



UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED
JUNE 30, 2020 AND JUNE 30, 2019



CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

(Canadian \$000s)	As at June 30, 2020	As at Dec 31, 2019
ASSETS		
Current Assets		
Trade and other receivables (NOTE 4)	8,874	17,990
Prepays and deposits (NOTE 5)	5,873	5,295
TOTAL CURRENT ASSETS	14,747	23,285
Property, plant and equipment (NOTE 8 & 9)		
Exploration and evaluation (NOTE 9)	320,046	334,881
Right of use asset (NOTE 10)	21,332	22,837
Deferred income tax	246	410
	5,081	2,381
TOTAL ASSETS	361,452	383,794
LIABILITIES		
Current Liabilities		
Trade and other payables (NOTE 6)	13,630	15,464
Operating loan (NOTE 12)	1,887	5,956
Derivative Liability (NOTE 18)	1,143	-
Lease liability (NOTE 11)	458	529
Decommissioning liability (NOTE 13)	473	1,128
TOTAL CURRENT LIABILITIES	17,591	23,077
Long term debt (NOTE 12)		
Lease liability (NOTE 11)	57,854	57,858
Decommissioning liability (NOTE 13)	-	188
	10,114	18,055
TOTAL LIABILITIES	85,559	99,178
SHAREHOLDERS' EQUITY		
Share capital (NOTE 14)	225,158	225,158
Contributed surplus (NOTE 14)	25,367	22,224
Accumulated earnings	25,368	37,234
TOTAL SHAREHOLDERS' EQUITY	275,893	284,616
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	361,452	383,794

COMMITMENTS (NOTE 17)

SUBSEQUENT EVENTS (NOTE 22)

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

Approved on behalf of the Board of Directors:

Signed "Donald A. Engle"

Signed "James C. Lough"

Donald A. Engle
Chairman of the Board

James C. Lough
Director

**CONSOLIDATED STATEMENTS OF NET (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME
(UNAUDITED)**

(Canadian \$000s, except per share amounts)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
REVENUE				
Petroleum and natural gas sales (NOTE 20)	13,323	35,450	41,270	70,098
Royalties	(993)	(2,907)	(3,245)	(5,512)
NET REVENUE	12,330	32,543	38,025	64,586
Other income (NOTE 15)	1,253	2,470	2,898	4,458
(Loss) gain on financial derivative contracts (NOTE 18)	(3,106)	-	1,287	-
Loss on investment (NOTE 7)	-	-	-	(2,565)
Interest income	-	-	-	9
TOTAL REVENUE AND OTHER INCOME	10,477	35,013	42,210	66,488
EXPENSES				
Operating	8,599	10,312	19,726	21,143
Transportation	746	811	1,874	2,230
General and administration	1,374	2,395	3,089	4,541
Depletion, depreciation and amortization (NOTE 9 & 10)	11,886	14,296	25,351	28,034
Financing (NOTE 12)	485	435	1,146	782
Accretion (NOTE 13)	359	252	743	430
Share-based compensation (NOTE 16)	1,563	1,337	3,143	2,764
Exploration and evaluation - expiries (NOTE 9)	790	197	1,705	631
Transaction costs (NOTE 8)	-	8	-	8
NET (LOSS) INCOME BEFORE TAX EXPENSE	(15,325)	4,970	(14,567)	5,925
TAX EXPENSE				
Deferred income tax expense (recovery)	(3,563)	(389)	(2,701)	615
NET (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME	(11,762)	5,359	(11,866)	5,310
(LOSS) INCOME PER SHARE (\$) (NOTE 14)				
Basic	(0.08)	0.04	(0.08)	0.04
Diluted	(0.08)	0.04	(0.08)	0.04

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

(Canadian \$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
SHARE CAPITAL				
Balance, beginning of period	225,158	216,208	225,158	216,208
Issue of common shares under option plans (NOTE 16)	-	111	-	111
BALANCE, END OF PERIOD	225,158	216,319	225,158	216,319
CONTRIBUTED SURPLUS				
Balance, beginning of period	23,804	20,726	22,224	19,299
Share-based compensation (NOTE 16)	1,563	1,337	3,143	2,764
BALANCE, END OF PERIOD	25,367	22,063	25,367	22,063
EARNINGS				
Balance, beginning of period	37,130	13,506	37,234	13,355
Net (loss) income and comprehensive (loss) income	(11,762)	5,359	(11,866)	5,310
BALANCE, END OF PERIOD	25,368	18,865	25,368	18,665

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Canadian \$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
CASH PROVIDED BY (USED IN):				
OPERATING ACTIVITIES				
Net (loss) income and comprehensive (loss) income	(11,762)	5,359	(11,866)	5,310
ITEMS NOT AFFECTING CASH:				
Depletion, depreciation and amortization (NOTE 9 & 10)	11,886	14,296	25,351	28,034
Accretion expense (NOTE 13)	359	252	743	430
Exploration and evaluation (NOTE 9)	790	197	1,705	631
Unrealized loss (gain) on foreign exchange	30	-	(73)	-
Share-based compensation (NOTE 16)	1,563	1,337	3,143	2,764
Loss on investment (NOTE 7)	-	-	-	2,565
Unrealized loss on financial derivatives (NOTE 18)	5,536	-	1,143	-
Deferred income tax expense (recovery)	(3,563)	(389)	(2,701)	615
Non-cash financing expense (NOTE 12)	61	102	144	135
Decommissioning expenditures (NOTE 13)	(89)	(1,458)	(319)	(1,919)
FUNDS FLOW FROM OPERATIONS	4,811	19,696	17,270	38,565
Change in non-cash working capital (NOTE 20)	(1,006)	105	12,185	(3,135)
CASH FLOW FROM OPERATING ACTIVITIES	3,805	19,801	29,455	35,430
INVESTING ACTIVITIES				
Exploration and evaluation (NOTE 9)	(294)	(695)	(427)	(803)
Property, plant and equipment (NOTE 9)	(282)	(14,523)	(19,145)	(33,500)
Acquisitions (NOTE 8)	-	(119)	-	(119)
Change in non-cash working capital (NOTE 20)	(9,944)	(2,883)	(5,407)	(7,085)
CASH FLOW USED FOR INVESTING ACTIVITIES	(10,520)	(18,220)	(24,979)	(41,507)
FINANCING ACTIVITIES				
Operating line (NOTE 12)	1,887	(1,367)	(4,069)	(3,807)
Financing lease expense (NOTE 11)	(139)	(114)	(277)	(226)
Long term debt (NOTE 12)	(4,130)	(100)	(130)	9,900
Change in non-cash working capital (NOTE 20)	-	-	-	210
CASH FLOW FROM FINANCING ACTIVITIES	(2,382)	(1,581)	(4,476)	6,077
Decrease in cash and cash equivalents	(9,097)	-	-	-
Cash and cash equivalents, beginning of period	9,097	-	-	-
CASH AND CASH EQUIVALENTS, END OF PERIOD	-	-	-	-

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



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

These interim consolidated financial statements are as at June 30, 2020 and for the three and six months ended June 30, 2020 and 2019. Tabular amounts in thousands of Canadian dollars, unless otherwise stated. Amounts in text are in Canadian dollars unless otherwise stated.

1. REPORTING ENTITY

Karve Energy Inc. ("Karve" or the "Company") is a growth-oriented, private oil and natural gas company whose principal business activities are the acquisition, exploration and development of oil and gas properties in western Canada.

The Company was incorporated under the laws of the Province of Alberta on January 30, 2014, under the name "1799380 Alberta Ltd.". On June 16, 2014, the Company changed its name to "Bruin Oil & Gas Inc." ("Bruin") and on September 15, 2016, the Company changed its name to "Karve Energy Inc.". On July 15, 2019, the Company amalgamated with High Ground Energy Inc.

The consolidated financial statements of the Company are comprised of Karve and its wholly-owned subsidiary "DTC Energy Inc." which was incorporated under the laws of the Province of Alberta.

Karve's head office is located at Suite 1700, 205 5 Avenue SW, Calgary Alberta, T2P 2V7.

2. BASIS OF PRESENTATION

Statement of Compliance and Authorization

The consolidated financial statements (the "financial statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of financial statements.

The financial statements were approved and authorized for issue by Karve's Board of Directors on August 12, 2020.

Basis of Measurement

These financial statements have been prepared on the historical cost basis, except for the revaluation to fair value of certain financial assets and financial liabilities, as required under IFRS. The financial statements are measured and presented in Canadian dollars as the functional currency of the Company.

All accounting policies and methods of computation followed in the preparation of these financial statements are consistent with those in the December 31, 2019 audited financial statements, except for income taxes. Income taxes for interim periods are accrued using the income tax rate that would be applicable to the expected annual net income (loss).

Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the periods reported. Actual results may differ from such estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in NOTE 2 of the December 31, 2019 audited consolidated financial statements.

3. UPDATE TO SIGNIFICANT ACCOUNTING POLICIES

Government Grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all conditions with the grant are met. Grants related to assets are recorded as a reduction to the asset's carrying value and are depreciated over the useful life of the asset. Claims under such government grant programs related to income are recorded as a deduction of the related expense.

4. TRADE AND OTHER RECEIVABLES

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Trade	7,310	16,814
Joint venture	2,106	1,680
Allowance for doubtful accounts	(542)	(504)
TRADE AND OTHER RECEIVABLES	8,874	17,990

In determining the recoverability of receivables, the Company uses the ECL model and considers the age of the outstanding receivable and the credit worthiness of the counterparties. During the second quarter of June 2020, the Company recorded an additional joint venture provision of \$38,000 (December 31, 2019 - \$504,000). All remaining joint venture receivables were collectible using the ECL model.

Of the Company's accounts receivable at June 30, 2020, approximately 33% was receivable from two oil marketers (17% and 16%). At December 31, 2019, approximately 54% was receivable from two oil marketers (39% and 15%). Accounts receivable outstanding greater than ninety days at June 30, 2020 was \$1.9 million (December 31, 2019 - \$2.3 million).

5. PREPAIDS AND DEPOSITS

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Prepays	5,775	5,197
Deposits	98	98
PREPAIDS AND DEPOSITS	5,873	5,295

6. TRADE AND OTHER PAYABLES

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Trade	6,586	7,689
Accrued	6,099	5,871
Royalties	475	1,102
GST	244	399
Joint venture	226	403
TRADE AND OTHER PAYABLES	13,630	15,464

7. OTHER LONG-TERM ASSET

On June 14, 2018 the Company acquired a 41% shareholding in a privately held oil and gas company ("PrivateCo") for \$3.0 million in conjunction with a non-core asset disposition. As the Company had significant influence over PrivateCo's operations, it had accounted for the investment using the equity method.

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Balance, beginning of period	-	2,565
Investment in PrivateCo	-	(2,565)
Equity share of loss	-	-
BALANCE, END OF PERIOD	-	-

The investment in PrivateCo was written down to nil in early 2019. On July 18, 2019, the investment in PrivateCo was disposed of for total cash proceeds of \$1.0 million. As such, the Company realized a 2019 net loss on investment of \$1.6 million. The net loss of PrivateCo for the period from January 1, 2019 to July 18, 2019 was \$8.3 million.



8. ACQUISITIONS

The Company accounts for business combinations using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value.

High Ground Energy Inc. Acquisition

On July 15, 2019, the Company acquired all the issued and outstanding common shares of High Ground Energy Inc. (“High Ground”) for total consideration of \$8.8 million and assumption of estimated net debt of \$32.0 million, including all severance and transaction costs. The acquisition was financed by issuing 3.2 million shares of Karve with an estimated fair value of \$2.75 per common share.

The Acquisition of sweet, light oil-weighted Viking assets added approximately 2,000 boe/d of production (52% liquids) contiguous to Karve’s existing core area at Monitor. The Acquisition increased Karve’s dominant footprint in the Alberta Viking with near term expansion of the Company’s waterflood project on acquired lands.

The following table summarizes the fair value of the net assets acquired and the preliminary allocation of the purchase price:

(\$000s)	
Property, plant and equipment	40,566
Cash	965
Derivative asset	531
Deferred tax asset	13,833
Net working capital deficiency	(1,856)
Bank debt	(31,150)
Decommissioning liabilities	(3,308)
FAIR VALUE OF NET ASSETS ACQUIRED	19,581
CONSIDERATION	
Issue of common shares	8,798
TOTAL PURCHASE PRICE	8,798
GAIN ON ACQUISITION	(10,783)

During the year ended December 31, 2019, the Company incurred \$299,000 of transaction costs for the High Ground Acquisition which were included in “Transaction costs” in the Company’s consolidated statement of net (loss) income and comprehensive (loss) income.

The Company’s 2019 consolidated statement of net income and comprehensive income includes the results of the operations for the period following closing of the High Ground Acquisition on July 15, 2019 to December 31, 2019 and includes \$10.1 million of revenue and \$6.0 million of net income relating to the High Ground Acquisition. If the acquisition had closed on January 1, 2019, the Company’s pro-forma revenue and net income are estimated to have been \$165.9 million and \$25.8 million respectively for the year ended December 31, 2019. This pro-forma information is not necessarily indicative of the results of operations that would have occurred had the acquisition been in effect on the date indicated, or the results that may be obtained in the future.

Other Miscellaneous Acquisitions

During the year ended December 31, 2019, the Company acquired various working interests, land, light oil producing properties, royalty interest, and reserves. The fair value of the net assets acquired was \$3.9 million and as consideration, the Company paid cash of \$3.8 million and issued common shares valued at \$0.1 million.

9. CAPITAL ASSETS

The following table reconciles movement of Petroleum and natural gas (“P&NG”) assets, corporate assets, and exploration and evaluation (“E&E”) assets during the period:

	Petroleum and Natural Gas Assets	Corporate Assets	Total Property, Plant and Equipment	Exploration & Evaluation Assets
COST (\$000s)				
BALANCE AT DECEMBER 31, 2018	337,618	733	338,351	23,213
Additions	69,584	83	69,667	1,178
Acquisitions (NOTE 8)	44,645	-	44,645	-
Transfers to (from) P&NG/E&E assets	187	-	187	(187)
Change in decommissioning provision (NOTE 13)	6,625	-	6,625	-
Expiries	-	-	-	(1,367)
BALANCE AT DECEMBER 31, 2019	458,659	816	459,475	22,837
Additions	18,979	166	19,145	427
Transfers to (from) P&NG/E&E assets	227	-	227	(227)
Change in decommissioning provision (NOTE 13)	(9,020)	-	(9,020)	-
Expiries	-	-	-	(1,705)
BALANCE AT JUNE 30, 2020	468,845	982	469,827	21,332
ACCUMULATED DD&A (\$000s)				
BALANCE AT DECEMBER 31, 2018	65,399	119	65,518	-
Depletion, depreciation and amortization	58,915	161	59,076	-
BALANCE AT DECEMBER 31, 2019	124,314	280	124,594	-
Depletion, depreciation and amortization	25,099	88	25,187	-
BALANCE AT JUNE 30, 2020	149,413	368	149,781	-
NET CARRYING AMOUNT, DECEMBER 31, 2019	334,345	536	334,881	22,837
NET CARRYING AMOUNT, JUNE 30, 2020	319,432	614	320,046	21,332

Petroleum and Natural Gas Assets

At June 30, 2020, future development and production costs of \$377.0 million (December 31, 2019 - \$415.3 million) are included in costs subject to depletion.

General and administration costs capitalized by the Company during the six months ended June 30, 2020 were \$314,000 (six months ended June 30, 2019 - \$465,000).

The Company assessed for indicators of impairment and there were no indicators of impairment at June 30, 2020 or at December 31, 2019.

Exploration and Evaluation

Exploration and evaluation assets consist of the Company's undeveloped land, seismic, geological and geophysical costs and exploration projects that are pending the determination of technical feasibility.

The Company assessed for indicators of impairment and there were no indicators of impairment at June 30, 2020 or at December 31, 2019.

10. RIGHT OF USE ASSETS

The following table reconciles the movement of right of use assets during the period:

(\$000s)	
Balance at December 31, 2019	738
Additions	-
BALANCE AT JUNE 30, 2020	738
ACCUMULATED DEPRECIATION AND AMORTIZATION	
Balance at December 31, 2019	(328)
Depreciation and amortization	(164)
BALANCE AT JUNE 30, 2020	(492)
NET CARRYING AMOUNT, JUNE 30, 2020	246

11. LEASE LIABILITY

The company has lease liabilities for office space. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Lease liabilities were measured at a discounted value of lease payments using a weighted average incremental borrowing rate of 5% at January 1, 2019.

(\$000s)	
Balance at December 31, 2019	717
Interest expense	18
Lease payments	(277)
BALANCE AT JUNE 30, 2020	458

	As at June 30, 2020	As at Dec 31, 2019
Lease liability - current	458	529
Lease liability - long term	-	188
TOTAL LEASE LIABILITY	458	717

Undiscounted cash outflows related to lease liabilities are:

(\$000s)	Within 1 year	1 to 5 years	Total
Lease payments	484	-	484

12. OPERATING LOAN AND LONG TERM DEBT

On June 30, 2020, the secured bank credit facilities was renewed to \$65.0 million, comprised of a \$58.0 million syndicated committed facility ("Credit Facility") and a \$7.0 million bank operating loan. The full facility is conforming. The Credit Facility is a committed 364 days + 1 year and extendible upon agreement annually. The Credit Facility and operating line incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75 and 4.75 percent depending on the type of borrowing and the Corporation's debt to EBITDA ratio. The Company is also subject to a standby fee of 0.6875 percent to 1.1875 percent based on the Corporation's debt to EBITDA ratio.

Prior to the June 30, 2020 redetermination, the Credit Facility and operating line incurred interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 0.50 and 3.50 percent depending on the type of borrowing and the Corporation's debt to EBITDA ratio. The Company was also subject to a standby fee of 0.3375 percent to 0.7875 percent based on the Corporation's debt to EBITDA ratio.

As at June 30, 2020, \$57.9 million (net of unamortized debt issue costs) (December 31, 2019 - \$57.9 million) was drawn on the Credit Facility and \$1.9 million (December 31, 2019 - \$6.0 million) was drawn on the bank operating loan.

Bank debt as at June 30, 2020 and December 31, 2019 is as follows:

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Credit Facility	58,000	58,000
Less: unamortized debt issue costs	(146)	(142)
LONG TERM DEBT	57,854	57,858
Bank operating loan	1,887	5,956
TOTAL BANK DEBT	59,741	63,814

Financing expense for the three and six months ended June 30, 2020 and 2019 is comprised of the following:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Credit facility interest and charges	380	265	932	522
Operating loan interest and charges	44	68	70	125
Amortization of debt issue costs	52	87	126	106
Interest on lease liability (NOTE 11)	9	15	18	29
FINANCING EXPENSES	485	435	1,146	782

For the six months ended June 30, 2020, the effective interest rate on the credit facility was 3.30 percent (six months ended June 30, 2019 – 4.32 percent).

13. DECOMMISSIONING LIABILITY

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company to abandon and reclaim the wells and facilities. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities and the discount rate applied in measuring the liability. The liability, the related asset and the expense are impacted by estimates with respect to the costs and timing of decommissioning.

The Company estimates its total undiscounted amount of cash flows required to settle its decommissioning liability is approximately \$194.0 million (\$100.4 million undiscounted, uninflated), which will be incurred over the remaining life of the assets with the majority of costs to be incurred between 2036 and 2060. The estimated future cash flows have been discounted using a credit adjusted rate of 11% (December 31, 2019 – 8%) and an inflation rate of 2% (December 31, 2019 – 2%). The change in estimate for the six months ended June 30, 2020 relates to an increase to the credit adjusted discount rate. The change in estimate for the year ended December 31, 2019 relates to a change in the estimated timing of abandonment and reclamation expenses.

The following table shows changes in the decommissioning liability:

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Balance, beginning of period	19,183	12,494
Decommissioning liabilities incurred during the period	21	90
Decommissioning liabilities acquired through acquisitions (NOTE 8)	-	3,534
Decommissioning liabilities settled during the period	(319)	(4,284)
Accretion expense during the period	743	814
Change in estimate	(9,041)	6,535
BALANCE, END OF PERIOD	10,587	19,183
Decommissioning liability - current	473	1,128
Decommissioning liability - long term	10,114	18,055
TOTAL DECOMMISSIONING LIABILITY - END OF PERIOD	10,587	19,183

14. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares.

Unlimited number of preferred shares, issuable in series.

b) Issued and Outstanding Common Shares

(\$000s except for share amounts)	Number	Amount
Common Shares		
Balance at December 31, 2018	137,269,270	216,208
Issued common shares	3,243,729	8,909
Issued on exercise of options and performance warrants	16,666	27
Allocation of contributed surplus - exercise of options	-	14
BALANCE AT DECEMBER 31, 2019 and JUNE 30, 2020	140,529,665	225,158

c) Contributed Surplus

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Balance, beginning of period	22,224	19,299
Share-based compensation - options	1,650	2,556
Share-based compensation - warrants	1,493	2,978
Options exercised	-	(2,596)
Transfer to share capital on exercise of options and performance warrants	-	(13)
BALANCE, END OF PERIOD	25,367	22,224

d) Per Share Amounts

(\$000s except per share amounts)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Net income (loss) for the period	(11,762)	5,359	(11,866)	5,310
Weighted average number of shares - basic	140,529,665	137,288,914	140,529,665	137,308,343
Dilutive impact of share-based compensation plans	-	10,618,825	-	10,618,825
Weighted average number of shares - diluted	140,529,665	147,907,739	140,529,665	147,927,168
Net (loss) income per share - basic	(0.08)	0.04	(0.08)	0.04
Net (loss) income per share - diluted	(0.08)	0.04	(0.08)	0.04

At June 30, 2020, 8,802,335 stock options and 12,560,000 performance warrants were excluded from the fully diluted calculation as they are anti-dilutive.

15. OTHER INCOME

The following table presents the composition of amounts included in Other Income in the consolidated statements of net (loss) income and comprehensive (loss) income:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Royalty income	523	1,417	1,246	2,391
Processing fee income	737	989	1,523	1,949
Other	(7)	64	129	118
TOTAL OTHER INCOME	1,253	2,470	2,898	4,458

Royalty income relates to freehold royalties, gross overriding royalties, royalties paid to the Company on fee title lands, and net profit interests.

Processing fee income relates to the Company processing third party oil and gas volumes through Karve owned and operated facilities.

Other income relates to foreign exchange gain (loss), road use income, seismic licensing income, and contract operating income.

16. SHARE-BASED COMPENSATION

The following table summarizes the Company's share-based compensation:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Share-based compensation - options	828	595	1,650	1,260
Share-based compensation - performance warrants	735	742	1,493	1,504
TOTAL SHARE-BASED COMPENSATION	1,563	1,337	3,143	2,764

a) Stock Options

Effective June 15, 2016, the Company adopted a new stock option plan under which officers, management, employees, directors and consultants of the Company are eligible to receive grants. Under the stock option plan, which was approved by the Board of Directors, the granted stock options vest to the grantee over a three-year period, the grantee has the right to exercise the stock options for seven years from the date of the grant and the stock options terminate 30 days following the termination of the grantee's employment. All stock options vest and may be exercisable in the event of a change of control or initial public offering. The maximum number of outstanding stock options under the plan is limited to 10% of the common shares outstanding. Stock option grants and the option exercise price are set by the Board of Directors at the time of grant. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for options outstanding has been approved by the board and is to be approved by the Shareholders on May 13, 2020.

Share-based compensation expense related to stock options during the three months ended June 30, 2020 was \$828,000 (three months ended June 30, 2019 - \$595,000).

The following table sets forth a reconciliation of the stock option plan activity from December 31, 2018 through to June 30, 2020:

	Number	Wtd. Avg. Exercise Price (\$)
Balance at December 31, 2018	13,442,260	1.57
Granted	3,908,499	2.26
Forfeited	(611,334)	2.16
Exercised	(3,055,165)	1.40
BALANCE AT DECEMBER 31, 2019	13,684,260	1.78
Granted	150,000	2.25
Forfeited	(83,000)	1.84
BALANCE AT JUNE 30, 2020	13,751,260	1.79

There were no stock options exercised during the six months ended June 30, 2020. As at June 30, 2020, 7,280,533 stock options were exercisable. There were 3,055,165 stock options exercised during the year ended December 31, 2019 and 7,191,533 stock options were exercisable at December 31, 2019.



The range of exercise prices of the outstanding options and weighted average contractual life remaining as at June 30, 2020 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life Remaining	Number of options outstanding	Number of options exercisable
\$0.85	2.96	2,320,976	2,320,976
\$1.00 - \$1.99	3.05	1,667,357	1,667,357
\$2.00 - \$3.00	5.04	9,762,927	3,292,200
	4.45	13,751,260	7,280,533

b) Performance Warrants

There were no performance warrants issued by the Board of Directors during the six months ended June 30, 2020 (year ended December 31, 2019 – nil).

The performance warrants entitle the holder to purchase one common share of the Company and have the following vesting dates and exercise prices:

	2016 Issuance	2017 Issuance
Warrants granted	16,125,000	17,937,500
Issue date	\$1.50	\$3.00
First anniversary	\$1.70	\$3.40
Second anniversary	\$1.90	\$3.80
Third anniversary	\$2.10	\$4.20
Fourth anniversary	\$2.30	\$4.60

The right to exercise the performance warrants is subject to a performance event taking place which includes the occurrence of any of the following (i) the Company raising a minimum of \$25.0 million through a private placement, excluding the securities issued as part of the recapitalization that occurred in June 2016 (ii) the occurrence of an initial public offering on a recognized Canadian or U.S. stock exchange, or (iii) a change of control. Only vested performance warrants based on the schedule above will become exercisable if the Company achieves performance event (i). In the event of performance event (ii) and (iii), all performance warrants outstanding which have not vested or become exercisable in accordance with their terms shall vest and become exercisable immediately. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for performance warrants has been approved by the Board of directors.

Share-based compensation expense related to performance warrants during the three months ended June 30, 2020 was \$735,000 (three months ended June 30, 2019 - \$742,000).

The following table sets forth a reconciliation of performance warrant activity from December 31, 2018 through to June 30, 2020:

	Number	Wtd. Avg. Exercise Price
BALANCE AT December 31, 2018	32,485,500	2.88
Forfeited	(356,000)	3.67
BALANCE AT DECEMBER 31, 2019	32,129,500	2.87
Forfeited	(56,000)	3.80
BALANCE AT JUNE 30, 2020	32,073,500	2.87

There were no performance warrants exercised during the six months ended June 30, 2020 (year ended December 31, 2019 - nil) and 6,460,000 performance warrants were exercisable at June 30, 2020 and December 31, 2019

The range of exercise prices of the outstanding performance warrants and weighted average contractual life remaining as at June 30, 2020 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life Remaining	Number of warrants outstanding	Number of warrants exercisable
\$1.50 to \$2.99	3.06	15,700,000	6,460,000
\$3.00 to \$3.99	4.24	9,824,100	-
\$4.00 to \$4.60	4.24	6,549,400	-
	3.66	32,073,500	6,460,000

17. COMMITMENTS

Future minimum payments under operating leases and pipeline transportation agreements as at June 30, 2020 are as follows:

(\$000s)	2020	2021	2022	Thereafter	Total
Operating leases	48	48	-	-	96
Pipeline transportation	716	1,449	985	1,005	4,155
TOTAL COMMITMENTS	764	1,497	985	1,005	4,251

18. FINANCIAL INSTRUMENTS

The Company has exposure to credit, liquidity, interest, and foreign currency risk from its use of financial instruments. Further qualitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for identifying the principal risks of the Company and ensuring the policies and procedures are in place to appropriately manage these risks. Karve's management identifies, analyzes and monitors risks and considers the implication of the market condition in relation to the Company's activities.

a) Fair Value of Financial Instruments

Financial instruments comprise cash and cash equivalents, trade and other receivables, deposits, derivative assets, trade and other payables, operating loan, and long term debt.

There are three levels of fair value by which a financial instrument can be classified:

Level 1 - Quoted prices in active markets for identical assets and liabilities such as traded securities on a registered exchange where there are a sufficient frequency and volume of transactions to provide ongoing pricing information.

Level 2 - Inputs other than quoted prices that are observable for the asset and liability either directly and indirectly such as quoted forward prices for commodities, time value and volatility factors which can be substantially observed or corroborated in the marketplace; and

Level 3 - Inputs that are not based on observable market data.

The fair value of cash and cash equivalents, trade and other receivables, deposits, and trade and other payables approximate their carrying amounts due to their short-term maturities. The fair value of the amounts drawn on the operating loan and long term debt is equal to its carrying amount as the facilities bear interest at floating rates and credit spreads that are indicative of market rates.

The following table summarizes Karve's financial instruments at June 30, 2020:

(\$000s)	Loans and receivables	Financial liabilities	Total carrying value	Total fair value
Assets				
Trade and other receivables	8,874	-	8,874	8,874
Deposits	98	-	98	98
	8,972	-	8,972	8,972
Liabilities				
Trade and other payables	-	13,630	13,630	13,630
Operating loan	1,887	-	1,887	1,887
Long term debt	57,854	-	57,854	57,854
	59,741	13,630	73,371	73,371

The following table summarizes Karve's financial instruments at December 31, 2019:

(\$000s)	Loans and receivables	Financial liabilities	Total carrying value	Total fair value
Assets				
Trade and other receivables	17,990	-	17,990	17,990
Deposits	98	-	98	98
	18,088	-	18,088	18,088
Liabilities				
Trade and other payables	-	15,464	15,464	15,464
Operating loan	5,956	-	5,956	5,956
Long term debt	57,858	-	57,858	57,858
	63,814	15,464	79,278	79,278

b) Risk Associated with Financial Assets and Liabilities

Commodity Price Risk

Due to the volatile nature of natural gas and oil commodity prices, the Company is exposed to adverse consequences if commodity prices decline. The Company is exposed to commodity price movements as part of its operations, particularly in relation to the prices received for its oil and gas production. Oil and gas is sensitive to numerous worldwide factors, many of which are beyond the Company's control. Changes in global supply and demand fundamentals in the oil and gas market and geopolitical events can significantly affect oil and gas prices. Consequently, these changes could also affect the value of the Company's properties, the level of spending for exploration and development and the ability to meet obligations as they come due. The Company's oil production is sold under short-term contracts, exposing it to the risk of near-term price movements depending on marketing conditions, it is the Company's policy to hedge a portion of its crude oil sales through the use of financial derivative contracts. The Company does not apply hedge accounting to these contracts.

At June 30, 2020, the Company had the following commodity contracts in place:

Type	Term	Basis ⁽¹⁾	Volume (Bbl/d)	Swap Price (\$CAD/Bbl) ⁽¹⁾	Current Liability (\$000s)
Fixed price swap	Jul. 1/20 - Dec. 31/20	WTI	1,000	45.10	(1,577)
Fixed price swap	Jul. 1/20 - Dec. 31/20	WTI	500	55.25	144
Fixed price swap	Jul. 1/20 - Dec. 31/20	WTI	500	54.00	28
Fixed price swap	Jul. 1/20 - Dec. 31/20	WTI	500	54.95	115
Fixed price swap	Jul. 1/20 - Dec. 31/20	WTI	500	55.30	147
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE			3,000	51.62	(1,143)

(1) Nymex WTI monthly average in \$CAD.

At June 30, 2020, the fair value of the financial derivative contracts was a current liability position of \$1.1 million resulting in an unrealized loss of \$1.1 million for the six months ended June 30, 2020. The fair value, or mark-to-market value, of the contracts are based on the estimated amount that would have been received or paid to settle the contracts as at June 30, 2020 and may be different from what will eventually be realized. Assuming all other variables remain constant, a \$5.00 USD increase in WTI would result in a \$533,000 increase in the unrealized loss and a \$5.00 USD decrease in WTI would result in a \$74,000 decrease in the unrealized loss. The Company did not have any commodity contracts in place at December 31, 2019.

The components of the gain on financial derivative contracts is as follows:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Unrealized loss on financial derivative contracts	(5,536)	-	(1,143)	-
Realized gain on financial derivative contracts	2,430	-	2,430	-
(LOSS) GAIN ON FINANCIAL DERIVATIVE CONTRACTS	(3,106)	-	1,287	-

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that bank debt is at a floating or short-term rate of interest in relation to interest expense on its long term debt and operating loan facility. The Credit Facility and operating line incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75 and 4.75 percent depending on the type of borrowing and the Company's debt to EBITDA ratio, and is subject to an annual standby fee on the undrawn portion. As at June 30, 2020, \$58.0 million (December 31, 2019 - \$58.0 million) was drawn on the Credit facility (\$57.9 million – net of amortized debt issue costs). Currently the Company has not entered into any agreements to manage this risk. An increase (decrease) in the interest rate by 1% would result in an increase (decrease) to net loss before tax of \$310,000 for the six months ended June 30, 2020 (six months ended June 30, 2019 - \$65,000).

Liquidity Risk

The Company's approach to managing liquidity risk is to have sufficient cash and/or credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of 12 months to identify any financing requirements. Liquidity is managed through daily and longer-term cash, debt, and equity management strategies. These include estimating future cash generated from operations based on reasonable production and pricing assumptions, estimating future discretionary and non-discretionary capital expenditures and assessing the amount of equity or debt financing available. Given the global measures put into place to limit the spread of a novel strain of the coronavirus ("COVID-19"), the ability to forecast cash flows is challenging (Note 19).



A contractual maturity analysis for the Company's financial liabilities as at June 30, 2020 is as follows:

(\$000s)	Within 1 year	1 to 5 years	More than 5 years	Total
Trade and other payables	13,630	-	-	13,630
Operating loan	1,887	-	-	1,887
Long term debt	-	57,854	-	57,854
TOTAL	15,517	57,854	-	73,371

19. CAPITAL MANAGEMENT

a) Capital Base

In order to continue the Company's future exploration and development program, the Company must maintain a strong capital base to enable access to equity and debt markets. The Company continually monitors the risk/reward profile of its exploration and development projects and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. After considering these factors, revisions to the Company's capital budget is made upon the approval of the Board of Directors.

The Company considers shareholders' capital and net debt/adjusted positive working capital (excluding derivative assets and current portion decommissioning liability) as components of its capital base. The Company can access or increase capital through the issuance of shares, through bank borrowings (based on reserves) and by building cash reserves by reducing its capital expenditure program.

The following table represents the net capital of the Company:

(\$000s)	As at June 30, 2020	As at Dec 31, 2019
Shareholders' capital	275,893	284,616
Total current assets	14,747	23,285
Trade and other payables	(13,630)	(15,464)
Operating loan	(1,887)	(5,956)
Long term debt	(57,854)	(57,858)
NET DEBT	(58,624)	(55,993)
CAPITAL BASE	217,269	228,623

The Company monitors its capital based primarily on its Net debt to annualized funds flow ratio. Net debt and annualized funds flow are non-GAAP measures. Net debt is defined as long term debt plus any net working capital deficiency excluding derivative contract asset/liability, current portion of decommissioning liability, and current portion of lease liability. Annualized funds flow is calculated as cash flow from operations before changes in non-cash working capital for the Company's most recent quarter, multiplied by four. To facilitate the management and control its' capital base, the Company prepares annual operating and capital expenditure budgets. The budgets are updated when critical factors change. These include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and Company specific factors or assumptions such as the Company's drilling results and its production profile. The Company's Board of Directors approves the budget and changes thereto. At June 30, 2020, the Company had net debt of \$58.6 million (December 31, 2019 – \$55.9 million).

The Company's share capital is not subject to external restrictions, but the Company does have key covenants of the credit facilities that include standard business operating covenants. As at June 30, 2020, the Company is in compliance with all covenants.

The current challenging economic climate may lead to further adverse changes in cash flows, working capital levels and/or debt balances, which may also have a direct impact on the Company's operating results and financial position. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. At June 30, 2020, the Company remains in compliance with all terms of our Credit Facility and based on current available information, management expects to comply with all terms during the subsequent 12-month period. However, in light of the current volatility in commodity prices and uncertainty regarding the timing for a recovery in such prices, pipeline and transportation capacity constraints, and the effects of the Coronavirus (COVID-19), preparation of financial forecasts is challenging.

20. SUPPLEMENTAL INFORMATION

The following table presents the composition of changes in non-cash working capital and the allocation to operating and investing activities:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
CHANGES IN NON-CASH WORKING CAPITAL:				
Trade and other receivables (NOTE 4)	327	3,925	9,433	(5,793)
Prepays and deposits (NOTE 5)	(959)	(1,337)	(577)	(994)
Trade and other payables (NOTE 6)	(10,318)	(5,366)	(2,078)	(3,223)
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	(10,950)	(2,778)	6,778	(10,010)
CHANGES IN NON-CASH WORKING CAPITAL RELATED TO:				
Operating activities	(1,006)	105	12,185	(3,135)
Investing activities	(9,944)	(2,883)	(5,407)	(7,085)
Financing activities	-	-	-	210
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	(10,950)	(2,778)	6,778	(10,010)

The following table presents the composition of petroleum & natural gas sales by product:

(\$000s)	For the three months ended		For the six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Crude oil	10,195	32,701	34,281	63,760
Natural gas liquids	346	955	1,205	1,699
Natural gas	2,782	1,794	5,784	4,639
TOTAL PETROLEUM AND NATURAL GAS SALES	13,323	35,450	41,270	70,098

21. RELATED PARTY DISCLOSURES

PrivateCo was a company with some common directors with Karve. On July 18, 2019, the investment in PrivateCo was disposed of for total cash proceeds of \$1.0 million and the Karve staff resigned from the PrivateCo Board of Directors (NOTE 7). For the period from January 1, 2019 to July 18, 2019, the Company received a total of \$1.9 million of gas processing income and royalty income (year ended December 31, 2018 - \$1.9 million) from PrivateCo, based on standard third-party agreements.

22. SUBSEQUENT EVENTS

Subsequent to June 30, 2020, the Company entered into a fixed price derivative swap contract for 500 bbl/d for the period January 1, 2021 to June 30, 2021 at a price of \$58.25 CAD WTI per barrel.