



HIGHWOOD
OIL COMPANY LTD.

HIGHWOOD OIL COMPANY LTD.
CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020
(unaudited)

The accompanying condensed interim consolidated financial statements for Highwood Oil Company Ltd. have been prepared by management in accordance with International Financial Reporting Standards. The Company's independent auditors have not performed a review of these financial statements in accordance with the standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

Highwood Oil Company Ltd.
Condensed Interim Consolidated Statement of Financial Position

(all tabular amounts expressed in thousands of Canadian dollars) (unaudited)	Note	As at September 30 2020	As at December 31 2019
Assets			
Current assets			
Accounts receivable	4, 16(a)	\$ 6,999	\$ 9,010
Insurance proceeds receivable	4	4,000	2,730
Deposits and prepaid expenses	5	1,814	3,610
Reclamation deposits		123	123
Commodity contracts	16(b)	1,020	-
Total current assets		13,956	15,473
Reclamation deposits		18	18
Commodity contracts	16(b)	183	-
Exploration and evaluation assets	6	6,366	7,569
Property, plant and equipment	7	66,417	90,893
Right-of-use assets	8	168	234
Total assets		\$ 87,108	\$ 114,187
Liabilities			
Current liabilities			
Bank overdraft		\$ 37	\$ 183
Accounts payable and accrued liabilities		18,827	20,281
Bank debt	9	36,700	36,894
Commodity contracts	16(b)	-	3,015
Current portion of lease liabilities	8	100	105
Total current liabilities		55,664	60,478
Accounts payable and accrued liabilities		-	1,145
Commodity contracts	16(b)	-	427
Lease liabilities	8	75	136
Decommissioning liabilities	10	40,346	31,099
Deferred tax liability		-	2,905
Total liabilities		96,085	96,190
Shareholders' Equity			
Share capital	12	16,310	16,310
Contributed surplus	13	1,752	1,091
Retained earnings (deficit)		(27,039)	596
Total equity		(8,977)	17,997
Total liabilities and shareholders' equity		\$ 87,108	\$ 114,187

Going concern (note 2(a))

Commitments and contingencies (note 15)

Subsequent events (note 2, 4, 9, 20)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements

Approved by the Board:

“signed”, Stephen J Holyoake, Director

“signed”, Arif Shivji, Director

Highwood Oil Company Ltd.

Condensed Interim Consolidated Statement of Loss and Comprehensive Loss

(all tabular amounts expressed in thousands of Canadian dollars, except for earnings per share information)

(unaudited)

	Note	Three Months Ended,		Nine Months Ended,	
		September	September	September	September
		30,	30,	30,	30,
		2020	2019	2020	2019
Revenue					
Oil sales	3	\$ 5,752	\$ 8,850	\$ 14,034	\$ 25,440
Royalties		(475)	(1,193)	(1,309)	(3,242)
Transportation pipeline revenues		790	1,316	2,719	4,048
Processing and road use revenues	3	229	766	901	1,793
		6,296	9,739	16,345	28,039
Realized gain (loss) on commodity contracts	16(b)	254	(1,004)	2,307	(5,143)
Unrealized gain (loss) on commodity contracts	16(b)	(569)	(1,325)	4,645	(3,100)
Total revenue, net of royalties and commodity contracts		5,981	7,410	23,297	19,796
Expenses					
Operating and transportation		4,522	5,145	12,794	13,748
General and administrative		1,212	1,359	4,158	3,976
Bad debt expense		282	7	283	8
Exploration and evaluation expenditures	6	-	-	-	22
Depletion and depreciation	7, 8, 10	2,108	2,306	5,746	6,727
Impairment loss	6, 7	17,617	-	28,741	-
Stock-based compensation	13	237	194	661	525
Total expenses		25,978	9,011	52,383	25,006
Operating loss		(19,997)	(1,601)	(29,086)	(5,210)
Other income (expenses)					
Gain on disposal of assets	6	-	650	586	2,600
Net listing expense and transaction recovery (costs)	18	300	(109)	184	(1,606)
Finance income and expenses, net	11	(957)	(800)	(2,224)	(2,095)
Total other income (expenses)		(657)	(259)	(1,454)	(1,101)
Loss before taxes		(20,654)	(1,860)	(30,540)	(6,311)
Current tax recovery		-	-	-	152
Deferred tax recovery		580	413	2,905	1,729
Total tax recovery		580	413	2,905	1,881
Loss and comprehensive loss for the period		\$ (20,074)	\$ (1,447)	\$ (27,635)	\$ (4,430)
Loss per share:					
Basic and Diluted	12(c)	\$ (3.34)	\$ (0.24)	\$ (4.59)	\$ (0.74)

See the accompanying Notes to the Condensed Interim Financial Statements

Highwood Oil Company Ltd.
Condensed Interim Consolidated Statement of Changes in Shareholders' Equity

(all tabular amounts expressed in thousands of Canadian dollars)
(unaudited)

	Note	Share capital	Contributed surplus	Retained earnings (deficit)	Total equity
Balance, January 1, 2019		\$ 12,820	\$ 151	\$ 11,609	\$ 24,580
Stock-based compensation	13	-	525	-	525
Shares issued		68	-	-	68
Shares issued on corporate acquisition		1,648	-	-	1,648
Reverse takeover transaction		1,699	149	-	1,848
Exercise of agent options		75	(35)	-	40
Loss and comprehensive loss for the period		-	-	(4,430)	(4,430)
Balance, September 30, 2019		\$ 16,310	\$ 790	\$ 7,179	\$ 24,279
Balance, January 1, 2020		\$ 16,310	\$ 1,091	\$ 596	\$ 17,997
Stock-based compensation	13	-	661	-	661
Loss and comprehensive loss for the year		-	-	(27,635)	(27,635)
Balance, September 30, 2020		\$ 16,310	\$ 1,752	\$ (27,039)	\$ (8,977)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements

Highwood Oil Company Ltd.

Condensed Interim Consolidated Statement of Cash Flows

(all tabular amounts expressed in thousands of Canadian dollars)		Three Months Ended,		Nine Months Ended,	
(unaudited)	Note	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Cash provided by (and used in)					
Operating activities					
Loss for the period		\$ (20,074)	\$ (1,447)	\$ (27,635)	\$ (4,430)
Items not involving cash:					
Unrealized (gain) loss on commodity contracts	16(b)	569	1,325	(4,645)	3,100
Exploration and evaluation expenditures	6	-	-	-	22
Depletion and depreciation expense	7, 8, 10	2,108	2,306	5,746	6,727
Impairment loss	6, 7	17,617	-	28,741	-
Finance expense	11	85	170	437	530
Deferred tax recovery		(580)	(413)	(2,905)	(1,729)
Stock-based compensation	13	237	194	661	525
Gain on disposal of assets	6	-	(650)	(586)	(2,600)
Non-cash operating and transportation expense		929	-	929	-
Listing expense		-	-	-	1,330
Cash abandonment expenditures	10	-	(7)	-	(168)
Proceeds on future abandonment expenditures	4	2,553	-	2,553	-
Change in long-term accounts receivable		-	(258)	-	(258)
Change in non-cash working capital	14	(1,521)	1,006	4,580	8,344
<i>Net cash from operating activities</i>		1,923	2,226	7,876	11,393
Financing activities					
Proceeds on exercise of agent options		-	-	-	40
Proceeds on issuance of shares for cash		-	-	-	68
Payments of lease obligations	8	(31)	(29)	(99)	(91)
Finance fees paid		-	(57)	-	(169)
Bank debt, net of repayments	9	(300)	1,600	(300)	3,600
<i>Net cash from (used in) financing activities</i>		(331)	1,514	(399)	3,448
Investing activities					
Acquisition deposit		-	6,150	-	-
Additions to property, plant and equipment	7	(52)	(469)	(4,368)	(2,920)
Additions to exploration and evaluation assets	6	(15)	(1,913)	(114)	(4,135)
Proceeds on disposition of exploration and evaluation assets	6	-	750	648	3,000
Corporate acquisitions, net of cash received		-	4	-	(2,315)
Change in non-cash working capital	14	(1,419)	(8,839)	(3,497)	(7,607)
<i>Net cash used in investing activities</i>		(1,486)	(4,317)	(7,331)	(13,977)
Change in cash		\$ 106	\$ (577)	\$ 146	\$ 864
Cash (bank overdraft), beginning of period		(143)	(432)	(183)	(1,873)
Cash (bank overdraft), end of period		\$ (37)	\$ (1,009)	\$ (37)	\$ (1,009)
Cash is comprised of:					
Balances with banks (bank overdraft)		\$ (37)	\$ (1,009)	\$ (37)	\$ (1,009)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

1. REPORTING ENTITY

Highwood Oil Company Ltd. (the “Company”) is a public oil and natural gas exploration, development and production Company incorporated in Alberta, Canada on August 24, 2012. The Company conducts its operations in the Western Canadian Sedimentary basin, primarily in the province of Alberta. The Company’s principal place of business is located at Suite 900, 222 – 3rd Avenue SW, Calgary, Alberta, T2P 0B4.

The Company completed a transaction on January 23, 2019 that resulted in the Company becoming a publicly traded entity. The Company’s common shares trade on the TSX Venture Exchange under the symbol “HOCL”.

The condensed interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Cataract Creek Environmental Ltd.

These Condensed Interim Financial Statements were approved and authorized for issuance by the Board of Directors on November 26, 2020.

2. BASIS OF PREPARATION

(a) Going concern

These financial statements have been prepared in accordance with International Financial Reporting Standards applicable to a going concern, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business.

The oil and natural gas commodity price environment has been extremely volatile and suppressed by historical standards in the past few years and has been made significantly worse with the recent COVID-19 outbreak and the resulting global oversupply of oil. The Company has, to the best of its ability, managed through this low price environment by maintaining an active risk management and hedging program, targeting low risk capital projects and accretive, long life asset acquisitions. The downward shift on global oil and natural gas commodity pricing since early 2020 has resulted in the deterioration in the Company’s projected cash flows over the next 12 months.

At September 30, 2020, the Company was in a negative working capital position, excluding bank debt, of \$5.0 million and the amounts outstanding on the bank facility (note 9) is \$36.7 million. At September 30, 2020, the bank facility is confirmed at \$38.0 million, consisting of a \$20.0 million operating facility that matures May 31, 2021, a \$9.0 million term facility that matures November 30, 2020 and a \$9.0 million term facility that matures December 31, 2020. Subsequent to September 30, 2020, the maturity date for the \$9.0 term facility that matured November 30, 2020 was extended to December 15, 2020. The bank facility is subject to semi-annual reviews of the borrowing base, with the next review to be undergone prior to November 30, 2020. The lender has sole discretion on the determination of the borrowing base which is based predominantly on the Company’s cash flows forecast from proved developed producing oil and natural gas reserves. The current state of the Western Canadian energy sector coupled with the suppressed global oil and natural gas commodity price environment has negatively impacted the availability for credit within the industry.

The bank facility has financial and hedging covenants as outlined in note 9. The Company was in violation of its financial covenants, but it has obtained a waiver from the bank prior to September 30, 2020. At planned production rates and forward prices for crude oil being traded in the futures market, management is forecasting a breach in covenants within the next 12 months. The Company forecasts that it can continue to meet its obligations including interest payments, general & administrative expenses and operating expenses within its internally generated cash flows. However, there are no assurances that the lender will maintain the borrowing base at the current level, or that the Company will be able to extinguish the term credit facilities due December 15, 2020 and December 31, 2020, which may result in a borrowing base shortfall. If the Company cannot generate sufficient funds to meet the borrowing base shortfall it would constitute an event of default under the loan agreement and the bank could demand immediate repayment of the outstanding loan amount. The Company is evaluating and planning to act on several liquidity options to help ensure the short-term availability of funds in this tumultuous time, including currently running a board approved strategic alternatives process and the disposition of the Company’s Red Earth properties (note 20).

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

Strategic alternatives may include, but are not limited to, the sale of the Company, investment in, merger or other business combination, recapitalization, sale of all or a portion of the Company's assets, or any combination thereof.

The global impact of COVID-19 as well as the volatility in commodity prices have resulted in significant declines in global stock markets and has forecasted a great deal of uncertainty as to the health of the global economy over the next several months. As a result, oil and gas companies are subject to liquidity risks in maintaining their revenues and earnings as well as ongoing and future development and operating expenditure requirements. These factors are likely to have a negative impact on the Company's ability to raise equity, if required, in the near future or on terms favorable to the Company. We continue to work on revisions to our company's forecasts and development plans in light of the current conditions and will use these updated assumptions / forecasts in our impairment indicator analysis and for impairment tests, if such tests are required in future periods. Impairment indicators for our property, plant and equipment could exist in future periods, if current conditions persist. The potential financial impact that COVID-19 will cause cannot be reasonably estimated at this time and further impairment provisions may be necessary.

During the second quarter of 2020 the Company shut-in certain properties that were uneconomic at prevailing prices. During the third quarter of 2020 the Company began to restore production when a recovery in prices was seen and the production became economic once more.

Due to the factors mentioned above, there is a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern. These financial statements do not include necessary adjustments to reflect the recoverability and classification of recorded assets and liabilities and related expenses that might be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and such adjustments could be material.

(b) Statement of compliance

These condensed interim consolidated financial statements of the Company have been prepared in accordance with International Accounting Standards (IAS) 34, "Interim Financial Reporting", using accounting policies consistent with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Certain information and disclosures normally included in the annual consolidated financial statements prepared in accordance with IFRS have been condensed or omitted.

The condensed interim consolidated financial statements should be read in conjunction with the Company's audited annual consolidated financial statements as at and for the year ended December 31, 2019 and the notes thereto.

The condensed interim consolidated financial statements have been prepared on a historical cost basis, except as detailed in the accounting policies disclosed in note 3 of the Company's audited consolidated financial statements for the year ended December 31, 2019. All accounting policies and methods of computation followed in the preparation of these condensed interim consolidated financial statements are consistent with those of the previous financial year, except as described in note 2(d).

(c) Use of estimates and judgments

The timely preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions based on currently available information that affect the application of accounting policies and reported amounts of assets and liabilities at the date of the statement of financial position and the reported amounts of income and expenses during the reporting period. Accordingly, actual results may differ from these estimates. Estimates and underlying assumptions and judgments are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

In March 2020, COVID-19 was declared a pandemic by the World Health Organization. Global commodity prices have faced significant downward pressure primarily due to the collapse in demand attributed to COVID-19 combined with a global price war. These events have resulted in volatile and challenging economic conditions. There is significant ongoing uncertainty surrounding COVID-19 and the extent and duration of the impacts that the Company may experience. The potential risk and impact due to the events described above relating to the Company has been taken into consideration in management's estimates used for the period end. However, there could be further prospective material impacts in future periods.

More specifically, the assumptions may change that are involved in the estimates of valuation of exploration and evaluation assets and property and equipment cash generating units, the timing of decommissioning obligations, the fair value of commodity contracts, the expected credit loss provisions related to accounts receivable as well as liquidity and going concern assessments.

A full list of significant estimates and judgments can be found in note 2(e) of the Company's annual financial statements for the year ended December 31, 2019. COVID-19 and current market conditions have increased the complexity of estimates and assumptions used to prepare the condensed interim financial statements.

(d) Changes in accounting policies

Business Combinations

On January 1, 2020, the Company adopted the amendment as issued on October 22, 2018 by the IASB related to IFRS 3, "*Business Combinations*" ("IFRS 3"), revising the definition of a business and providing for the addition of an optional 'concentration test' to determine if the acquisition is a business. To be considered a business under the amendments to IFRS 3, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The three elements of a business are defined as follows:

- Input – Any economic resource that creates outputs, or has the ability to contribute to the creation of outputs, when on or more processes are applied to it.
- Process – Any system, standard, protocol, convention or rule that, when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs.
- Output – The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income or generate other income from ordinary activities.

The optional 'concentration test' permits a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets. An entity may elect to apply, or not apply, the test. An entity may make such an election separately for each transaction or other event. If the concentration test is met, the sets of activities and assets is determined to not be a business and no further assessment is needed. The amendment to IFRS 3 had no effect to the Company for the period ended September 30, 2020.

3. REVENUE

Oil sales:

The Company sells its production pursuant to variable-price contracts. The transaction price for variable price contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Commodity prices are based on market indices that are determined on a monthly or daily basis. Revenue is recognized when a unit of production is delivered to the customer and control of the product transferred.

Revenues are typically collected on the 25th day of the month following production.

Highwood Oil Company Ltd.
Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

The following table summarizes the Company's product sales.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Oil	\$ 5,752	\$ 8,850	\$ 14,034	\$ 25,440
Total	\$ 5,752	\$ 8,850	\$ 14,034	\$ 25,440

Processing and other income:

The following table summarizes the Company's processing and road use revenues.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Processing	\$ 116	\$ 541	\$ 534	\$ 1,355
Road Use	113	225	367	438
Total	\$ 229	\$ 766	\$ 901	\$ 1,793

4. ACCOUNTS RECEIVABLE AND INSURANCE PROCEEDS RECEIVABLE

Accounts receivable is comprised of the following:

	September 30, 2020	December 31, 2019
Oil marketers	\$ 3,743	\$ 4,568
Joint interest partners	2,352	3,409
Commodity contract receivable	158	-
Road use receivable	701	672
Government sales tax	-	221
Insurance proceeds ¹	4,000	2,730
Other	45	140
Balance, end of period	\$ 10,999	\$ 11,740

¹ Insurance proceeds relates to an insurable event that occurred during the year ended December 31, 2018. During the three months ended September 30, 2020 the Company negotiated a settlement on the claim which was cash settled subsequent to September 30, 2020. The amount recorded as a receivable at September 30, 2020 represents the final payment to be received with respect to the claim. Subsequent to September 30, 2020 the insurance proceeds were received in full. The Company anticipates costs associated with future clean up to occur over the next 10 years and have recorded \$3.7 million in decommissioning liabilities at September 30, 2020, representing the present value of the future inflated expenditures. At September 30, the Company has accrued an amount in accounts payable and accrued liabilities totalling \$0.2 million (December 31, 2019 - \$33.3 million) (including a long-term portion of \$nil, (December 31, 2019 - \$1.1 million)), representing costs to be incurred in the next 12 months.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

5. DEPOSITS AND PREPAID EXPENSES

Deposits and prepaid expenses are comprised of the following:

	September 30, 2020	December 31, 2019
Deposits ¹	\$ 132	\$ 3,207
Prepaid expenses	1,682	403
Balance, end of period	\$ 1,814	\$ 3,610

¹Balance at December 31, 2019 includes \$3.1 million related to a deposit that was made on a purchase and sale agreement that was terminated by the Company during the year ended December 31, 2019. The Company terminated the purchase and sale agreement when the other partner did not consent to the transfer of the partnership units. The deposit was held in trust by a law firm. The Company had commenced legal action to attempt to recover the funds. The counter party to the terminated transaction had filed a statement of defence and counterclaim seeking payment of the full deposit. During the nine months ended September 30, 2020 the Company and the counter party settled the claims and the Company received \$3.1 million.

Prepaid expenses include prepaid annual fees, which are based on the invoiced amount and amortized over the term of the related payment.

6. EXPLORATION AND EVALUATION ASSETS

Evaluation and evaluation assets is comprised of the following:

	September 30, 2020	December 31, 2019
Balance, beginning of period	\$ 7,569	\$ 8,130
Additions ¹	114	8,443
Change in decommissioning liabilities (note 10)	-	301
Dispositions	(62)	(400)
Land lease expiries	-	(419)
Impairment	(1,255)	-
Transfers to property, plant and equipment	-	(8,486)
Balance, end of period	\$ 6,366	\$ 7,569

¹Including \$150 thousand acquisition deposit made in 2019 for the year ended December 31, 2019.

Exploration and evaluation assets include undeveloped lands, unproved properties and seismic costs where management has not fully evaluated for technical feasibility and commercial viability.

Impairment

The Company assesses many factors when determining if an impairment test should be performed. As at September 30, 2020, the Company conducted an assessment of impairment indicators for the Company's CGUs. In performing the review, management determined that there were no indicators of impairment or impairment reversal present and therefore no impairment test was performed at September 30, 2020, with the exception of the Company's Red Earth CGU's. Subsequent to September 30, 2020, the Company has reached an agreement to dispose of the Red Earth CGU's (note 20) and has recognized an impairment loss relating to the Red Earth CGU's of \$1.1 million, representing the full carrying value of the Red Earth CGU's exploration and evaluation assets, due to the carrying value exceeding its recoverable amount of \$nil. The recoverable amount was determined to be \$nil as the consideration to be received for the Red Earth CGU's was determined on current production.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

During the first quarter of 2020, due to depressed commodity pricing and the impact this has on the economic performance of the Company's CGUs justified calculation of the recoverable amounts of all CGUs. The recoverable amounts were estimated at fair value less costs to sell based on recent land sales in the areas surrounding the Company's lands. During the three month period ended March 31, 2020, the Company determined that, Viking, one of its non-core CGU's would no longer be pursued and the Company intends to allow the leases to expire. The Company recognized an impairment loss relating to the non-core CGU of \$198 thousand, representing the full carrying value of the non-core CGU, due to the carrying value exceeding its recoverable amount of \$nil.

Clearwater royalty disposition

In August 2019, the Company, along with its 50% joint venture partner in the Clearwater area, disposed of a 4% royalty over certain jointly held Clearwater mineral rights, in the Craigend area, for gross proceeds of \$1.3 million (\$648 thousand being the Company's share). As a condition of the royalty divestiture, the Company and its joint venture partner were required drill a well in the Craigend formation prior to March 31, 2020.

Upon rig release of the applicable well in February 2020, \$1.3 million (\$648 thousand Company's share), was paid to the Company.

During the three and nine months ended September 30, 2020, the Company recorded a gain on disposition of \$nil and \$586 thousand, respectively, being the difference between the proceeds of \$648 thousand earned through drilling activity and received in 2020 and the estimated cost of the divested royalty interests removed from exploration and evaluation assets of \$62 thousand.

To determine the cost base of the Clearwater Craigend area mineral rights, the Company assessed the total fair value of the Clearwater mineral rights at the date of the acquisition and of the 4% non-deduct royalty based on anticipated future cash flows from the applicable wells to determine a pro-rata factor. The pro-rata factor was applied to the total cost base of the jointly held lands and drillings cost of the well to determine the disposed cost base.

7. PROPERTY, PLANT AND EQUIPMENT

	September 30, 2020	December 31, 2019
<u>Oil and natural gas properties</u>		
COSTS		
Balance, beginning of period	\$ 128,555	\$ 111,843
Change in decommissioning liabilities (note 10)	4,251	(788)
Additions	4,368	3,767
Acquisitions	-	5,247
<u>Transfers from exploration and evaluation assets (note 6)</u>	-	8,486
<u>Balance, end of period</u>	<u>\$ 137,174</u>	<u>\$ 128,555</u>
ACCUMULATED DEPLETION, DEPRECIATION AND IMPAIRMENT		
Balance, beginning of period	\$ (37,662)	\$ (29,132)
Depletion and depreciation	(5,609)	(8,530)
<u>Impairment loss</u>	<u>(27,486)</u>	-
<u>Balance, end of period</u>	<u>\$ (70,757)</u>	<u>\$ (37,662)</u>
<u>Net book value, end of period</u>	<u>\$ 66,417</u>	<u>\$ 90,893</u>

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

Depletion

Future development costs of \$64.6 million (September 30, 2019 - \$53.3 million) associated with the development of the Company's proved plus probable reserves were included in the calculation of depletion for the period ended September 30, 2020.

Impairment

The Company assesses many factors when determining if an impairment test should be performed. At September 30, 2020, the Company conducted an assessment of impairment indicators for the Company's CGUs. The Company determined there were no indicators of impairment or reversal of prior impairments present, therefore no impairment test was performed at September 30, 2020, with the exception of the Company's Red Earth CGUs.

Subsequent to September 30, 2020, the Company reached an agreement to dispose of the Red Earth area to an arm's length third party. Total consideration for the transaction will be \$2.0 million, therefore the Company has recorded an impairment loss in the three month period ended September 30, 2020 of \$16.6 million representing the amount the carrying value exceeded the recoverable value. The recoverable value was determined based on the consideration that will be received on the anticipated disposition of the Red Earth area CGUs, after factoring in all assets and liabilities that will comprise the transaction.

As at March 31, 2020, management determined that the continued depressed commodity pricing and the impact this has on the economic performance of the Company's CGUs justified calculation of the recoverable amounts of all CGUs. The recoverable amounts were estimated at the value in use based on the net present value of the before tax future net cash flows from oil and natural gas proved and probable reserves using forecasted prices and costs estimated by external engineers at December 31, 2019 and internally updated by Company engineers at March 31, 2020. The future net cash flows were discounted at a before tax rate of 15% (December 31, 2019 – 15%).

During the first quarter of 2020, the Company determined that the following CGU's were impaired:

CGU	Recoverable amount	Impairment	Sensitivities			
			Increase in rate ²	Decrease in rate ²	Increase in cash flows ³	Decrease in cash flows ³
House Creek ¹	\$ 6,934	\$ 1,617	\$ 2,168	\$ 904	\$ 946	\$ 1,866
Panny ¹	15,174	3,642	4,598	2,673	2,703	4,530
North Senex ¹	2,076	438	540	329	334	540
South Senex ¹	2,235	3,125	3,619	2,591	2,647	3,598
Kidney ¹	-	1,772	2,016	1,512	1,587	1,993
Saskatchewan	3,862	332	486	168	133	541
\$ 10,926						

¹ CGU's are part of the Red Earth area

² What impairment would be based on a 1% change in the assumed discount rate over the life of the reserves independently

³ What impairment would be based on a 5% change in cash flows

The impairment expense for the three month period ended March 31, 2020 was primarily a result of lower forecasted benchmark commodity prices resulting in a downward revision to the Company's reserve base and lower future cash flows.

The forecasted commodity prices used in the impairment test at March 31, 2020 were as follows:

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
WTI Crude Oil (USD\$/bbl)	30.00	41.00	47.50	52.50	57.50	58.95	60.13	61.33	62.56	63.81	+2%/yr
WCS Oil (CAD\$/bbl)	20.34	34.25	43.54	50.68	57.72	59.93	61.51	63.11	64.75	66.41	+2%/yr

For purposes of the impairment test, the benchmark commodity prices forecast above are adjusted to reflect varied delivery points and quality differentials in the products delivered.

Highwood Oil Company Ltd.**Notes to the Condensed Interim Consolidated Financial Statements**

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

8. LEASES**Right-of-use assets**

	Vehicles	Office Premises ⁽¹⁾	Total
At January 1, 2020	\$ 33	\$ 201	\$ 234
Additions	38	-	38
Dispositions	(13)	-	(13)
Depreciation	(33)	(58)	(91)
At September 30, 2020	\$ 25	\$ 143	\$ 168

⁽¹⁾ The office premise lease is a sub-lease from a Company with common shareholders and directors.**Lease liabilities**

Lease liabilities were as follows:

	September 30, 2020	December 31, 2019
Balance, beginning of period	\$ 241	\$ 313
Accretion of lease obligations (note 11)	8	16
Additions	38	32
Dispositions	(13)	-
Payments of lease obligations	(99)	(120)
Balance, end of period	\$ 175	\$ 241
Current portion	100	105
Long term portion	75	136

Total expected payments, for the Company's facilities and equipment recorded as lease obligations are:

	Within 1 year	After 1 year but not more than 5 years	Total
Office space	\$ 80	\$ 70	\$ 150
Vehicles and equipment	20	5	25
Total	100	75	175
Principal	\$ 100	\$ 75	\$ 175

During the three and nine months ended September 30, 2020 the variable component of office rent expensed through general and administrative expense was \$39 thousand and \$117 thousand, respectively (three and nine months ended September 30, 2019 - \$38 thousand and \$114 thousand, respectively).

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

9. BANK DEBT

During the three and nine month period ended September 30, 2020 the Company executed an Amended and Restated Credit Agreement (the "ARCA"). The ARCA is comprised of a \$20.0 million operating facility, \$9.0 million non-revolving term facility A and a \$9.0 million non-revolving term facility B. The operating facility bears interest at the Bank's prime rate or bankers acceptance discount rates plus an applicable margin of 300bps to 550bps on prime rate loans and 400bps to 650bps on stamping fees related to bankers acceptances, determined by reference to the Company's net debt to cash flow ratio (as defined in the credit facility agreement). Term facility A and B bears interest at an additional 300bps to the operating facility. Interest on the credit facilities are due monthly. Term facility A matures November 30, 2020, term facility B matures December 31, 2020 and the operating facility maximum reduces \$12.0 million effective January 31, 2021 with the remaining balance due May 31, 2021. The reduction in the operating facility is based on an assumption of certain assets remaining in the Company's portfolio and is subject to change based on the outcome of the strategic alternatives process. Subsequent to September 30, 2020 the maturity date for term facility A was extended to December 15, 2020. Any amounts unpaid on the term facilities at November 30, 2020 will result in a fee of 60bps.

The borrowing base, will be reviewed at least semi-annually by the lender, and more frequently under certain circumstances. The borrowing base can be determined, at the sole discretion of the lender, and any amount outstanding under the credit facility in excess of a newly established borrowing base must be repaid in full within 30 days.

The Company is required to maintain a current ratio of not less than 1.0:1.0, and such ratio is to be tested at the end of each fiscal quarter. Current ratio is defined as the ratio of (i) current assets, excluding financial derivatives, plus any undrawn availability under the credit facility to (ii) current liabilities, excluding financial derivatives, any amounts drawn under the credit facility and any current liabilities related to lease contracts. The Company is required to maintain a net debt to cash flow ratio no greater than 3.0:1.0 as at the last day of the fiscal quarter ended September 30, 2020 and each quarter thereafter. For the three month period ended September 30, 2020, the working capital covenant and net debt to cash flow covenant for the Company was waived. The Company believes it may be in violation of the net debt to cash flow ratio in future reporting periods at current forecasted prices and is regular communications with its lender. For the purposes of the covenant, net debt is defined by the agreement as working capital deficit (excluding financial derivatives) plus bank debt and cash flow is defined effectively as cash flow from operating activities before changes in non-cash working capital for the most recent two quarters annualized and normalized for extraordinary and nonrecurring earnings, gains, and losses. The Company will also be required to meet certain reporting requirements on a quarterly and annual basis. Under the ARCA, the Company was required within 5 business days of the effective date of the ARCA to put in place additional commodity contracts such that an aggregate of 800 bbl per day are subject to commodity swap contracts for the second half of 2020; and within 60 days of the effective date of the ARCA to put in place additional commodity contracts such that an aggregate of 800 bbl per day are subject to commodity swap contracts for the first half of 2021 (note 16(b)), which the Company has done.

The Company's next review and borrowing base determination is scheduled on or before November 30, 2020 but may be set at an earlier or later date at the discretion of the bank.

10. DECOMMISSIONING LIABILITIES

The Company's decommissioning liabilities result from its ownership interest in oil and natural gas properties including well sites and facilities. The total decommissioning liability is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning liabilities to be \$40.3 million as at September 30, 2020 (December 31, 2019 - \$31.1 million) based on an undiscounted total future liability of \$46.5 million (December 31, 2019 - \$41.4 million) and discounted using a long-term risk-free rate of 1.11% (2019 - 1.76%) and an inflation rate of 1.29% (2019 - 1.35%). The expected timing of decommissioning expenditures extends to 2070.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

The following table summarizes changes in the decommissioning liabilities:

	September 30, 2020	December 31, 2019
Balance, beginning of period	\$ 31,099	\$ 30,794
Change in discount rate	3,796	2,663
Change in cash flow estimates	4,724	(4,169)
Abandonment expenditures	-	(168)
Liabilities assumed in corporate and asset acquisitions	-	370
Additions	404	1,019
Accretion expense (note 11)	323	590
Balance, end of period	\$ 40,346	\$ 31,099

The carrying value of certain oil and natural gas properties of the Company is \$nil. Accordingly, the change in discount rate and cash flow estimates related to these properties was recorded as an increase to depletion and depreciation expense for the three and nine months ended September 30, 2020 of \$12 thousand and \$48 thousand, respectively (three and nine months ended September 30, 2019 – increase of \$6 thousand and \$76 thousand, respectively), an increase to operating and transportation expense for the three and nine months ended September 30, 2020 of \$929 thousand and \$929 thousand (three and nine months ended September 30, 2019 - \$nil and \$nil, respectively). The amounts recorded as operating and transportation expense relate to properties that have never had any asset value associated to them.

11. FINANCE INCOME AND EXPENSES, NET

Finance income and expenses, net is comprised of:

	Three months ended		Nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Interest on bank debt	\$ 462	\$ 222	\$ 759	\$ 639
Stamping fees on bank debt	410	408	1,057	905
Financing fees	-	27	131	59
Accretion of decommissioning liabilities (note 10)	83	139	323	457
Accretion of lease liabilities (note 8)	2	4	8	13
Other interest expense (income)	-	-	(54)	22
Total	\$ 957	\$ 800	\$ 2,224	\$ 2,095

12. SHARE CAPITAL

a) Authorized

Unlimited number of voting common shares and unlimited number of preferred shares issuable in series.

b) Issued and outstanding common shares

	Number of Shares (000's)	Stated Value
Balance, December 31, 2019 and September 30, 2020	6,014	\$16,310

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

c) Loss per share

	Three Months Ended September 30, 2020			Three Months Ended September 30, 2019		
	Net loss	Common shares (000's)	Loss per share	Net Loss	Common shares (000's)	Loss per share
Loss - basic	\$ (20,074)	6,014	\$ (3.34)	\$ (1,447)	6,014	\$ (0.24)
Dilutive effect of options	-	-	-	-	-	-
Loss - diluted	\$ (20,074)	6,014	\$ (3.34)	\$ (1,447)	6,014	\$ (0.24)

	Nine Months Ended September 30, 2020			Nine Months Ended September 30, 2019		
	Net loss	Common shares (000's)	Loss per share	Net Loss	Common shares (000's)	Loss per share
Loss - basic	\$ (27,635)	6,014	\$ (4.59)	\$ (4,430)	5,968	\$ (0.74)
Dilutive effect of options	-	-	-	-	-	-
Loss - diluted	\$ (27,365)	6,014	\$ (4.59)	\$ (4,430)	5,968	\$ (0.74)

For the three and nine months ended September 30, 2020 and 2019 all options and RSU's were excluded from the calculation of diluted loss per share as they were anti dilutive.

13. SHARE-BASED PAYMENTS

Options

The Company adopted a stock option plan during the year ended December 31, 2019 for officers, directors, employees and consultants "the Option Plan". Under the Option Plan, the Board of Directors sets the exercise price, expiry date and vesting terms for each option grant provided that no options will be granted at a discount to market prices and no option will have a term exceeding ten years. The Option Plan limits the total number of Common Shares that may be issued on exercise of options outstanding at any time under the Option Plan to 10% of the number of Common Shares issued and outstanding (less the number of Common Shares reserved for issuance under any other share based compensation arrangement of the Company, including the Restricted Share Unit Plan).

A summary of the stock options issued and outstanding as at September 30, 2020 are as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2019	136	\$ 10.43
Forfeited	(8)	11.54
Granted	45	16.50
Outstanding, September 30, 2020	173	11.95
Exercisable, September 30, 2020	46	7.49

The weighted average contractual term of all outstanding options at September 30, 2020 is 3.76 years.

During the three month and nine months ended September 30, 2020, the Company recorded stock-based compensation expense relating to options of \$98 thousand and \$236 thousand, respectively (three and nine months ended September 30, 2019 - \$72 thousand and \$194 thousand, respectively) with a corresponding increase to contributed surplus.

During the three and nine months ended September 30, 2020, the Company granted 45 thousand options at an exercise price of \$16.50 per option. The options granted vest 1/3 on each of the twelve, twenty-four and thirty-six month anniversaries from the grant date and have a five year term.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

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

	August 27, 2020
Number of options	45,000
Exercise price (\$/share)	\$ 16.50
Stock price on grant date	\$ 16.50
Expected life (years)	5.0
Risk-free interest rate	0.43%
Expected volatility	70%
Option fair value (per option)	\$ 9.42
Estimated forfeiture rate	0%
Expected dividend yield	0%

A forfeiture rate of 0% was used when recording stock-based compensation as it is expected that all officers, directors, employees and consultants will continue with the Company over the vesting period, and or, all options will be exercised. Stock price on date of grant was determined by the price of Common Shares issued on the date of grant and based on publicly available information. Expected volatility was determined based on an average of volatilities of similar publicly traded entities in Company's peer group.

Restricted Share Units ("RSU's")

The Company adopted a RSU plan, during the year ended December 31, 2019, for officers, directors, employees and consultants "the RSU Plan". The RSU Plan is administered by the Board of Directors (or a committee thereof) which has the power, subject to the limits imposed by the RSU Plan, to: (i) award RSUs; (ii) determine the terms under which RSUs are granted; (iii) interpret the RSU Plan and adopt, amend and rescind such administrative guidelines and other rules and regulations relating to the RSU Plan; and (iv) make all other determinations and take all other actions in connection with the implementation and administration of the RSU Plan. The RSU Plan is a fixed plan which reserves for issuance a maximum of 240 thousand Common Shares (being approximately 4% of the currently issued and outstanding Common Shares).

	Number of RSU's
Outstanding, December 31, 2019	118
Forfeited	(8)
Granted	45
Outstanding, September 30, 2020	155
Exercisable, September 30, 2020	28

During the three and nine months ended September 30, 2020, the Company recorded stock-based compensation expense relating to RSU's of \$139 thousand and \$425 thousand, respectively (three and nine months ended September 30, 2019 - \$122 thousand and \$331 thousand, respectively) with a corresponding increase to contributed surplus.

During the three and nine months ended September 30, 2020, the Company granted 45 thousand RSU's exercisable for nominal consideration. The RSU's granted vest 1/3 on each of September 30, 2021, September 30, 2022 and September 30, 2023 and expire on December 31, 2023.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

The fair value of the RSU's issued and granted were estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	August 27, 2020
Number of options	45,000
Exercise price (\$/share)	\$ -
Stock price on grant date	\$ 16.50
Expected life (years)	5.0
Risk-free interest rate	0.43%
Expected volatility	70%
Option fair value (per option)	\$ 16.50
Estimated forfeiture rate	0%
Expected dividend yield	0%

A forfeiture rate of 0% was used when recording stock-based compensation as it is expected that all officers, directors, employees and consultants will continue with the Company over the vesting period, and or, all options will be exercised. Stock price on date of grant was determined by the price of Common Shares issued on the date of grant and based on publicly available information. Expected volatility was determined based on an average of volatilities of similar publicly traded entities in Company's peer group.

14. SUPPLEMENTAL CASH FLOWS INFORMATION

Changes in non-cash working capital is comprised of:

Source/(use) of cash	Three months ended		Nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Accounts receivable and insurance proceeds receivable	\$ (2,273)	\$ (7,620)	\$ 741	\$ 16,670
Deposits and prepaid expenses	30	521	1,796	(941)
Accounts payable and accrued liabilities	(697)	2,766	(1,454)	(14,992)
Commodity contract premium payable	-	(3,500)	-	-
Changes in non-cash working capital	\$ (2,940)	\$ (7,833)	\$ 1,083	\$ 737

The above figure relates to:	Three months ended		Nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Operating activities	\$ (1,521)	\$ 1,006	\$ 4,580	\$ 8,344
Investing activities	(1,419)	(8,839)	(3,497)	(7,607)
Changes in non-cash working capital	\$ (2,940)	\$ (7,833)	\$ 1,083	\$ 737
Interest paid	\$ 872	\$ 630	\$ 1,816	\$ 1,544
Taxes paid (recovered)	\$ -	\$ -	\$ -	\$ -

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

15. COMMITMENTS AND CONTINGENCIES

(a) Commitments

At September 30, 2020, the Company had the following commitments in addition to the leases described in note 12:

(i) Physical delivery electricity services contract:

	Average monthly contracted kW	Term	Fixed Price
Electricity	429 kW	January 1, 2020 to December 31, 2020	5.046¢/kWh

(b) Contingencies

By nature of its oil and gas operations in Northern Alberta, the Company is subject to numerous safety and environmental regulations, with which non-compliance may result in adverse financial impact. The Company mitigates these risks through the adherence to formal safety and environmental policies, as well as adequate insurance coverage. The Company is currently remediating three environmental pipeline releases at Red Earth, Alberta, all relating to the same segment of pipeline. While the Company believes it has recorded its best estimate of the impact of this contingency in these financial statements, the ultimate outcome is uncertain. The event is insurable and the Company has made payments on the majority of remediation work in 2018 and 2019. There will be ongoing monitoring costs which the Company anticipates paying over the next several years subject to the overview and approval of the provincial regulatory bodies. In relation to the pipeline release the Company, as at September 30, 2020 has recorded \$4.0 million of accounts receivable for the final insurance settlement proceeds received subsequent to September 30, 2020, \$0.2 million of accounts payable and accrued liabilities and \$3.7 million of decommissioning liabilities in relation to the estimated costs of the remediation work

16. FINANCIAL RISK MANAGEMENT

The Board of Directors has the overall responsibility for the establishment and oversight and execution of the Company's risk management framework. The Board of Directors has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company employs risk management strategies and policies to ensure that any exposures to risk are in compliance with the Company's business objectives. While the Board of Directors has the overall responsibility for the Company's risk management framework, the Company's management has the responsibility to administer and monitor those risks.

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- market risk; and
- liquidity risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk. There were no changes to the Company's risk management policies or processes since the year ended December 31, 2019.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

(a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk at year end is as follows:

	September 30, 2020	December 31, 2019
Accounts receivable and insurance proceeds receivable	\$ 10,999	\$ 11,740
Commodity contracts	1,203	-
Deposits	132	3,207
Reclamation deposits	141	141
Total	\$ 12,475	\$ 15,088

Cash and cash equivalents:

Cash and cash equivalents consist of amounts on deposit with Canadian chartered banks and undeposited funds. The Company manages credit exposure of cash and cash equivalents, if any, by selecting financial institutions with high credit ratings.

Accounts receivable:

Substantially all of the Company's oil and natural gas production is marketed under standard industry terms. Receivables from oil and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with credit worthy purchasers. Joint interest receivables are typically collected within one to three and nine months of the joint interest bill being issued to the partner. However, the receivables are from participants in the oil and natural gas sector and collection of the outstanding balances can be impacted by industry factors such as commodity price fluctuations, limited capital availability and unsuccessful drilling programs.

The Company manages credit exposure of insurance proceeds receivable by maintaining insurance coverage with reputable brokers with high credit ratings.

The Company's accounts receivable are aged as follows:

	September 30, 2020	December 31, 2019
Current (less than 90 days)	\$ 8,163	\$ 10,546
Past due (more than 90 days)	2,836	1,194
Total	\$ 10,999	\$ 11,740

As at September 30, 2020, management believes all receivables net of provision for expected credit losses will be collected.

Deposits

The Company had a balance of \$6.2 million, which is held a trust account by a law firm, related to a deposit that was made on a purchase and sale agreement that was terminated by the Company. The Company had recorded an impairment of \$3.1 million in 2019 due to the uncertainty of the outcome of the lawsuit, leaving a net balance recorded in deposits and prepaid expenses of \$3.1 million. The Company received \$3.1 million during the second quarter of 2020 (see further discussion in note 5).

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

Reclamation deposits and other deposits:

Reclamation deposits consist of amounts on deposit with the Provinces of Alberta, Saskatchewan and British Columbia. The Company believes the credit risk associated with these deposits and other deposits is minimal.

Commodity contracts:

The Company manages the credit risk exposure related to commodity contracts, if in an asset position, by selecting investment grade counterparties and by not entering into contracts for trading or speculative purposes. At September 30, 2020, the counterparty was the Company's lending institution, which is a financial institution with a strong credit rating.

(b) Market risk

Market risk is the risk that changes in market conditions, such as commodity prices, foreign exchange rates and interest rates, will affect the Company's cash flow, income or the value of its financial instruments. The objective of the Company's market risk management is to manage and control market risk exposures within acceptable parameters, while maximizing the Company's return. There have been no changes to the Company's policies for managing foreign currency risk, interest rate risk and commodity price risk.

Foreign currency risk

Foreign currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company does not sell or transact in any foreign currency. The Company's financial instruments are only indirectly exposed to currency risk as the underlying commodity prices in Canada for oil and natural gas are impacted by changes in exchange rates between the Canadian and United States dollar.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is subject to interest rate risk related to its exposure to interest rate fluctuations on its credit facility, which bears a floating rate of interest. At September 30, 2020 the total amount drawn on the credit facility under a bankers' acceptance ("BA") was \$36.7 million which is at a fixed rate basis, therefore not subject to interest rate risk until renewal of the BA's. A 1% interest rate increase or decrease on the full \$36.7 million outstanding would decrease or increase net income by approximately \$212 thousand for the nine months ended September 30, 2020.

Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar but also North American and global economic events that dictate the levels of supply and demand. The nature of the Company's operations results in exposure to fluctuations in commodity prices. The Company's production is sold using "spot" pricing with prices fixed at the time of transfer of custody or on the basis of a monthly average market price.

Highwood Oil Company Ltd.**Notes to the Condensed Interim Consolidated Financial Statements**

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

The Company currently has the following commodity contracts outstanding at September 30, 2020:

Swaps:

Product	Notional Volume	Term	Fixed Price (CAD/bbl)	Index
Crude Oil	50bbls/day	January 1, 2020 to December 31, 2020	\$ 70.05	WTI - NYMEX
Crude Oil	50bbls/day	January 1, 2020 to December 31, 2020	\$ 71.53	WTI - NYMEX
Crude Oil	250bbls/day	January 1, 2020 to December 31, 2020	\$ 65.00	WTI - NYMEX
Crude Oil	100bbls/day	January 1, 2020 to December 31, 2020	\$ 66.00	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 54.27	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 54.60	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 55.05	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 54.50	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 55.00	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 55.00	WTI - NYMEX
Crude Oil	50bbls/day	July 1, 2020 to December 31, 2020	\$ 56.05	WTI - NYMEX
Crude Oil	50bbls/day	January 1, 2021 to June 30, 2021	\$ 57.15	WTI - NYMEX
Crude Oil	100bbls/day	January 1, 2021 to June 30, 2021	\$ 58.19	WTI - NYMEX
Crude Oil	50bbls/day	January 1, 2021 to June 30, 2021	\$ 58.70	WTI - NYMEX
Crude Oil	100bbls/day	January 1, 2021 to June 30, 2021	\$ 55.64	WTI - NYMEX
Crude Oil	50bbls/day	January 1, 2021 to June 30, 2021	\$ 55.20	WTI - NYMEX
Crude Oil	250bbls/day	January 1, 2021 to December 31, 2021	\$ 65.40	WTI - NYMEX

Participating Swaps:

Product	Notional Volume	Term	Fixed Price (CAD/bbl)	Index
Crude Oil	50bbls/day	January 1, 2021 to June 30, 2021	\$ 50.50 with a 50 % participation above \$50.50	WTI - NYMEX

Differential:

Product	Notional Volume	Term	Fixed Price Differential (CAD/bbl)	Index
Crude Oil	200bbls/day	April 1, 2020 to December 31, 2020	\$ (21.20)	WCS vs. WTI - NYMEX
Crude Oil	100bbls/day	April 1, 2020 to December 31, 2020	\$ (21.40)	WCS vs. WTI - NYMEX

The commodity contracts had a total fair value at September 30, 2020 of an asset of \$1.2 million (December 31, 2019 – liability of \$3.4 million). The corresponding unrealized gain/(loss) for the three and nine months ended September 30, 2020 was \$(569 thousand) and \$4.6 million, respectively (three and nine months ended September 30, 2019 – unrealized loss of \$1.3 million and \$3.1 million, respectively) and is included in the statement of loss and comprehensive loss. Total realized gains for the three and nine months ended September 30, 2020 were \$254 thousand and \$2.3 million, respectively (three and nine months ended September 30, 2019 – loss of \$1.0 million and \$5.1 million, respectively) and are also included in the statement of loss and comprehensive loss.

For the three-month period ended September 30, 2020, a \$0.10/bbl increase/decrease in oil prices would have a negative/positive impact on net income of approximately \$28 thousand.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

(c) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with the financial liabilities as they become due. The decrease in commodity prices as a result of the COVID-19 impact reducing demand and the oversupply of oil caused by the Saudi-Russia price war will negatively impact the Company's financial performance and position, which increases the liquidity risk of the Company. The Company's financial liabilities consist of bank overdraft, accounts payable and accrued liabilities and bank debt, all of which are due within a year and lease liabilities which are due as disclosed in note 8. The Company is in the process of a strategic alternatives process that was approved by the board of directors to mitigate liquidity risk (note 2(a)). The Company also maintains and monitors a certain level of cash flow which is used to partially finance all operating and capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas sales on the 25th of each month.

At September 30, 2020, the Company had negative working capital of \$5.0 million, excluding bank debt (note 9). In addition, the Company is required to make certain minimum payments under other commitments (note 15). The Company expects to repay its financial liabilities in the normal course of operations and to fund future operational and capital requirements through operating cash flows and through deleveraging transactions. The Company also has a credit facility (note 9) to facilitate the management of liquidity risk. At September 30, 2020, approximately \$1.3 million was available under the credit facility. Term facility A matures December 15, 2020, term facility B matures December 31, 2020 and the operating facility reduces by \$12.0 million effective January 31, 2021 with the remaining balance maturing May 31, 2021, therefore the credit facility has been classified as current. The reduction in the operating facility is based on an assumption of certain assets remaining in the Company's portfolio and is subject to change based on the outcome of the strategic alternatives process.

The Company may need to conduct asset sales (note 20), equity issues or issue debt if liquidity risk increases in a given period. Liquidity risk may increase as a result of a change in the amounts settled monthly from the commodity contract (note 16(b)), along with potential revisions to the Company's borrowing base (note 9). The Company believes it has sufficient funds to meet foreseeable obligations by actively monitoring its credit facilities through use of the revolving debt, asset sales, coordinating payment and revenue cycles each month, and an active commodity hedge program to mitigate commodity price risk and secure cash flows.

17. CAPITAL MANAGEMENT

The Company manages its capital with the following objectives:

- To ensure sufficient financial flexibility to achieve the ongoing business objectives including funding of future growth opportunities; and
- To maximize shareholder return through enhancing share value.

The Company considers its capital employed to be bank debt and shareholders' equity:

	September 30, 2020	December 31, 2019
Bank debt	\$ 36,700	\$ 36,894
Shareholder's equity	(4,910)	17,997

The Company monitors capital based adjusted working capital, defined as current assets less current liabilities (excluding bank debt and commodity contracts).

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

Adjusted working capital

	September 30, 2020	December 31, 2019
Adjusted current assets	\$ 12,936	\$ 15,473
Adjusted current liabilities	(18,964)	(20,569)
Adjusted working capital surplus (deficiency)	\$ (6,028)	\$ (5,096)

The Company makes adjustments to capital employed by monitoring economic conditions and investment opportunities. The Corporation generally relies on credit facilities and cash flows from operations in excess of dividends to fund capital requirements. To maintain or modify its capital structure, the Company may issue new common or preferred shares, issue new subordinated debt, renegotiate existing debt terms, or repay existing debt. The Company is not currently subject to any externally imposed capital requirements, other than covenants on its bank debt (note 9).

The Company also monitors capital structure based on net debt to cash flow. The definition of net debt to cash flow for capital management purposes is the same measure used in the calculation of the Company's financial covenants on its credit facility (note 9). The Company's strategy is to monitor the ratio and the ratio can, and will, fluctuate based on the timing of commodity prices and the mix of exploratory and development drilling.

18. NET LISTING EXPENSE AND TRANSACTION RECOVERY (COSTS)

	Three months ended		Nine months ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Listing expense	\$ -	\$ -	\$ -	\$ (1,300)
Transaction costs	-	(109)	(116)	(306)
Transaction cost recovery	300	-	300	-
Total	\$ 300	\$ (109)	\$ 184	\$ (1,606)

19. RELATED PARTY TRANSACTIONS

Except as discussed elsewhere, the Company had the following transactions with related parties:

- During the three and nine months ended September 30, 2020, the Company incurred charges of \$59 thousand and \$205 thousand, respectively (three and nine months ended September 30, 2019 – \$62 thousand and \$136 thousand, respectively) from a company with common officers and directors for management fees, office space, subscriptions and supplies of which \$29 thousand and \$114 thousand, respectively (three and nine months ended September 30, 2019 – \$32 thousand and \$45 thousand, respectively) was recorded as an increase general and administrative expense and \$30 thousand and \$90 thousand (three and nine months ended September 30, 2019 – \$30 thousand and \$91 thousand, respectively) was recorded as a reduction to lease liabilities. In addition the Company was charged \$nil and \$93 thousand, respectively (three and nine months ended September 30, 2019 – \$124 thousand and \$330 thousand, respectively) for net non-operated gas sales, butane purchases and gas processing fees which is included in operating and transportation expense. During the three and nine months ended September 30, 2020, the Company was also charged \$nil and \$573 thousand, respectively (three and nine months ended September 30, 2019 – \$169 thousand and \$1.0 million, respectively) for propane purchases and distribution from this company which is included in operating and transportation expenses on the statement of loss and comprehensive loss. As at September 30, 2020, \$480 thousand (December 31, 2019 - \$4 thousand) is included within accounts receivable and \$1.5 million (December 31, 2019 - \$1.0 million) is included within accounts payable with respect to these charges.

Highwood Oil Company Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three and nine months ended September 30, 2020

(all tabular amounts expressed in thousands of Canadian dollars, except per share information)

(unaudited)

20. SUBSEQUENT EVENTS

- (a) Subsequent to to September 30, 2020, the Company entered into a purchase and sale agreement with a private company (the “Purchaser”) to dispose of all of the Company’s Red Earth assets for total consideration of \$2.0 million cash. The transaction does not include the Company’s ownership of the Wabasca River Pipeline System. The purchase price for these assets is subject to customary closing adjustments with the effective date of the sale being the closing date. The sale will close conditional on the Alberta Energy Regulator approval and other industry standard closing conditions. The transaction is a white-map transaction, whereby the purchaser will take all assets and abandonment liabilities within the defined white-map area.