



**CONSOLIDATED FINANCIAL STATEMENTS AND NOTES
THERE TO**

FOR THE YEARS ENDED DECEMBER 31, 2018 and 2017

MANAGEMENT'S LETTER

Management is responsible for the integrity and objectivity of the information contained in these consolidated financial statements. In the preparation of these consolidated financial statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected with all information available up to July 3, 2019. The consolidated financial statements have been prepared using policies and procedures established by management in accordance with International Financial Reporting Standards and reflect fairly Drakkar's financial position, results of operations and cash flows.

BDO Canada LLP, independent auditors appointed by the shareholders, have examined the consolidated financial statements, and GLJ Petroleum Consultants Ltd. have reviewed the corporate reserves. Their examinations provide independent views as to the amounts and disclosures in the consolidated financial statements.

The Audit Committee, consisting of a majority of independent directors, has reviewed in detail the consolidated financial statements with management and the external auditors and has recommended their approval to the Board of Directors.

The Board of Directors has approved the consolidated financial statements.

Signed
Keith Macdonald
President
July 3, 2019
Calgary, Alberta, Canada



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Independent Auditor's Report

To the Shareholders of Drakkar Energy Ltd.

Opinion

We have audited the consolidated financial statements of Drakkar Energy Ltd. and its subsidiaries (the Group), which comprise the consolidated statements of financial position as at December 31, 2018 and 2017, and the consolidated statement of comprehensive loss, the consolidated statement of changes in equity and the consolidated statement of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2018 and 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 1 in the financial statements, which indicates that the Group had an accumulated deficit of \$15,072,554 since its inception, had positive cash flows from operations of \$241,121, and current liabilities in excess of current assets of \$412,934 during the year ended December 31, 2018, and expects to incur further losses in the development of its business. As stated in Note 1, these events or conditions, along with other matters as set forth in Note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Other Information

Management is responsible for the other information. The other information comprises the information, other than the consolidated financial statements and our auditor's report thereon, included in the *Management Discussion and Analysis* ("MD&A"). The MD&A is expected to be made available to us after the date of this audit report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.



When we read the MD&A if we conclude that there is a material misstatement therein we are required to communicate that with Those Charged with Governance.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is John Leavitt.

BDO Canada LLP

Chartered Professional Accountants

*Calgary, AB
July 3, 2019*

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31, 2018	December 31, 2017
Assets		
Current Assets:		
Cash and cash equivalents	\$ 359,228	\$ 683,582
Accounts receivable and accrued receivables	474,111	197,365
Prepaid expenses	20,507	28,156
	<u>853,846</u>	<u>909,103</u>
 Petroleum properties and equipment (note 6)	 <u>2,836,927</u>	 <u>2,302,222</u>
	<u><u>\$ 3,690,773</u></u>	<u><u>\$ 3,211,325</u></u>
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable and accrued liabilities (note 14)	\$ 866,781	\$ 582,465
Short-term loan (note 8)	400,000	400,000
	<u>1,266,781</u>	<u>982,465</u>
 Convertible debentures (note 9)	 561,487	 497,133
Convertible preferred shares (note 11)	586,047	468,981
Decommissioning obligations (note 10)	855,385	851,240
	<u>3,269,700</u>	<u>2,799,819</u>
Shareholders' Equity		
Share capital (note 11)	13,195,569	12,426,767
Contributed surplus	1,986,170	1,962,164
Equity component of convertible instruments (note 11)	311,888	308,170
Deficit	<u>(15,072,554)</u>	<u>(14,285,595)</u>
	<u>421,073</u>	<u>411,506</u>
	<u><u>\$ 3,690,773</u></u>	<u><u>\$ 3,211,325</u></u>
 Going concern (Note 1)		
Subsequent event (Note 17)		
 On behalf of the Board:		
(Signed) "Rick Pawluk"		
Director		
(Signed) "Keith Macdonald"		
Director		
 See accompanying notes to the consolidated financial statements.		

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	For the year ended December 31, 2018	For the year ended December 31, 2017
Revenue:		
Petroleum and natural gas	\$ 1,365,965	\$ 1,143,821
Less: Crown and other royalties	(471,058)	(337,824)
	894,907	805,997
Other income	3,464	-
	<u>898,371</u>	<u>805,997</u>
Expenses:		
Operating	529,741	495,588
Transportation and processing	128,878	141,751
General and administrative (note 14)	250,174	30,282
Stock-based compensation (note 11(b),(c))	152,000	55,000
Financing expense	264,705	218,993
Impairment of petroleum properties (note 5)	83,638	107,054
Gain on disposition of assets	(12,400)	-
Depreciation and depletion	232,356	242,970
	<u>1,629,092</u>	<u>1,291,638</u>
Net and comprehensive loss for the period	\$ (730,721)	\$ (485,641)
 Net loss and comprehensive loss per share (note 12)		
- basic	(\$0.04)	(\$0.03)
- diluted	(\$0.04)	(\$0.03)
 Weighted average shares outstanding (note 12)		
- basic	20,005,797	17,052,719
- diluted	20,005,797	17,052,719
 See accompanying notes to the consolidated financial statements.		

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended December 31, 2018	For the year ended December 31, 2017
Cash provided by (used in):		
Operating:		
Net and comprehensive loss for the period	\$ (730,721)	\$ (485,641)
Add (deduct) items not affecting cash:		
Depreciation and depletion	232,356	242,970
Impairment of petroleum properties (note 5)	83,638	107,054
Finance expense	264,705	218,993
Stock-based compensation	152,000	55,000
Gain on disposition of assets	(12,400)	-
	(10,422)	138,376
Net change in non-cash working capital accounts (Note 13)	251,543	(191,707)
	<u>241,121</u>	<u>(53,331)</u>
Financing:		
Issuance of Class A common share units (note 11(b))	350,000	154,500
Issuance of convertible preferred share units (note 11(b))	54,000	670,000
Issuance of flow through common share units (note 11(b))	-	35,000
Warrants exercised	287,424	9,623
Interest expense	(99,186)	(101,484)
Dividends paid	(56,238)	(21,764)
Transaction costs for unit offerings (note 11(b))	(100,351)	(68,601)
Net change in non-cash working capital accounts (note 13)	(190,949)	211,048
	<u>244,700</u>	<u>888,322</u>
Investing:		
Purchase of petroleum properties and equipment (note 6)	(767,060)	(305,684)
Net proceeds on disposition of assets	25,000	-
Purchase of exploration and evaluation assets (note 5)	(96,238)	(107,054)
Net change in non-cash working capital accounts (note 13)	28,123	3,506
	<u>(810,175)</u>	<u>(409,232)</u>
Decrease in cash and cash equivalents	(324,354)	425,759
Cash and cash equivalents, beginning of the period	683,582	257,823
Cash and cash equivalents, end of the period	<u><u>\$ 359,228</u></u>	<u><u>\$ 683,582</u></u>
 Supplementary information		
Interest received	\$ 4,930	\$ 488
Interest paid	\$ 99,186	\$ 101,484
Convertible debentures issued for services (note 9)	\$ -	\$ 30,000
Shares issued for services (note 11(b), 14(b))	\$ 73,500	\$ 127,162
See accompanying notes to the consolidated financial statements.		

DRAKKAR ENERGY LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Number of Class A Common Shares	Class A Common Shares	Contributed Surplus	Equity Component of Convertible instruments	Deficit	Total
Balance at December 31, 2016	16,224,405	\$ 11,994,640	\$ 1,798,233	\$ 137,010	\$ (13,778,190)	\$ 151,694
Net and comprehensive loss for the period					(485,641)	(485,641)
Issue of shares, net of costs	2,345,647	419,074				419,074
Warrants issued, net of costs			121,984			121,984
Warrants exercised (Note 9)	38,492	13,053	(13,053)			-
Equity component of convertible instruments (note 11)				171,160		171,160
Dividends paid					(21,764)	(21,764)
Share-based compensation (note 11)			55,000			55,000
Balance at December 31, 2017	18,608,544	\$ 12,426,767	\$ 1,962,164	\$ 308,170	\$ (14,285,595)	\$ 411,506
Net and comprehensive loss for the period					(730,721)	(730,721)
Issue of shares, net of costs	1,758,800	271,894				271,894
Warrants issued, net of costs			81,491			81,491
Warrants exercised (Note 11)	1,149,696	344,909	(57,485)			287,424
Equity component of convertible instruments (note 11)				3,718		3,718
Dividends paid					(56,238)	(56,238)
Share-based compensation (note 11)	760,000	152,000				152,000
Balance at December 31, 2018	22,277,040	\$ 13,195,570	\$ 1,986,170	\$ 311,888	\$ (15,072,554)	\$ 421,074

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 and 2017

1. NATURE OF OPERATIONS AND GOING CONCERN

Drakkar Energy Ltd. ("Drakkar" or the "Corporation") is a private entity, incorporated under the *Business Corporations Act* (Alberta) on January 31, 2007. The Corporation's Class A common shares and preferred shares are not posted for trading on any stock exchange.

Drakkar's principal business activity is in the exploration, exploitation, development and production of petroleum and natural gas resources in the Girouxville Montney oil producing and the Peace River oil sands regions of Alberta.

The business of exploring for petroleum and natural gas reserves involves a high degree of risk and there can be no assurance that the Corporation's exploration and development programs will result in profitable operations. The Corporation's ability to meet its obligations arising from normal business operations, continue its exploration and development programs and discover economically recoverable reserves and generate future profits is dependent upon its ability to obtain necessary financing. While Drakkar has been successful at raising funds in the past, there can be no assurance that it will be able to do so in the future.

At December 31, 2018, the Company had not yet achieved profitable operations, had an accumulated deficit of \$ 15,072,554 since its inception (December 31, 2017 - \$14,285,594), had positive cash flows from operations of \$241,121 (December 31, 2017 negative cash flow - \$53,331) and had current liabilities in excess of current assets of \$412,934 (2017 - \$73,362), and expects to incur further losses in the development of its business. The ability to continue as a going concern is dependent on obtaining continued financial support, completing public equity financing or generating profitable operations in the future. Management is committed to raising additional capital to meet its exploration and operating obligation, however, additional equity financing is subject to the global financial markets and economic conditions, and the debt and equity markets, which are distressed, particularly for junior petroleum and natural gas companies. All of these factors, together with weak natural gas prices and the current unstable economic conditions, indicate the existence of material uncertainties related to events or conditions that may cast significant doubt as to whether the Company can continue as a going concern and, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. These consolidated financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications that would be necessary if the going concern assumption was not appropriate. Any adjustments necessary to the consolidated financial statements if the Company ceases to be a going concern could be material.

2. BASIS OF PREPARATION

- (a) Statement of compliance: The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB. The consolidated financial statements were authorized for issuance by the Board of Directors on July 3, 2019.
- (b) Basis of measurement: The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value. The methods used to measure fair values are discussed in note 4.
- (c) Functional and presentation currency: The consolidated financial statements are presented in Canadian dollars, which is the Corporation's and its subsidiary's functional currency.
- (d) Use of estimates and judgments:

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Estimates and their underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and for any future years affected.

Critical Judgments in Applying Accounting Policies: The following are critical judgments that

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2018 and 2017**

management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements.

The Corporation's assets are aggregated into cash-generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit's ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality. The Company currently has only one CGU within the petroleum properties asset category.

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

The application of the Corporation's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found in assessing if technical feasibility and commercial reserves have been achieved.

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

Key Sources of Estimation Uncertainty

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

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

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

The Corporation's estimate of stock-based compensation is dependent upon estimates of historic volatility and forfeiture rates.

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

The Corporation issues convertible debentures, units, and preferred shares, which are comprised of embedded derivatives, debt and equity components. In determining the fair value on the issuance date and at the date of the consolidated statements of financial position, management uses internally developed

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 and 2017

models. This method requires the input of a number of assumptions including market rate of interest and future volatility. These assumptions are determined using Management's best estimates and involve inherent uncertainties. They are reviewed quarterly and may have a significant impact on estimates of fair value.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements, and have been applied consistently to the Corporation and its subsidiaries.

Operating expenses in profit or loss are presented as a combination of function and nature to conform with industry practice. Depletion and depreciation is presented on a separate line by its nature, while operating expenses and general and administrative expenses are presented on a functional basis. Significant expenses such as stock-based compensation are presented by their nature in the notes to the financial statements.

Subsidiaries

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

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

The Company has one subsidiary, 1343358 Alberta Ltd., of which it owns 100%.

Jointly owned assets

Many of the Corporation's oil and natural gas activities involve jointly owned assets. The consolidated financial statements include the Corporation's share of these jointly owned assets and a proportionate share of the relevant revenue and related costs.

The relationships with jointly owned asset partners have been referred to as joint ventures in the remainder of these financial statements as is common in the Canadian oil and gas industry.

Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency

Transactions in foreign currencies are translated to the functional currencies of each entity at exchange rates prevailing on the date of each transaction. Monetary assets and liabilities denominated in foreign currencies are translated to each entity's functional currency at the period-end exchange rate. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 and 2017

currency are translated using the exchange rate at the date of transaction. Foreign currency differences arising on translation are recognized in profit or loss. Foreign currency gains and losses are reported on a net basis.

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and have an original maturity date of three months, or less.

(d) Petroleum and natural gas properties

Exploration and evaluation expenditures

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

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as exploration and evaluation assets. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

The technical feasibility and commercial viability of extracting a mineral resource is generally considered to be determinable when proved and/or probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and/or probable reserves have been discovered. Upon determination of technical feasibility and commercial viability, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to petroleum and natural gas properties.

Development and production costs

Petroleum and natural gas properties, which include oil and gas development and production assets, are measured at cost, less accumulated depletion and depreciation and accumulated impairment losses. The cost of development and production assets includes; transfers from exploration and evaluation assets, which generally include the cost to drill the well and the cost of the associated land upon determination of technical feasibility and commercial viability; the cost to complete and tie-in the wells; facility costs; the cost of recognizing provisions for future restoration and decommissioning; geological and geophysical costs; and directly attributable overheads.

When significant parts of an item of petroleum and natural gas properties have different useful lives, then they are accounted for as separate components.

Gains and losses on disposal of petroleum and natural gas properties, property swaps and farm-outs are determined by comparing the proceeds from disposal, or fair value of the asset received or given up, with the carrying amount of petroleum and natural gas properties and are recognized net in profit or loss.

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of petroleum and natural gas properties are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of petroleum and natural gas properties are recognized in profit or loss as incurred.

Depletion and Depreciation

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved plus probable reserves,

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 and 2017

taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives.

Proved plus probable reserves are estimated annually by independent qualified reserve evaluators and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. For financial statements, internal estimates of changes in reserves and future development costs are used for determining depletion for the period. For purposes of this calculation, petroleum and gas reserves are converted to a common unit of measure on the basis of their relative energy content, where six thousand cubic feet of gas equals one barrel of oil or liquids.

Drakkar has deemed the estimated useful lives for gas processing plants, pipeline facilities, and compression facilities to be consistent with the reserve lives of the areas for which they serve. As a result, Drakkar includes the cost of these assets within their associated major component (area or group of areas) for the purpose of depletion using the unit of production method.

Office equipment is depreciated using a declining balance method using rates from 20% to 100% dependent on the type of equipment. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Impairment

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

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.

Non-financial assets

The carrying amounts of the Corporation's non-financial assets, other than exploration and evaluation (E&E) assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Exploration and evaluation assets are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are tested at the operating segment level.

For the purpose of impairment testing, assets are grouped together 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 recoverable amount of an asset or a CGU is the greater of its value in use ("VIU") and its fair value less costs to sell ("FVLCS").

In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to

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the asset. VIU is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

FVLCS is the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. The FVLCS is generally determined as the net present value of the estimated future cash flows expected to arise from a CGU, including any expansion prospects, and its eventual disposal, using assumptions that an independent market participant may take into account. These cash flows are discounted using a rate that would be applied by a market participant to arrive at a net present value of the CGU.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

In respect of petroleum and natural gas properties and exploration and evaluation assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

Impairment charges are recognized in profit or loss.

(f) Convertible debentures and preference shares

These convertible instruments are non-derivative, financial instruments, which create a financial liability of the entity and grant an option to the holder of the instrument to convert it into common shares of the Corporation. The liability component of the instrument is initially recorded at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially as the difference between gross proceeds and the fair value of the liability component. Transaction costs are allocated to the liability and equity components in proportion to the allocation of proceeds. Subsequent to initial recognition, the liability component of the instrument is measured at amortized cost using the effective interest method and is accreted each period, such that the carrying value will equal the principal amount outstanding at maturity. The equity component is not re-measured. The carrying amounts of the liability and equity components of the instrument are reclassified to shareholders' capital on conversion to common shares

(g) Decommissioning obligations

The Corporation's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of abandonment and site restoration and capitalized in the relevant asset category. Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation as at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

The increase in the provision due to the passage of time is recognized as accretion (within finance expense) whereas increases/ decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(h) Income tax

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

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

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(i) Stock-based compensation and warrant valuation

The Corporation uses the fair value method for valuing stock options and warrants. Under the fair value method, compensation costs attributable to all stock options and warrants granted to employees are measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus or warrants. A forfeiture rate is estimated on the date of grant and is adjusted to reflect the actual number of awards that vest. Performance share awards are also subject to a performance multiplier that is adjusted to reflect the final number of awards. The fair value of each option, performance warrant or warrant granted is estimated using the Black-Scholes option pricing model that takes into account the grant date, the exercise price and expected life of the option, performance warrant or warrant, the price of the underlying security, the expected volatility, the risk-free interest rate and dividends, if any, on the underlying security. The fair value of each restricted and performance share award is determined with reference to the price of the Corporation's common shares on the date of grant. Upon the exercise of the stock options, restricted and performance share awards, performance warrants and warrants, consideration received together with the amount previously recognized in contributed surplus or warrants is recorded as an increase to share capital and the contributed surplus or warrants balance is reduced.

(j) Revenue recognition

The Company adopted IFRS 15 with a date of initial application of January 1, 2018. The Company used the full retrospective approach to adopt the new standard. The Company has reviewed its revenue streams and major contracts with customers using the IFRS 15 five-step model and there are no material changes to the timing or amounts of revenue recognized. As a result, no adjustments were required in the January 1, 2017 opening statement of financial position.

Revenue from the sale of crude oil, natural gas, and natural gas liquids ("NGLs") is measured based on the consideration specified in contracts with customers and excludes amounts collected on behalf of third parties. The Company recognizes revenue when it transfers control of the product to the buyer. This is generally at the time the customer obtains legal title to the product and when it is physically transferred to the delivery mechanism agreed with the customer, often pipelines or other transportation methods.

Applying the five step model required by IFRS 15, Revenue from Contracts with Customers, revenue is recognized as follows for these contracts:

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Step in Model	Oil and Gas Sales
Identify the contract	The contractual arrangement executed with the customers, specifying the quantity and market price.
Identify distinct performance obligations	Single performance obligation to provide crude oil and gas to the customers.
Estimate transaction price	Transaction price is based on current commodity market prices.
Allocate the transaction price to performance obligations	Total revenue is allocated to the single performance obligation.
Recognize revenue as performance obligations are satisfied	Revenue to be recognized at a point in time once control passes to the customers (i.e when product is delivered).

The Company evaluates its arrangements with third parties and partners to determine if the Company acts as the principal or as an agent. In making this evaluation, management considers whether the Company obtains control of the product delivered, which is indicated by the Company having the primary responsibility for the delivery of the product, having the ability to establish prices, or having inventory risk. If the Company acts in the capacity of an agent, rather than as a principal, in a transaction then the revenue is recognized on a net basis, only reflecting the fee, if any, realized by the Company from the transaction.

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

(k) Finance income and expenses

Finance expense comprises interest expense on borrowings and accretion of the discount on provisions.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Corporation's outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

(l) Per share information

Per share amounts are calculated based on the weighted average number of common shares outstanding during the year. The diluted weighted average number of shares is adjusted for the dilutive effect of options, restricted and performance share awards, performance warrants and warrants. Under the treasury stock method, only "in the money" dilutive instruments are included in the weighted average diluted number of shares. It is also assumed that any proceeds obtained upon the exercise of options, performance warrants and warrants plus the unamortized portion of stock-based compensation would be used to purchase common shares at the average price during the period. The weighted average number of shares is then reduced by the number of shares acquired.

(m) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance, the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes, is recognized on the statement of financial position. As expenditures are incurred, the deferred tax liability associated with the renounced tax deductions are recognized through profit and loss along with a pro-rata portion of the deferred premium.

(n) Leased assets

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

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

Other leases are operating leases, which are not recognized on the Corporation's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(o) Financial instruments

The Company adopted IFRS 9 effective January 1, 2018. IFRS 9 replaces IAS 39 – Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 introduces new requirements for the classification and measurement of financial assets, amends the requirements related to hedge accounting, and introduces a forward-looking expected loss impairment model. The adoption of this standard has no impact on the Company's financial statements on the date of adoption, or for comparative periods. There was no change in the carrying amounts recognized under IAS 39, despite the new measurement categories stipulated under IFRS 9. The Company has applied IFRS 9 retrospectively, without restatement. All financial assets are initially measured at fair value. Financial assets are subsequently measured at either, amortized cost, fair value through other comprehensive income, or fair value through profit or loss, depending on the Company's business model for managing the financial assets, and the contractual cash flow characteristics of the financial assets. Financial assets are not reclassified subsequent to their initial recognition, except if the Company changes its business model for managing financial assets.

A financial asset is subsequently measured at amortized cost if it meets both of the following conditions:

- (i) The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- (ii) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets that meet condition (ii) above that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets is subsequently measured at fair value through other comprehensive income ("FVOCI"). All other financial assets are subsequently measured at their fair values, with changes in fair value recognized in profit or loss ("FVTPL").

There was no change to the measurement categories for financial liabilities. Financial liability classifications are all unchanged from their classifications under IAS 39.

Impairment of financial assets: IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" model. The new impairment model applies to financial assets measured at amortized cost, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. A comparison of financial instrument classifications, pre and post adoption of IFRS 9, is as follows:

Financial Assets and Liabilities	IAS 39	IFRS 9
Cash and cash equivalents	FVTPL	Amortized cost
Accounts and accrued receivables	Loans and receivables (1)	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities (1)	Amortized cost
Short-term loan	Other financial liabilities (1)	Amortized cost
Convertible debentures	Other financial liabilities (1)	Amortized cost
Convertible preferred shares	Other financial liabilities (1)	Amortized cost

(1) These items were initially recognized at fair value inclusive of any directly attributable transaction costs. Subsequent to initial recognition, these items were measured at amortized cost using the effective interest

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method.

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the statement of financial position at the time the Corporation becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. The Corporation has made the following classifications:

- Cash and cash equivalents, accrued receivables and accounts receivable are classified as loans and receivables and are initially measured at fair value plus directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Short term loans, the liability portion of the convertible debentures, accounts payable, accrued liabilities and liability portion of convertible preferred shares are classified as other liabilities and are initially measured at fair value, less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.

Transaction costs related to financial instruments classified as fair value through profit or loss are expensed as incurred. All other transaction costs related to financial instruments are recorded as part of the instrument and are amortized using the effective interest method.

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Corporation's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) do not qualify as financial instruments and thus, are accounted for as executory contracts. These contracts are not fair valued on the statement of financial position. Settlements are recognized in the statement of income as they occur.

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

(p) Future accounting policies In future accounting periods, the Corporation will adopt the following IFRS:

- IFRS 16 "Leases" - IFRS 16 was issued January 2016 and replaces IAS 17 Leases. The standard introduces a single lessee accounting model for leases with required recognition of assets and liabilities for most leases. The standard is effective for fiscal years beginning on or after January 1, 2019 with early adoption permitted if the Corporation is also applying IFRS 15 Revenue from Contracts with Customers. IFRS 16 will be adopted by the Corporation on January 1, 2019 and the Corporation is currently reviewing contracts that are currently identified as leases and evaluating the impact of the standard on the consolidated financial statements.

4. DETERMINATION OF FAIR VALUES

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

The Corporation classifies its financial instruments recorded at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

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- Level 3 - Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The liability portion of the Corporation's convertible debentures and liability portion of convertible preferred shares are considered level 3 in the fair value hierarchy.

(a) Petroleum and natural gas properties

The fair value of petroleum and natural gas properties recognized on an acquisition or for use in an impairment test is based on market values. The market value of petroleum and natural gas properties is the estimated amount for which petroleum and natural gas properties could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports.

The market value of other items of petroleum and natural gas properties is based on the quoted market prices for similar items.

(b) Cash and cash equivalents, accounts receivable and accrued receivables, short term loan and accounts payable and accrued liabilities

The fair value of cash and cash equivalents, accounts receivable and accrued receivables, short term loans, accounts payable and accrued liabilities, convertible debentures and preferred shares are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2018 and December 31, 2017, the fair value of accounts receivable and accrued receivables, accounts payable and accrued liabilities approximated their carrying value due to their short term to maturity. Short term loans bear an interest rate of 12% and are indicative of current credit spreads and, therefore, carrying values approximate fair value.

(c) Stock options and performance warrants

The fair value of employee stock options and performance warrants are measured using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate (based on government bonds).

5. EXPLORATION AND EVALUATION ASSETS

Exploration and evaluation assets consist of the Corporation's exploration projects which are pending the determination of proved or probable reserves. Additions represent the Corporation's share of costs incurred during the period.

The costs of the Corporation's remaining exploration and evaluation assets were subject to a separate test for impairment. In the years ended December 31, 2018 and 2017, the Company capitalized certain costs \$83,638 (2017 - \$107,054) in respect of E&E activities. At the end of 2018 and 2017, the Company decided that further development was not likely under present conditions and the assets were impaired accordingly.

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6. PROPERTY AND EQUIPMENT

	Petroleum and natural gas properties and equipment			Office equipment	Total
<u>Cost</u>					
Balance at December 31, 2016	\$	2,239,504	\$	6,449	\$ 2,245,952
Additions		303,792		1,892	305,684
Balance at December 31, 2017	\$	2,543,296	\$	8,341	\$ 2,551,636
Additions		765,104		1,956	767,060
Balance at December 31, 2018	\$	3,308,400	\$	10,297	\$ 3,318,696
 <u>Accumulated depletion & depreciation</u>					
Balance at December 31, 2016	\$	-	\$	(6,444)	\$ (6,444)
Amortization and depletion		(241,073)		(1,897)	(242,970)
Balance at December 31, 2017	\$	(241,073)	\$	(8,341)	\$ (249,414)
Amortization and depletion		(230,400)		(1,956)	(232,356)
Balance at December 31, 2018	\$	(471,473)	\$	(10,297)	\$ (481,770)
 <u>Carrying amounts</u>					
Balance at December 31, 2017	\$	2,302,223	\$	-	\$ 2,302,222
Balance at December 31, 2018	\$	2,836,927	\$	-	\$ 2,836,926

At December 31, 2018, estimated salvage values associated with developed properties of \$64,746 (December 31, 2017 - \$64,746) were excluded from, and future development costs of \$12,970,000 (December 31, 2017 - \$12,112,000) were included in, petroleum properties and equipment for the purposes of calculating depletion.

7. INCOME TAXES

The income tax provision is calculated by applying the applicable Canadian federal and provincial statutory tax rate to pre-tax income with adjustments as set out in the following table:

<u>Years ended</u>	<u>December 31, 2018</u>	<u>December 31, 2017</u>
Loss before income taxes	\$ (730,721)	\$ (485,640)
Statutory combined federal and provincial tax rate	27.00%	27.00%
Computed income tax provision	(197,295)	(131,123)
Increase in income taxes resulting from:		
Stock-based compensation	41,040	14,850
Other	67,272	60,632
Valuation Allowance	88,983	55,641
Provision for income tax recovery	\$ -	\$ -

The Corporation's net unrecognized temporary differences are as follows:

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	December 31, 2018	December 31, 2017
Petroleum properties and equipment	\$ 4,701,395	\$ 5,941,761
Share issue costs	180,241	176,814
Losses carryforward	6,391,216	4,663,905
	<u>\$ 11,272,851</u>	<u>\$ 10,782,480</u>

For income tax purposes, the Corporation has losses carried forward from prior years which can be applied to reduce future years' taxable income. These losses expire as follows:

2027	\$ 180,436
2028	417,454
2029	339,429
2030	355,762
2031	560,838
2032	308,231
2033	110,549
2034	94,455
2035	140,966
2036	143,209
2037	2,012,576
2038	1,727,310
	<u>\$ 6,391,216</u>

The benefit of these losses has been recognized in the calculation of the Corporation's net future income tax asset.

As of December 31, 2018, the Company had accumulated \$13,258,689 (2017 - \$12,318,377), in aggregate, in deductible income tax pools.

8. SHORT-TERM LOAN

On November 25, 2016, Drakkar entered into a loan agreement to borrow \$400,000 in order to complete the acquisition of a 70 percent working interest in a Montney oil producing property at Girouxville, Alberta. The lender purchased the remaining 30 percent working interest. The loan had a maturity date of May 25, 2017 and is secured by a 20 percent working interest in Drakkar's portion of the acquired property. Drakkar is required to pay monthly interest on the principal at a rate of 12 percent per annum, until such time that the loan is repaid in full. The loan was not repaid at maturity, with consent of the lender, and is now, effectively, a demand loan.

9. CONVERTIBLE DEBENTURES

As at December 31, 2018, the face value of the convertible debentures outstanding was \$705,600 (2017 - \$705,600).

The convertible debentures pay interest of 8.5%, per annum, semi-annually on March 1 and September 1. These debentures mature August 31, 2021. Each \$100 principal amount of Debentures will be convertible into 400 Common Shares, representing a conversion price of \$0.25 per Common Share. The Corporation can force conversion at a share price of \$0.25 after two years subject to certain terms and conditions.

In April 2017, two companies owned by a director and officer agreed to settle their trade amounts due from the Corporation of \$115,162, in aggregate, in exchange for \$30,000 of convertible debentures and 340,647 class A Common Shares. The consideration given equals the liability settled. The convertible debentures pay interest of 8.5%, per annum, semi-annually on March 1 and September 1. These debentures mature August 31, 2021.

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The convertible debentures are compound financial instruments and have been classified as debt, net of issuance costs, with the residual value, representing the conversion feature, allocated to shareholders' equity. The fair value of the debt component of the debentures was determined by discounting the contractually determined stream of future cash flows using an average of estimated interest rates (ranging from 14 to 21 percent) for similar debt instruments without a conversion feature, adjusted upwards for a risk premium and adjusting the value for the fair value of the Company's right of early redemption, valued at \$59,425 on issue. Total issuance costs of \$252,773, of which \$154,599 and \$12,680 pertained to the fair values of the Warrants and Finder's Warrants described above (see note 11(d) and 11(e)), respectively, were deducted from the debt and equity components on a pro-rata basis. The issuance costs allocated to the debt component will be amortized over the term of the convertible debentures and will accrete over time until maturity to the principal balance of the debentures. The accretion of issuance costs and the interest paid on the convertible debentures are expensed on the statements of net income (loss) and deficit.

As at December 31, 2018, there were 2,822,400 (2017 - 2,822,400) common shares reserved for issuance in the event of conversion of the convertible debentures.

As at December 31, 2018 and 2017, the debt and equity components of the convertible debentures were as follows:

	December 31, 2018	December 31, 2017
Debt component, beginning of period	\$ 497,133	\$ 414,191
Issuance, net of transaction costs	-	30,000
Accretion	121,780	107,824
Interest repayment	(57,426)	(54,882)
Debt component, end of period	\$ 561,487	\$ 497,133
Equity component, beginning of period	\$ 228,656	\$ 228,656
Common shares, net of transaction costs	-	-
Contributed surplus, net of transaction costs	-	-
Equity component, end of period	\$ 228,656	\$ 228,656

10. DECOMMISSIONING OBLIGATIONS

The following table summarizes changes in asset retirement obligations for the year:

	December 31, 2017	December 31, 2016
Decommissioning obligations, beginning of year	\$ 851,240	\$ 838,240
Changes in liabilities during the year related to:		
Liabilities related to property disposition	(11,224)	-
Change in estimate	-	-
Accretion expense	15,369	13,000
Decommissioning obligations, end of year	\$ 855,385	\$ 851,240

The undiscounted amount of the estimated future cash flows required to settle the obligations as at December 31, 2018 was \$1,108,023 (December 31, 2017 - \$1,057,000). These obligations will be settled at the end of the useful lives of the underlying assets, which currently average 15.5 years (December 31, 2017 – 16.3 years), but extend up to 20 years in the future. The estimated future cash flows have been calculated using an inflation rate of 2.4% (2017 – 2.4%) and discounted at credit adjusted risk free rate of 1.7% (2017 – 1.7%).

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11. SHARE CAPITAL

- (a) Authorized
Unlimited number of Class A, B, C and D common shares
Unlimited number of preferred shares

(b) Issued and outstanding

As at December 31, 2018, there were 38,248 (2017 - 36,736) convertible preferred shares outstanding was \$956,200 (2017 - \$918,400). The table below shows the face value of the shares. The accounting allocation of the convertible preferred shares is explained for in the notes below.

	<u>December 31, 2018</u>		<u>December 31, 2017</u>	
	<u>#</u>	<u>Face value</u> <u>\$</u>	<u>#</u>	<u>Face value</u> <u>\$</u>
Preferred shares - beginning of the year	36,736	918,400	17,976	449,400
Issued for cash	1,512	37,800	18,760	469,000
Preferred shares - end of the year	38,248	956,200	36,736	918,400

Each Preferred Share Unit consisted of \$700 of series A non-voting convertible preferred shares (the "Preferred Shares") at a price of \$25 per Preferred Share (28 Preferred Shares), 1,200 Class A common shares and 1,200 Warrants of the Corporation. The holders of Preferred Shares are entitled to receive, as and when declared by the Corporation's board of directors, non-cumulative dividends at a rate of 6.0 percent per annum compounded annually. Dividends shall be payable semi-annually on March 1st and September 1st each year beginning March 1, 2017 until the redemption date, August 31, 2021. In the event that any preferred shares remain outstanding at the redemption date, the Corporation is required to redeem the preferred shares at \$25 per share prior to the redemption date. Holders of Preferred Shares will have the right to convert all, or any part of, the Preferred Shares into Common Shares at a price of \$0.30 per Common Share. The Corporation may force the conversion of the Preferred Shares, in whole or in part, into Common Shares at any time after 24 months following the initial issuance date of the Preferred Shares at a conversion price of \$0.30 per Common Share (83.33 Common Shares per Preferred Share), provided that at the time of such conversion the fair market value of the Common Shares exceeds \$0.40 per Common Share based upon an arm's length transaction or issuance of Common Shares by the Corporation.

On January 26, 2017, the Corporation entered into Stock Bonus Agreements with certain directors, officers and employees whereby Drakkar issued, in aggregate, 275,000 Class A common shares valued at a price of \$0.20 per Class A common share to the directors, officers and employees in consideration for past services rendered and to provide incentive for continued service to the Corporation. The directors, officers and employees may not pledge, dispose, hypothecate or transfer any of the shares issued pursuant to the agreements until the occurrence of the earlier of one of the following events: (i) a future date stipulated in each respective agreement, until which the employee, director or officer must continue to be employed with the Corporation as an employee, director or officer from the date of the agreement; or (ii) immediately prior to the occurrence of a liquidity event as defined within the agreement. During the year ended December 31, 2017, the Company recorded \$55,000 in stock-based compensation expense.

On February 13 and March 9, 2017, 28,242 and 3,750 Class A common shares, respectively, were issued from treasury resulting from the exercise of 28,242 and 3,750 Class A common share warrants, respectively, at an exercise price of \$0.25 per Class A common share. Total proceeds received were \$7,061.

On February 24 and April 3, 2017, the Corporation completed two additional closings to a non-brokered private placement offering consisting of 120 Preferred Share Units (for 3,360 convertible preferred shares, 144,000 common shares, and 144,000 warrants) and 65 Preferred Share Units (for 1,820 convertible preferred shares, 78,000 common shares, and 78,000 warrants), respectively, at a price of \$1,000 per Preferred Share Unit for total gross proceeds of \$120,000 and \$65,000, respectively (see note 11(b)). The

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Corporation paid finder's fees totaling \$13,300, representing the finder's commission plus expenses related to subscriptions resulting from the finder's efforts. In addition, the Corporation granted to the finder 66,000 Finder's Warrants. Each Finder's Warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of 18 months from the closing date.

On April 3, 2017, the Corporation completed a non-brokered private placement offering consisting of 140,000 Class A common shares issued on a flow-through basis eligible for renunciation of CEE at a price of \$0.25 per Flow-Through Share, for total gross proceeds of \$35,000. The Corporation has \$35,000 of CEE qualifying expenditures to incur on, or before, December 31, 2018. The Corporation paid a finder's fee of \$2,850, representing the finder's commission plus expenses related to subscriptions resulting from the finder's efforts, and issued 14,000 Finder's Warrants. Each Finder's Warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of 18 months from the closing date.

On April 4, 2017, the Corporation issued an aggregate of 340,647 Class A common shares and \$30,000 in convertible debentures to private companies, of which a director of the Corporation is an officer and controlling shareholder, for payment of outstanding invoices from April 1, 2011 to April 30, 2017 totaling \$115,162. The Class A common shares were valued at \$0.25 per share. The convertible debentures will pay interest at a rate of 8.5% per annum, with interest payable semi-annually on March 1 and September 1 of each year, commencing September 1, 2017. The convertible debentures will mature on August 31, 2021. Each \$100 amount of convertible debentures are convertible, at the holder's option, into 400 Class A common shares, representing a conversion price of \$0.25 per share, at varying times prior to maturity on August 31, 2021. Drakkar may redeem the convertible debentures through payment of the outstanding principle and any accrued and unpaid interest and/or may force conversion of the convertible debentures at any time after 24 months of first issuance at a conversion price of \$0.25 per share, provided the market value of the shares exceeds \$0.40 per share based upon a non-arms-length transaction or issuance of shares by the Corporation.

On April 7, 2017, the Corporation notified the holders of certain warrants, totaling 140,750 (expiring on April 11, 2017) that the Board of Directors of Drakkar approved the extension of the expiry date of the warrants from April 11, 2017 to April 11, 2018. All other terms and conditions of exercise remain unchanged.

On April 11, 2017, 6,500 Class A common shares, respectively, were issued from treasury resulting from the exercise of 6,500 Class A common share warrants, respectively, at an exercise price of \$0.25 per Class A common share. Total proceeds received were \$3,289.

On June 14, 2017, the Corporation issued an aggregate of 168,000 Class A common shares to a private company, of which a director of the Corporation is an officer and controlling shareholder, for payment of outstanding invoices from August 31, 2016 to March 31, 2017 totaling \$42,000. The Class A common shares were valued at \$0.25 per share.

On October 30, 2017 the Corporation closed an offering that consisted of 400 Convertible Preferred Share Units ("PSU") at \$1,000 per PSU (11,200 convertible preferred shares, 480,000 class A Common Shares and 480,000 warrants) for gross proceeds of \$400,000. Each PSU consisted of 28 convertible preferred shares, 1,200 Class A Common Share and 1,200 Warrants. Each Warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of two years from the closing date. The Corporation paid finders' fees totaling \$32,000, representing the finder's commissions, plus expenses, related to subscriptions resulting from the finder's efforts.

On November 30, 2017 the Corporation closed an offering that consisted of 618,000 Common Share Units ("CSU") at \$0.25 per CSU (618,000 class A Common Shares and 618,000 warrants) for gross proceeds of \$154,500. Each CSU consisted of 1 Class A Common Share and 1 Warrant. Each Warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of two years from the closing date. The Corporation paid finders' fees totaling \$12,460, representing the finder's commissions plus expenses related to subscriptions resulting from the finder's efforts. In addition, the Corporation granted to the finders 61,800 Finder's Warrants. Each Finder's Warrant

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entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of 18 months from the closing date.

On December 18, 2017, the Company closed an offering that consisted of 85 PSU (for 2,380 convertible preferred shares, 102,000 common shares, and 102,000 warrants) at \$1,000 per PSU for gross proceeds of \$85,000. The Corporation paid finders' fees totaling \$6,800, representing the finder's commissions plus expenses related to subscriptions resulting from the finder's efforts. In addition, the Corporation granted to the finders 34,000 Finder's Warrants. Each Finder's Warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share for a period of 18 months from the closing date.

In 2017, of the total proceeds from the respective PSU unit offerings of \$670,000 (face value of \$469,000) the Corporation recognized the total debt component of the respective unit offering to be \$234,268, using present value techniques, with the residual being allocated to equity. Total transaction costs relating to the unit offerings amounted to \$52,001, an amount of \$18,799 was netted against the debt liability with the remainder being netted against the equity components of the unit offerings. The residual proceeds, net of transaction costs were allocated to share capital with \$160,800, warrants with \$70,568 and the equity component of convertible instrument with \$171,160.

In 2018, of the total proceeds from the respective PSU unit offerings of \$54,000 (face value of \$37,800) the Corporation recognized the total debt component of the respective unit offering to be \$23,500, using present value techniques, with the residual being allocated to equity. Total transaction costs relating to the unit offerings amounted to \$7,935, an amount of \$3,453 was netted against the debt liability with the remainder being netted against the equity components of the unit offerings. The residual proceeds, net of transaction costs were allocated to share capital with \$12,960, warrants with \$9,340 and the equity component of convertible instrument with \$3,718.

On January 9, 2018 and April 23, 2018, the Corporation entered into Stock Bonus Agreements with certain directors, officers and employees whereby Drakkar issued, in aggregate, 670,000 and 90,000 Class A common shares, respectively, valued at a price of \$0.25 per Class A common share to the directors, officers and employees in consideration for past services rendered and to provide incentive for continued service to the Corporation. The Corporation recorded \$152,000 in stock-based compensation based on the fair value (\$0.20/share) of the shares issued.

On February 12, 2018 and August 20, 2018, the Company settled some outstanding invoices, owed to a company controlled by a director and director, by issuing 189,000 and 105,000, respectively, Class A common shares, based on the Corporation's previous financing price of \$0.25 per Class A common share, in lieu of cash payment of \$47,250 and \$26,250, respectively.

The April 16, 2018 closing consisted of 300,000 Common Share Units ("CSU") at \$0.25 per CSU (300,000 class A Common Shares and 300,000 warrants) for gross proceeds of \$75,000 and 54 Preferred Share Units ("PSU") at a price of \$1,000 per PSU for gross proceeds of \$54,000, respectively. Each CSU consisted of 1 Class A Common Share and 1 Warrant. Each PSU consisted of \$700 of series A non-voting convertible Preferred Shares at a price of \$25 per Preferred Share (28 Preferred Shares), 1,200 Class A common shares and 1,200 Warrants of the Corporation. The Corporation paid finder's fees totaling \$9,570, representing the finder's commission plus expenses related to subscriptions resulting from the finder's efforts. In addition, the Corporation granted to the finder 47,600 Finder's Warrants. Each warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common share, limited to a period of two years from the closing date for subscriber warrants and for a period of 18 months from the closing date for finder's warrants.

The June 30, 2018 closing consisted of 1,100,000 Common Share Units ("CSU") at \$0.25 per CSU (1,100,000 class A Common Shares and 1,100,000 warrants) for gross proceeds of \$275,000. Each CSU consisted of 1 Class A Common Share and 1 Warrant. The Corporation paid finders' fees totaling \$22,050, representing the finders' commissions plus expenses related to subscriptions resulting from the finders' efforts. In addition, the Corporation granted to the finders 110,000 Finder's Warrants. Each warrant entitles the holder to purchase one Class A common share at an exercise price of \$0.25 per Class A common

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share, limited to a period of two years from the closing date for subscriber warrants and for a period of 18 months from the closing date for finder's warrants.

The Company incurred \$100,351 (2017 - \$68,601) of cash transaction costs related to 2018 issuances.

As at December 31, 2018, there were 3,187,333 (2017 – 3,061,333) common shares reserved for issuance in the event of conversion of the preferred shares.

As at December 31, 2018 and 2017, the components of the convertible preferred shares were as follows:

	December 31, 2018	December 31, 2017
Preferred debt component, beginning of period	\$ 468,981	\$ 201,947
Issuance, net of transaction costs	20,047	215,467
Accretion	97,019	51,567
Preferred debt component, end of period	\$ 586,047	\$ 468,981
Equity components, beginning of period	\$ 758,188	\$ 355,660
Common shares, net of transaction costs	12,960	160,800
Contribution surplus, net of transaction costs	9,340	70,568
Equity component of convertible instrument, net of transaction costs	3,718	171,160
Equity components, end of period	\$ 784,206	\$ 758,188

(c) Stock options

The Corporation has a stock option plan whereby options to purchase common shares may be granted by the board of directors to directors, officers, employees and consultants of the Corporation. The plan has reserved for issuance a number of common shares equal to ten percent of the total number of common shares issued and outstanding from time to time, calculated on a non-diluted basis. The board of directors shall determine the option price and the period during which an option may be exercised at the time the option is granted. All options granted will be exercisable for a period not to exceed five years, and will be non-transferable and non-assignable, and will comply with all requirements under applicable securities law.

The following table summarizes information about the Corporation's stock options:

	Number of stock options outstanding	Weighted average exercise price
Balance, December 31, 2016	150,000	\$ 1.00
Expired in 2017	(150,000)	1.00
Balance, December 31, 2017 and 2018	-	\$ -
Exercisable, December 31, 2017 and 2018	-	\$ -

On January 21, 2017, a total of 150,000 options to acquire Class A common shares of the Corporation expired unexercised.

(d) Warrants

The following table summarizes information about the Corporation's Class A common share warrants:

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	Number of Class A common share purchase warrants outstanding	Weighted average exercise price
Balance, December 31, 2016	3,344,742	\$ 0.25
Issued	1,422,000	\$ 0.25
Exercised	(38,492)	\$ 0.25
Balance, December 31, 2017	4,728,250	\$ 0.25
Issued	1,464,800	\$ 0.25
Expired	(616,000)	\$ 0.25
Exercised	(1,040,000)	\$ 0.25
Balance, December 31, 2018	4,537,050	\$ 0.25
Exercisable, December 31, 2018	4,537,050	\$ 0.25

On November 13, 2018, the Company extended the expiry date of 1,516,000 warrants from November 25, 2018 to June 30, 2019. All other terms and conditions remain the same. In addition, the expiry date of 311,200 finder's warrants was extended from November 22, 2018 to June 30, 2019. All other terms and conditions of the warrants and finder's warrants remain the same.

265,867 Class A common share warrants with an exercise price of \$0.25 per share were set to expire on April 11, 2017, and were extended to April 11, 2018 and then again to April 11, 2019, whereon they expired. All other terms and conditions of exercise remain unchanged.

In connection with the July 21, September 7 and November 22, 2016 closings of the Corporation's Unit and Debenture Unit offerings and the November 22, 2016 Preferred Share Unit offering the Corporation issued an aggregate of 3,172,000 Class A common share warrants with an exercise price of \$0.25 per share and an expiry date of 24 months after issuance, and were extended for an additional 7 months.

A summary of the outstanding Class A common share warrants as at December 31, 2018 and 2017 is as follows:

December 31, 2018	Class A common share warrants outstanding	Class A common share Warrants exercisable
	Weighted average	
Exercise price	Number outstanding at December 31, 2018	remaining contractual life (years)
\$0.25	4,537,050	0.80
	Number exercisable at December 31, 2018	
	4,537,050	

December 31, 2017	Class A common share warrants outstanding	Class A common share warrants exercisable
	Weighted average	
Exercise price	Number outstanding at December 31, 2017	remaining contractual life (years)
\$0.25	4,728,250	1.02
	Number exercisable at December 31, 2017	
	4,728,250	

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Year ended	December 31, 2017
Risk-free interest rate (%)	0.48 - 1.2%
Expected life (years)	0.01 – 1.01 years
Expected volatility (%)	78.1 – 103.3%
Expected dividend yield (%)	0%
Expected vesting period (years)	0 years
Fair value of warrants with new expiry date (\$/warrant)	\$0.0832 - \$0.1093
Fair value of warrants with original expiry dates (\$/warrant)	\$0.1045

The assumptions used in the Black and Scholes Option Pricing model and the resulting fair value of the warrants issued, during the year ended December 31, 2018, were as follows:

Year ended	December 31, 2018
Risk-free interest rate (%)	1.77% - 1.88%
Expected life (years)	2 years
Expected volatility (%)	83.57%
Expected dividend yield (%)	0%
Expected vesting period (years)	0 years
Fair value of Class A common share warrants issued (\$/warrant)	\$0.0787

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(e) Finder's warrants

The following table summarizes information about the Finder's Warrants:

	Number of Class A common share purchase warrants outstanding	Weighted average exercise price
Balance, December 31, 2016	468,800	\$ -
Issued	175,800	\$ 0.25
Balance, December 31, 2017	644,600	\$ 0.25
Issued	157,600	\$ 0.25
Exercised	(109,696)	\$ 0.25
Expired	(127,904)	\$ 0.25
Balance, December 31, 2018	564,600	\$ 0.25
Exercisable, December 31, 2018	564,600	\$ 0.25

In connection with the April 16 and June 29, 2018 Common Share Unit, and Preferred Share Unit offerings above described in note 11 (a) and (b) above, the Corporation issued an aggregate of 157,600 Class A common share warrants to the finder. The warrants have an exercise price of \$0.25 per share and an expiry date of 18 months after issuance.

A summary of the outstanding Finder's Warrants as at December 31, 2018 is as follows:

December 31, 2018	Class A common share warrants outstanding	Class A common share warrants exercisable
	Weighted average	
Exercise price	Number outstanding at December 31, 2018	remaining contractual life (years)
		Number exercisable at December 31, 2018
\$0.25	564,600	0.48
		564,600

The assumptions used in the Black-Scholes Option Pricing model and the resulting fair value of the warrants issued during the year ended December 31, 2018 were as follows:

Year ended	December 31, 2018	December 31, 2017
Risk-free interest rate (%)	1.77% - 1.88%	0.48% - 0.63%
Expected life (years)	1.5 years	1.5 years
Expected volatility (%)	89.41% - 84.05%	92 - 96%
Expected dividend yield (%)	0%	0%
Expected vesting period (years)	0 years	0 years
Fair value of Class A common share warrants issued (\$/warrant)	\$0.0718 - \$0.0793	\$0.0732 - \$0.0772

The fair value of the Finder's Warrants was estimated to be \$31,520 (2017 - \$10,731). This amount was classified as an issuance cost allocated, on a pro-rata basis, to the debt and equity components of the Corporation's Debentures and a reduction to share capital with a corresponding increase to contributed surplus.

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12. PER SHARE AMOUNTS

A reconciliation of net loss per share is summarized as follows:

Years ended	December 31, 2018	December 31, 2017
Basic – Class A common shares	20,005,797	17,052,719
Dilutive effect of options	-	-
Diluted – Class A common shares	20,005,797	17,052,719
Net loss per share – basic and diluted	\$ (0.04)	\$ (0.03)

For the calculation of weighted average number of diluted shares outstanding for the year ended December 31, 2018, Nil stock options (December 31, 2017 – Nil) 4,719,750 warrants (December 31, 2017 – 4,723,450) and 604,610 Finder's Warrants (December 31, 2017 – 644,600) were excluded as they were determined to be anti-dilutive.

13. SUPPLEMENTAL CASH FLOW INFORMATION

Years ended	December 31, 2018	December 31, 2017
Changes in non-cash working capital:		
Accounts receivable and accrued receivables	\$ (276,746)	\$ (53,367)
Prepaid expenses	7,649	(6,648)
Accounts payable and accrued liabilities	357,816	82,862
	\$ 88,719	\$ 22,847
Changes in non-cash working capital:		
Operating	\$ 251,545	\$ (191,707)
Financing	(190,949)	211,048
Investing	28,123	3,506
	\$ 88,719	\$ 22,847

14. RELATED PARTY TRANSACTIONS**As at December 31, 2018:**

- (a) As at December 31, 2018, accounts payable and accrued liabilities included \$26,277 owing to a law firm in which a director of the Corporation is a partner. The amount was comprised of \$10,195 related to transaction costs associated with the Corporations 2016 financing initiatives (see note 11 and 11(b)) and \$16,082 related to general corporate matters. These costs were recorded to share issue costs, convertible debentures, share capital and general and administrative expenses.
- (b) During the year ended December 31, 2018, the Corporation paid, in Class A common shares of the Corporation (see note 11(b)), \$73,500 to a private company, of which a director of the Corporation is an officer and controlling shareholder. As December 31, 2018, accounts payable and accrued liabilities included an additional \$62,921. During the year, the company incurred \$63,000 related to management fees, \$12,000 related to office rent and \$15,458 related to administrative services. These costs were recorded to petroleum and natural gas acquisitions, convertible debentures, share capital, and general and administrative expenses.

As at December 31, 2018, accounts payable and accrued liabilities included \$82,290 related to financial consulting services owing to a private financial consulting company, of which an officer of the Corporation is an officer and controlling shareholder. These costs were recorded to general and administrative expenses, and \$7,875 was incurred in 2018.

As at December 31, 2017:

- (a) As at December 31, 2017, accounts payable and accrued liabilities included \$81,111 owing to a law firm in which a director of the Corporation is a partner. The amount was comprised of \$33,508 related

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to the Corporation's April 10, 2015 rights offering, \$22,932 related to transaction costs associated with the Corporation's 2016 financing initiatives (see note 11 and 11(b)) and \$24,671 related to general corporate matters. These costs were recorded to share issue costs, convertible debentures, share capital and general and administrative expenses.

- (b) During the year ended December 31, 2017, the Corporation paid, in Class A common shares of the Corporation (see note 11(b)), \$157,162 to private companies, of which a director of the Corporation is an officer and controlling shareholder. As December 31, 2018, accounts payable and accrued liabilities included an additional \$219,816, comprised \$13,125 related to acquisitions (see note 4), \$13,125 related to transaction costs associated with the Corporation's 2016 financing initiatives (see note 9 and 11(b)), \$130,200 related to management fees, \$73,500 related to office rent and \$2,991 related to administrative services. These costs were recorded to petroleum and natural gas acquisitions, convertible debentures, share capital, and general and administrative expenses.
- (c) As at December 31, 2017, accounts payable and accrued liabilities included \$82,247 related to financial consulting services owing to a private financial consulting company, of which an officer of the Corporation is an officer and controlling shareholder. These costs were recorded to general and administrative expenses, and \$26,700 was incurred in 2017.

15. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Corporation's financial instruments consist of cash and cash equivalents, accounts receivable and accrued receivables, accounts payable and accrued liabilities, convertible debentures and convertible preferred shares.

The Corporation has exposure to credit risk, liquidity risk and market risk from its use of financial instruments. The Corporation's risk management strategies and policies are designed to identify and analyze the risks faced by the Corporation and ensure that any exposure to risk is in compliance with the Corporation's business objectives and risk tolerance levels.

(a) Credit risk

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

As at December 31, 2018 the Corporation's accounts receivable and accrued receivables was comprised of amounts owing from its crude oil marketer and its joint venture partner. They amount owing from its crude oil marketer was paid within 30 days and the amounts owed by its joint venture partner were offset by amounts owed by the Company to the partner.

The Corporation's accounts receivable and accrued receivables were aged as follows:

	Current	Past Due	Total
As at December 31, 2018	\$ 78,274	\$ 395,837	\$ 474,111
As at December 31, 2017	\$ 136,885	\$ 60,480	\$ 197,365

At the time of the preparation of these financial statements, the Corporation had received payment for 10% of the above outstanding amounts. Of the total amount due, 77% is due from the lender of the short term loan and related to joint venture activities. Also, \$250,578 related to JV activities is due to the joint venture partner.

The Corporation's cash and cash equivalents consist of cash balances and short-term investments with redemption features and/or a maturity of 90 days or less at the time of issue. Drakkar manages the credit exposure related to short-term investments by selecting redeemable guaranteed investment certificates and avoiding complex investment vehicles with higher risk such as asset backed commercial paper. Additionally, cash and cash equivalents are held with a reputable Canadian chartered bank, from which management believes the risk of loss to be minimal.

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The maximum exposure to credit risk is represented by the carrying amount of accounts receivable and accrued receivables and cash and cash equivalents.

(b) 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, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Corporation's reputation.

The Corporation monitors its working capital position and monthly administrative and operating costs, prepares capital expenditures budgets, which are monitored and updated as considered necessary, and utilizes authorizations for expenditures to manage capital expenditures. As at December 31, 2018, Drakkar had a working capital deficiency of \$412,934. The corporation believes that it can meet short term obligations from operating income and ongoing efforts to raise additional funds from issuance of equity and longer term debt. The maturity dates for the Corporation's financial liabilities are as follows:

	< Six Months	Six Months – One Year	One – Four Years
Accounts payable and accrued liabilities	\$ 866,781	\$ -	\$ -
Short-term loan	\$ 400,000	\$ -	\$ -
Convertible debentures	\$ -	\$ -	\$ 705,600
Convertible preferred shares	\$ -	\$ -	\$ 956,200

The Corporation does not yet have a revolving reserves based credit facility. To date, Drakkar has relied primarily on equity and debt financings and revenues generated from its producing conventional properties to fund its capital expenditures program and support administrative and operating costs. While the Corporation has been successful to date in raising additional equity and generating cash flow from its producing conventional properties, there is no assurance that debt and/or equity financing will continue to be available on terms acceptable to the Corporation in the future or that its producing properties will continue to be profitable.

To further manage its liquidity risk, the Corporation maintains an insurance program to minimize exposure to insurable losses.

(c) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net earnings (loss) or the fair value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

Foreign currency exchange rate risk is the risk that the Corporation's future cash flows or the fair value of its financial instruments will fluctuate as a result of changes in foreign exchange rates. The Corporation's exposure to this risk relates to prices received for its petroleum and natural gas, which are primarily determined in reference to US dollars. As at December 31, 2018, the Corporation had no forward exchange rate contracts in place and no working capital items denominated in foreign currencies.

Commodity price risk is the risk that the Corporation's future cash flows or the fair value of its financial instruments will fluctuate as a result of changes in commodity prices. Commodity prices are impacted by world economic events that affect supply and demand, which are generally beyond the Corporation's control. Drakkar's production is sold under short-term contracts and thus, the Corporation is at risk to near term price movements. The Corporation manages this risk by monitoring commodity prices and factoring them into its net revenue accrual estimates and operational decisions, such as contracting or expanding its capital expenditures program. As at December 31, 2018, the

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Corporation had not entered into any financial derivatives or physical delivery fixed price sales contracts.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. As at and during the year ended December 31, 2018, the Corporation had convertible debentures with fixed interest rates and had not entered into any interest rate swap or other financial contracts. The Corporation's exposure to interest rate risk was limited to interest rate fluctuations on cash held in short-term investments.

(d) Capital management strategy

The Company's policy on capital management is to maintain a prudent capital structure so as to maintain financial flexibility, preserve access to capital markets, maintain investor, creditor and market confidence and to allow the Company to fund future developments. The Company considers its capital structure to include share capital, cash and cash equivalents, working capital, convertible debentures and convertible preferred shares. In order to maintain or adjust capital structure, the Company may from time to time issue shares or enter into debt agreements and adjust its capital spending to manage current and projected operating cash flows and debt levels.

The Company's share capital is not subject to any external restrictions. There have been no changes to the Company's capital management strategy during the year ended December 31, 2018.

16. CORPORATE TRANSACTION

On July 3, 2018 the Company entered into a non-binding letter of intent with Blacksteel Energy Inc. ("BEY") for a proposed business combination whereby each Drakkar shareholder would receive one common share of the resulting entity and each BEY shareholder would receive one common share in the resulting entity for each 3.25 BEY common shares. The transaction and timing is subject to the signing of a definitive agreement and customary representations, warranties and closing conditions and if necessary, shareholder approvals. Among other things, the parties have agreed to a commercially reasonable efforts financing to support an agreed upon capital and business plan, seek to extend the maturity date of BEY unsecured convertible debentures and agreed upon resale restrictions on shares of the post transaction company.

17. SUBSEQUENT EVENTS

- (a) On January 31, 2019, the Company extended the expiry date of 144,000 warrants from February 24, 2019 to September 30, 2019 and 78,000 warrants from April 30, 2019 to September 30, 2019. All other terms and conditions remain the same.
- (b) To date 300,000 warrants were exercised at \$0.25 per share for proceeds of \$75,000.
- (c) On May 27, 2019, the Company extended the expiry date of 1,516,000 warrants from June 30, 2019 to March 31, 2020. All other terms and conditions remain the same. In addition, the expiry date of 61,800, 34,000, 311,200 finder's warrants were extended from May 30, 2019, June 18, 2019 and June 30, 2019 respectively to December 31, 2019. All other terms and conditions of the warrants and finder's warrants remain the same.
- (d) In March 2019, the Company repaid \$30,000 of the short term loan.