02	0.01
Total assets	1,759,904	1,948,572	2,325,848
Total long-term liabilities	2,111,021	1,805,068	1,487,336
Weighted average number of Class A common shares outstanding, basic and diluted	33,374,555	36,108,451	33,071,839

During the year ended April 30, 2017, the Corporation wrote down the TERIC \$610,000 loan receivable to its expected fair value of \$372,627, based on expected future collectability. Interest receivable of \$75,573 on the loan was also written off.

### RESULTS OF OPERATIONS

#### Revenue/Cost of Goods Sold and Gross Profit

During the three and six months ended October 31, 2018, the Corporation realized average daily production of 27 and 29 barrels ("bbls") respectively (2017 – 22 and 28 respectively), total oil production of 2,524 and 5,245 respectively (2017 – 2,042 and 4,690 respectively) resulting in sales of \$130,527 and \$326,176 respectively (2017 - \$134,570 and 254,295 respectively) or approximately \$52 and \$62 per barrel (2017 - \$65 and \$54). Royalty were \$59,759 and \$139,574 respectively (2017 - \$40,756 and \$75,217). Operating expenses were \$48,014 and 141,110 respectively (2017 - \$99,100 and \$168,889 respectively), resulting in a net operating profit of \$22,754 and \$45,492 respectively (2017 - \$5,286 and \$10,189 respectively) or approximately \$9 and \$9 (2016 - \$3 and \$2 respectively) per barrel.

	Three months ended October 31,		Six months ended October 31,	
	2018	2017	2018	2017
Daily average oil production (bbls)	27	22	29	28
Total oil production for the period (bbls)	2,524	2,042	5,245	4,690
Petroleum revenue, gross	\$ 130,527	\$ 134,570	\$ 326,176	\$ 254,295
Royalties	(59,759)	(40,756)	(139,574)	(75,217)
Operating and transportation expenses	(48,014)	(99,100)	(141,110)	(168,889)
Net petroleum income	\$ 22,754	\$ (5,286)	\$ 45,492	\$ 10,189

#### General and Administrative ("G&A") Expenses

General and administrative expenses increased to \$47,835 from \$34,858 for the quarter ended October 31, 2018 and decreased to \$53,041 from \$54,569 for the six months ended October 31, 2018, compared to the same period in 2017. The increase in G&A expenses during last quarter was due to increased legal fees associated with the Corporation's proposed Drakkar Energy Ltd. transaction.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

A comparative summary of general and administrative expenses for the three and six months ended October 31, 2018 and 2017 is as follows:

	Three months ended October 31,		Six months ended October 31,	
	2018	2017	2018	2017
Management consulting services	\$ 5,000	\$ 5,000	\$ 13,000	\$ 10,000
Professional fees	37,558	25,303	29,558	36,816
Shareholders services	5,277	6,135	6,250	7,068
Other	-	(1,580)	4,233	685
Total	\$ 47,835	\$ 34,858	\$ 53,041	\$ 54,569

### Stock-based Compensation

The Corporation has a stock-based compensation plan granting directors, officers, employees and consultants of Blacksteel options to purchase Class A common shares of the Corporation. The Corporation recorded stock-based compensation expense of \$Nil for the quarter and period ended October 31, 2018, compared to \$19,458 and \$38,916 for the comparative periods in 2017 of which \$Nil (2017 - \$19,458 and \$38,916 respectively) relates to extensions of the expiry dates of outstanding warrants and \$Nil and \$Nil (2017 - \$Nil and \$Nil) relates to stock options.

As at October 31, 2018, Blacksteel had a total of 1,245,000 stock options outstanding that were granted to directors of the Corporation.

### Loss and Comprehensive Loss

The Corporation recognized a loss of \$122,270 for the quarter ended October 31, 2018 compared to a loss of \$152,411 for the quarter ended October 31, 2017, and a loss of \$202,586 for the six months ended October 31, 2018, compared to a loss of \$248,405 for the same period last year.

### Supplemental Quarterly Information

The data in the following table has been derived from the Company's financial statements for the eight most recently completed financial quarters.

	Three Months Ended			
	Oct. 31, 2018	Jul. 31, 2018	Apr. 30, 2018	Jan. 31, 2018
Petroleum revenue, net	\$ 130,527	\$ 195,649	\$ 123,728	\$ 157,677
Net income (loss)	(122,270)	(80,316)	(271,632)	(27,617)
Net income (loss) per share, basic and diluted	(0.00)	(0.00)	(0.01)	(0.00)
Weighted average number of shares, basic	36,227,416	35,898,490	35,262,202	35,049,785
Weighted average number of shares, diluted	36,227,416	35,898,490	35,262,202	35,049,785

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

	Three Months Ended			
	Oct. 31, 2017	Jul. 31, 2017	Apr. 30, 2017	Jan. 31, 2017
Petroleum revenue, net	\$ 134,570	\$ 119,725	\$ 98,800	\$ -
Net income (loss) for the quarter	(152,411)	(95,994)	(394,567)	(114,271)
Net income (loss) per share, basic and diluted	(0.00)	(0.00)	(0.01)	(0.00)
Weighted average number of shares, basic	35,049,785	36,108,451	36,108,451	36,108,451
Weighted average number of shares, diluted	35,049,785	36,108,451	36,108,451	36,108,451

The Corporation has not experienced general trends, nor does the Corporation have seasonal variations. However, the following discussion explains the variations over the quarters.

Stock-based compensation varies each quarter with the number of options granted and their respective calculated option values as well as warrant extensions.

Loss per share has remained relatively stable over the quarters, other than a large increase due to the asset write-downs during the quarters ending April 30, 2017.

### CAPITAL EXPENDITURES

Blacksteel's capital expenditures for the three and six months ended October 31, 2018 totalled \$101,501 and \$221,921 respectively (2017 - \$20,913 and \$20,913 respectively).

### LIQUIDITY AND CAPITAL RESOURCES

Liquidity risks arise from the use of liquid financial resources to meet the day-to-day funding requirements of the Corporation and in the management of assets and liabilities in order to maintain an optimal capital structure. Blacksteel manages liquidity risk to meet its financial obligations and commitments in a cost effective manner and to fund growth and expansion opportunities that are recognized by the Corporation.

The Corporation's working capital at October 31, 2018 was \$316,740 (April 30, 2018 – \$480,685), and has incurred net losses and negative cash flow from operating activities in the year ended April 30, 2018 and currently has limited production from its oil and gas property. These factors indicate a material uncertainty that may cast significant doubt on the ability of the Corporation to continue as a going concern. The accompanying condensed interim financial statements have been prepared with the assumption that the Corporation will realize its assets and discharge its liabilities in the normal course of business. The recoverability of the amounts classified as property and equipment assets is dependent upon the ability of the Corporation to obtain financing necessary to complete its exploration and development initiatives and the discovery of economically recoverable petroleum and natural gas resources. The Corporation believes it has sufficient cash reserves to continue as a going concern. If the going concern assumption is not appropriate, adjustments may be necessary to the carrying values of assets and liabilities, reported revenues and expenses, and the balance sheet classifications used in the financial statements.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

### Working capital

As at October 31, 2018, the Corporation had a working capital of \$316,740 which included \$65,916 of cash, compared to a working capital of \$480,685 as at April 30, 2018, which included \$100,660 of cash.

Blacksteel's cash consist of cash held primarily in accounts on deposit with a major Canadian bank. The Corporation's policy is to ensure that its cash investments are liquid and not invested in investment vehicles with high risk.

### Capital Resources

To date, the Corporation has relied on equity issuances to fund its capital program and pay for administrative expenses related to running the Corporation's day-to-day operations. Future sources of cash could include further equity issuances, advances from bank credit facilities if they can be arranged, and generation of cash from profitable operations. Management believes that the Corporation will continue to successfully raise sufficient funds through equity issuances and will be able to increase internal cash generation in the near future. However, there can be no certainty that financing will be successful. Additionally, there can be no certainty that internal cash generation will occur.

The table below shows the capitalization of the Corporation as at the effective date of this MD&A, October 31, 2018 and April 30, 2018.

### OUTSTANDING NUMBER OF SHARES, OPTIONS AND WARRANTS DATA

	December 28, 2018	October 31, 2018	April 30, 2018
Class A common shares	36,227,416	36,227,416	35,601,416
Warrants	-	-	4,569,945
Stock options	1,245,000	1,245,000	1,245,000
Total equity instruments outstanding	37,472,416	37,472,416	41,416,361

### OFF BALANCE SHEET ARRANGEMENTS

The Corporation does not have any special-purpose entities nor is it a party to any arrangement that would be excluded from the balance sheet.

### RELATED PARTY TRANSACTIONS

During the three and six months ended October 31, 2018, the Corporation incurred a total of \$5,000 and \$13,000 respectively (2017 - \$5,000 and \$10,000, respectively) related to management services, to a private corporation of which an officer of the Corporation is an owner. These costs were recorded to general and administrative expenses. As at October 31, 2018, \$10,000 (April 30, 2018 - \$8,000) owing to this private corporation was included in accounts payable.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

During the three and six months ended October 31, 2018, the Corporation incurred a total of \$30,392 and \$35,392 (2017 – \$29,380 and \$40,893, respectively) related to legal services to a law firm in which a director of the Corporation is a partner. These costs were recorded to general and administrative expenses. As at October 31, 2018, \$25,638 (April 30, 2018 - \$17,056) owing to this law firm was included in accounts payable.

During the three and six months ended October 31, 2018, the Corporation earned \$4,994 and \$9,988 respectively (2017 - \$NIL) of interest income on loans receivable from directors totalling \$235,000 (note 4) of which \$1,665 (2017 - \$NIL) was in accounts receivable at October 31, 2018.

During the three and six months ended October 31, 2018, the Corporation incurred \$4,994 and \$9,988 respectively (2017 - \$NIL) of cash interest expense and \$5,049 and \$10,098 respectively (2017 - \$NIL) of non-cash accretion expense on convertible debentures held by directors (note 6) of which \$1,683 (2017 - \$NIL) remained in accounts payable and accrued liabilities at October 31, 2018.

### FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### Fair Values

The fair values of cash, accounts receivable, short term loans receivable, and accounts payable and accrued liabilities approximate their carrying value due to the short term maturity of these instruments. The fair value of long-term loans receivable approximates its carrying value as management believes it currently bears an interest rate reflective of the risk profile of the loans. The fair value of convertible debentures approximates its carrying value as the Corporation believes market discount rates and the Corporation's risk profile have not changed materially since issuance.

The fair values of cash, accounts receivable, and accounts payable and accrued liabilities approximate their carrying value due to the short term maturity of these instruments. The fair value of convertible debentures approximates its carrying value as the Corporation believes market discount rates and the Corporation's risk profile have not changed materially since issuance.

IFRS established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

Level 1: Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

When the inputs used to measure fair value fall within different level of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measure in its entirety.

At October 31, 2018 cash is measured at fair value of \$65,916 (April 30, 2018 - \$100,660) falls under level 1 of the hierarchy.



# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

The fair value of the convertible debentures liability is determined using a level 3 valuation model at recognition. Inputs include interest rates for similar non-convertible debt and consideration of term to maturity.

The Corporation is exposed to financial risks arising from its financial assets and liabilities.

The Corporation manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Corporation are credit risk, market risk and liquidity risk.

### **Credit Risk**

Credit risk is the risk of financial loss to the Corporation of a customer or counterparty to a financial instrument failing to meet its contracted obligations. The Corporation's credit risk related to accounts receivable is limited as it is comprised solely of GST amounts due from the federal government. The Corporation considers all receivables greater than 90 days to be past due. There were no past due receivables as at October 31, 2018.

At October 31, 2018, the maximum exposure to credit risk was \$936,005 (April 30, 2018 - \$764,415) being the carrying value of its cash, accounts receivable and loan receivable.

Cash consist of cash bank balances. The Corporation manages the credit exposure of cash by selecting financial institutions with high credit ratings and monitors all short-term deposits to ensure an adequate return. The Corporation does not invest its excess cash in high risk investment vehicles such as asset backed commercial paper.

### **Market Risk**

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Corporation's net earnings or the value of financial instruments. The objective of the Corporation is to manage and mitigate market risk exposures within acceptable limits, while maximizing returns. Market risks are as follows:

#### *Commodity Price Risk*

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by world and continental/regional economic and other events that dictate the levels of supply and demand. Given the Corporation's limited production, the Corporation has chosen not to hedge any of its oil and natural gas production and consequently, the Corporation had no financial derivative sales contracts in place as at or during the period ended October 31, 2018 and year ended April 30, 2018. The Corporation manages this risk by monitoring commodity prices and factoring any changes into operational decisions.

#### *Foreign Currency Exchange Risk*

Foreign currency exchange rate risk is the risk that future cash flows will fluctuate as a result of changes in foreign exchange rates. The Corporation is exposed to foreign currency exchange risk as the underlying market prices in Canada for oil and natural gas fluctuate with changes in the exchange rate between the Canadian and United States dollar. As of October 31, 2018, the Corporation did not conduct business transactions in other currencies, had no forward exchange rate contracts in place, and had no

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

working capital items denominated in foreign currencies. The Corporation manages this risk by monitoring foreign currency exchange rates and factoring any changes into operational decisions.

### *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 Corporation is exposed to interest rate price risk to the extent that its loan receivable and convertible debentures bear interest at fixed rates. The Corporation had no interest rate swaps or financial contracts in place as at or during the period ended October 31, 2018, or year ended April 30, 2018.

### **Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking harm to the Corporation's reputation. The Corporation monitors this risk by preparing capital expenditure forecasts which are regularly monitored and updated as considered necessary. As well, the Corporation utilizes authorizations for expenditures on non-operated projects to manage capital expenditures and liquidity. See also discussion under "Liquidity and Capital Resources".

### **Capital Management**

The Corporation considers its capital structure to include shareholders' equity and long-term debt, if any. The Corporation's objective when managing capital is to safeguard its ability to continue as a going concern (note 2(a) to the condensed interim financial statements) so that it can continue to maintain investor confidence and to not expose the Corporation to excess risk.

The Corporation manages its capital structure and makes adjustments to it based upon the level of funds available to support the exploration and development of its petroleum and natural gas properties. The Corporation currently generates no cash flow from its operations. As such, the Corporation continues to be dependent on external financing to fund its exploration and development activities, and as necessary, to pay general and administrative and other ongoing costs. To date, external financing has included only issuing common shares, common share, purchase warrants and convertible debentures.

The Corporation will pursue additional sources of external financing to attempt to ensure that it has necessary financial resources available. To the extent that market conditions are not believed to be positive for raising equity or debt, adjustments may be made to the timing of planned capital expenditures and operating costs reduced to the extent possible until those market conditions become acceptable. Management reviews its capital management approach on an ongoing basis. There were no changes in the Corporation's approach to capital management during the period ended October 31, 2018 or year ended April 30, 2018. The Corporation's capital consists of shareholders' equity and long-term debt, if any, as follows.

	October 31, 2018	April 30, 2018
Shareholders' deficiency	\$ (507,270)	\$ (429,884)
Long-term debt	1,792,475	1,716,061
Capital	\$ 1,285,205	\$ 1,286,177

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

### SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

#### Critical Accounting Estimates and Judgements

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

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected.

The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets, liabilities and equity:

#### *Depletion and valuation of property and equipment*

The amounts recorded for depletion and depreciation of property and equipment and the valuation of property and equipment are based on estimates. These estimates include proved and probable reserves, production rates, future oil and natural gas prices, future development costs, remaining lives and periods of future benefits of the related assets and other relevant assumptions.

Oil and natural gas interests, exploration and evaluation assets and other corporate assets are aggregated into cash-generating units ("CGUs") based on their ability to generate largely independent cash flows and are used for impairment testing. The classification of assets into CGUs requires significant judgment and interpretations with respect to the integration between assets, the existence of active markets, external users, shared infrastructures and the way in which management monitors the Corporation's operations. The determination of the Corporation's CGUs is subject to management's judgement.

The Corporation's reserve estimates are evaluated annually pursuant to the parameters and guidelines stipulated under *National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities*.

#### *Valuation and classification of exploration and evaluation assets*

The valuation of exploration and evaluation assets are dependent upon the discovery of economically recoverable reserves which in turn is dependent on future oil and natural gas prices, future capital expenditures and environmental and regulatory restrictions. The decision to transfer exploration and evaluation assets to property and equipment is based upon management's determination of an area's technical feasibility and commercial viability based on proved and/or probable reserve estimates.

#### *Convertible debentures*

The allocation between the debt and equity components of convertible debentures is based on estimates of the interest rate the Corporation would pay on non-convertible debt instruments with similar terms.

#### *Decommissioning provisions*

The value of decommissioning provisions depends on estimates of current risk-free interest rates, future

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

restoration and reclamation expenditures and the timing of those expenditures.

### *Valuation of accounts receivable*

The valuation of accounts receivable is based on management's best estimate of the provision for doubtful accounts.

### *Income taxes*

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of the Corporation utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices and changes in legislation, tax rates and interpretations by taxation authorities. The availability of tax pools and the Corporation's classification of expenditures eligible for renouncement under flow-through shares is subject to audit and interpretation by taxation authorities.

### *Stock-based compensation*

The amounts recorded relating to the fair value of stock options and warrants issued are based on estimates of the future volatility of the Corporation's share price, market price of the Corporation's shares at grant date, expected lives of the options and warrants, expected forfeiture rates, expected dividends and other relevant assumptions.

## **Oil and Natural Gas Reserves and Resources Determination**

The process of estimating reserves and resources is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. Reserve and resource estimates are based on current production forecasts, prices and economic conditions. These estimates may change substantially as additional data from ongoing development and production activities becomes available and as economic conditions impact oil and natural gas prices and costs.

## **Depletion Expense**

All costs associated with development activities, whether successful or not, are capitalized. The aggregate of net capitalized costs and estimated future development costs (less estimated salvage values) is amortized using the unit-of-production method based on estimated proved and probable oil and natural gas reserves. An increase in estimated proved and probable oil and natural gas reserves or a decrease in estimated future development costs would each result in a corresponding reduction in depletion and depreciation expense.

## **Impairment of Petroleum and Natural Gas Assets**

The Corporation is required to review the carrying value of all petroleum and natural gas assets, on a cash generating unit basis, for potential impairment. Impairment is indicated if the carrying amount of the oil and natural gas property and equipment is not recoverable by the future discounted funds flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the property and equipment is charged to earnings. The assessment of impairment is dependent on estimates of reserves, production rates, future prices, future costs and other relevant assumptions.

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

### Stock-Based Compensation

Under the fair value method of accounting for stock options and warrants, compensation expense is determined on the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Blacksteel's stock options and warrants are not transferable, cannot be traded and are subject to vesting restrictions that would tend to reduce value. The Black-Scholes model requires the input of several variables including estimated volatility of the issuer's stock price over the life of the option, estimated forfeitures and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the Black-Scholes model.

### Decommissioning Provisions

The Corporation is required to provide for future removal and restoration costs. The Corporation must estimate these costs in accordance with existing laws, contracts or other policies. The fair value of the liability for the Corporation's asset retirement obligations is recorded in the period in which it is expected to be incurred, discounted to its present value using the Corporation's risk-free interest rate and the expected inflation rate. The offset to the liability is recorded in the carrying amount of property and equipment. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of funds flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

### Income Taxes

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### CHANGE IN ACCOUNTING POLICIES

The accounting policies adopted in the preparation of the condensed interim financial statements are consistent with those followed in the preparation of the Corporation's annual financial statements for the year ended April 30, 2018 except as described below. There have been no changes to the use of estimates or judgements since April 30, 2018.

#### New standards adopted by the Corporation

##### (i) IFRS 9, "Financial Instruments"

On May 1, 2018, the Corporation adopted IFRS 9, "Financial Instruments", which replaces IAS 39 "Financial Instruments". This new standard accounts for all aspects of financial instruments and includes a logical model for classification and measurement, a single forward looking 'expected-loss' impairment model and a substantially reformed approach to hedge accounting. Adoption of this new standard did not have a material impact on the Corporation's financial statements. The Corporation has adopted IFRS 9

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

using a retrospective approach with no impact to net loss or opening retained earnings of comparative periods.

The Corporation has revised the description of its accounting policy for financial instruments to reflect the new classification approach as follows:

### Financial Instruments

On initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods depends on the classification of the financial instrument as described below:

**Amortized cost:** Financial instruments under this classification include accounts receivable, deposits, loans receivable, accounts payable and accrued liabilities and convertible debentures.

**Fair value through profit or loss:** Financial instruments under this classification include cash and cash equivalents.

**Fair value through other comprehensive income:** The Corporation has no financial instruments under this classification.

### (ii) IFRS 15, "Revenue from Contracts with Customers"

On May 1, 2018, the Corporation adopted IFRS 15, "Revenue from Contracts with Customers". IFRS 15 replaces the existing revenue recognition guidance with a single comprehensive accounting model. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive when control is transferred to the purchaser. The Corporation has adopted IFRS 15 using a modified retrospective approach.

As a result of the adoption of IFRS 15, no changes to the Corporation's comparative financial statements were required. IFRS 15 did not have a material impact on the condensed interim statements of loss and comprehensive loss for the three month period ended October 31, 2018 or its condensed interim balance sheets as at October 31, 2018.

The Corporation has revised the description of its accounting policy for revenue recognition to reflect the new standard as follows:

Revenue from the sale of oil, natural gas and natural gas liquids is recorded when control of the product is transferred to the buyer based on the consideration specified in the contracts with customers. This usually occurs when the product is physically transferred at the delivery point agreed upon in the contract and legal title to the product passes to the customer.

The Corporation evaluates its arrangements with third parties and partners to determine if the Corporation acts as the principal or as an agent. In making this evaluation, the Corporation considers if it obtains control of the product delivered or services provided, which is indicated by the Corporation having the primary responsibility for the delivery of the product or rendering of the service, having the ability to establish prices or having inventory risk. If the Corporation acts in the capacity of an agent rather than as

# BLACKSTEEL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE AND SIX MONTH PERIODS ENDED OCTOBER 31, 2018 (continued)

---

a principal in a transaction, then the revenue is recognized on a net-basis, only reflecting the fee, if any, realized by the Corporation from the transaction.

### RISKS AND UNCERTAINTIES

The petroleum and natural gas industry is subject to numerous risks and uncertainties that can affect the Corporation's ability to grow and generate cash flows from operations. These risks and uncertainties include, but are not limited to, the following:

- Fluctuations in interest rates, commodity prices and foreign currency exchange rates;
- Capital markets risk and the ability to finance future growth;
- Government and regulatory risk in respect of changes to royalty and income tax regimes;
- Economic risk in respect of finding and producing reserves at a reasonable cost, and marketing those reserves;
- Operational risk in respect of availability and cost of drilling and related equipment;
- Seasonal risk in respect of the ability to enter leases and drill wells due to weather conditions; and
- Environmental risk in respect of the ability to remediate sites and remedy spills, releases or emissions of various substances that may be produced in association with the Corporation's petroleum and natural gas operations.

While many of these risks are beyond the Corporation's control and it is impossible to ensure that the Corporation's exploration initiatives will result in commercial operations, Blacksteel strives to minimize the aforementioned risks by:

- Employing management and technical staff and consultants with extensive industry and/or area experience;
- Maintaining an appropriate working capital position to cover the Corporation's capital and overhead costs;
- Maintaining a low cost structure and a tight cost control system; and
- Maintaining insurance in accordance with industry standards to address the risk of liability for pollution, personal injury, property damage, blow-outs and other hazards.

# BLACKSTEEL ENERGY INC.

## Corporate Information

---

### Board of Directors

Eugene Chen <sup>(1) (2) (3)</sup>

Chris Scase, BComm, CGA <sup>(1) (3)</sup>

Les Treitz <sup>(2) (3)</sup>

*(1) Audit Committee*

*(2) Compensation and Corporate Governance Committee*

*(3) Reserves Committee*

### Officers

Les Treitz, Interim President and Chief Executive Officer

Derek Batorowski, Chief Financial Officer

### Corporate Office

2204 6 AVE NW

Calgary, AB T2N 0W9

Phone (403) 453-0060

Fax (403) 265-3783

### Auditors

Collins Barrow Calgary LLP

### Legal Counsel

Shea Nerland LLP

### Transfer Agent

Alliance Trust Company

### Bankers

Royal Bank of Canada

### Stock Exchange Listing

The TSX Venture Exchange

Trading Symbol: BEY