



## **Interim Condensed Consolidated Financial Statements**

**For the three months ended March 31, 2018 and 2017**

# Strategic Oil & Gas Ltd.

Interim condensed consolidated balance sheets (unaudited)

(\$000) As at	Note	March 31, 2018	December 31, 2017
<b>Assets</b>			
Current Assets:			
Cash and cash equivalents		\$ 8,165	\$ 13,138
Term deposits	4	4,472	4,522
Trade and other receivables		4,492	4,011
Inventory		166	159
		<b>17,295</b>	<b>21,830</b>
Property, plant, and equipment, net	7	<b>160,406</b>	155,108
Exploration and evaluation assets	6	<b>9,532</b>	9,651
<b>Total Assets</b>		<b>\$ 187,233</b>	<b>\$ 186,589</b>
<b>Liabilities</b>			
Current Liabilities:			
Accounts payable and accrued liabilities		\$ 10,420	\$ 5,553
Accrued interest on convertible debentures		748	2,836
Decommissioning liabilities	8	5,863	3,190
		<b>17,031</b>	<b>11,579</b>
Convertible debentures	9	<b>98,754</b>	94,323
Decommissioning liabilities	8	<b>54,547</b>	59,303
<b>Total Liabilities</b>		<b>170,332</b>	<b>165,205</b>
<b>Shareholders' Equity</b>			
Share capital	10	<b>365,486</b>	365,466
Equity component of convertible debentures	9	<b>10,489</b>	10,247
Contributed surplus		<b>13,470</b>	13,052
Deficit		<b>(372,544)</b>	(367,381)
		<b>16,901</b>	<b>21,384</b>
<b>Total Liabilities and Shareholders' Equity</b>		<b>\$ 187,233</b>	<b>\$ 186,589</b>

See accompanying notes to the Interim Condensed Consolidated Financial Statements

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of net loss and comprehensive loss (unaudited)

(\$000, except per share amounts)	Note	Three months ended March 31	
		2018	2017
<b>Revenue</b>			
Petroleum and natural gas sales	12	\$ 10,081	\$ 8,888
Royalties		(1,496)	(1,132)
<b>Revenue, net of royalties</b>		<b>8,585</b>	<b>7,756</b>
Net realized gain on risk management contracts	17	6	-
Finance income		55	122
		<b>8,646</b>	<b>7,878</b>
<b>Expenses</b>			
Operating		5,096	3,800
Transportation		126	294
General and administrative		1,049	1,279
Finance costs	13	3,290	3,009
Stock-based compensation	11	418	43
Depletion, depreciation and amortization		4,051	3,961
Gain on disposal of property, plant and equipment	5	(131)	-
		<b>13,899</b>	<b>12,386</b>
<b>Operating loss before taxes</b>		<b>(5,253)</b>	<b>(4,508)</b>
Deferred tax recovery	14	90	68
<b>Net loss and comprehensive loss</b>		<b>\$ (5,163)</b>	<b>\$ (4,440)</b>
<b>Net loss per weighted average share</b>			
Basic & Diluted	10 (c)	\$ (0.11)	\$ (0.10)

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of changes in shareholders' equity (unaudited)

(\$000)	Share Capital	Convertible Debenture Equity Component	Contributed Surplus	Deficit	Total Equity
<b>Balance January 1, 2018</b>	\$ 365,466	\$ 10,247	\$ 13,052	\$ (367,381)	\$ 21,384
Debentures converted	20	-	-	-	20
Equity component of convertible debentures	-	242	-	-	242
Stock based compensation	-	-	418	-	418
Net loss	-	-	-	(5,163)	(5,163)
<b>Balance March 31, 2018</b>	<b>\$ 365,486</b>	<b>\$ 10,489</b>	<b>\$ 13,470</b>	<b>\$ (372,544)</b>	<b>\$ 16,901</b>

(\$000)	Share Capital	Convertible Debenture Equity Component	Contributed Surplus	Deficit	Total Equity
<b>Balance January 1, 2017</b>	\$ 360,073	\$ 9,878	\$ 11,063	\$ (277,879)	\$ 103,135
Shares issued	5,750	-	-	-	5,750
Share issue costs	(411)	-	-	-	(411)
Stock based compensation	-	-	43	-	43
Equity component of convertible debentures	-	183	-	-	183
Net loss	-	-	-	(4,440)	(4,440)
<b>Balance March 31, 2017</b>	<b>\$ 365,412</b>	<b>\$ 10,061</b>	<b>\$ 11,106</b>	<b>\$ (282,319)</b>	<b>\$ 104,260</b>

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of cash flow (unaudited)

(\$000)	Note	Three months ended March 31	
		2018	2017
<b>Operating activities:</b>			
Net loss for the period		\$ (5,163)	\$ (4,440)
Non-cash items:			
Depletion, depreciation, and amortization		4,051	3,961
Stock-based compensation		418	43
Deferred tax recovery	14	(90)	(68)
Gain on disposal of property, plant and equipment		(131)	-
Non-cash finance costs	13	2,469	2,887
Expenditures on decommissioning liabilities		(2,515)	(1,668)
Change in non-cash working capital	15	1,730	(665)
<b>Cash provided by operating activities</b>		<b>769</b>	<b>50</b>
<b>Financing activities:</b>			
Issue of common shares, net of share issuance costs		-	5,339
Issue of debentures, net of transaction costs		(19)	(19)
Change in non-cash working capital	15	-	(93)
<b>Cash provided by (used in) financing activities</b>		<b>(19)</b>	<b>5,227</b>
<b>Investing activities:</b>			
Expenditures – property, plant and equipment		(9,161)	(18,037)
Expenditures – exploration and evaluation assets		-	(30)
Redemption of (investment in) term deposits		49	(874)
Proceeds on disposal of property, plant and equipment		127	-
Changes in non-cash working capital	15	3,262	5,229
<b>Cash used in investing activities</b>		<b>(5,723)</b>	<b>(13,712)</b>
<b>Decrease in cash and cash equivalents during the period</b>		<b>(4,973)</b>	<b>(8,435)</b>
<b>Cash and cash equivalents, beginning of the period</b>		<b>13,138</b>	<b>50,802</b>
<b>Cash and cash equivalents, end of the period</b>		<b>\$ 8,165</b>	<b>\$ 42,367</b>

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

Certain comparative figures have been reclassified to conform to the current year's presentation (Note 2).

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)

As at and for the three month periods ending March 31, 2018 and 2017

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## 1. Corporate information

Strategic Oil & Gas Ltd. (“Strategic”) is a company registered and domiciled in Alberta. Strategic is a publicly traded company whose shares are listed on the TSX Venture Exchange. Strategic, together with its subsidiaries, (collectively referred to as the “Company”), is engaged in the exploration for and development of petroleum and natural gas reserves in Western Canada. On February 28, 2018, the Company’s subsidiary Strategic Oil & Gas Inc. sold its entire working interest in the Western United States. The Company is headquartered in Canada at Suite 1100, 645 – 7th Avenue SW, Calgary, Alberta.

## 2. Basis of presentation

### a) Going concern

These interim condensed consolidated financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. For the quarter ended March 31, 2018, the Company reported positive cash flow from operating activities of \$0.8 million, a net loss of \$5.2 million and an accumulated deficit of \$372.5 million. Sustained low commodity prices in recent years have put pressure on the Company’s cash flows.

At March 31, 2018, the Company had \$8.2 million in cash and a positive working capital of \$0.3 million. Cash from operating activities is dependent on future commodity prices and production levels. In order to continue funding future capital programs, the Company will need to obtain additional equity or debt financing, or assess other options. The ability to access the required capital to maintain current production levels and cash flows is dependent on a variety of external factors. This material uncertainty may cast significant doubt upon the Company’s ability to continue as a going concern.

The consolidated financial statements do not reflect adjustments that would be necessary if the going concern basis was not appropriate. The appropriateness of the going concern basis is dependent upon, among other things, the ability to obtain debt or equity financing, or other sources of funding for future capital programs.

### b) Statement of compliance

These interim condensed consolidated financial statements (the “financial statements”) have been prepared in accordance with International Accounting Standard (“IAS”) 34 “Interim Financial Reporting” using accounting policies consistent with International Financial Reporting Standards (“IFRS”). These financial statements are condensed as they do not include all of the information required by IFRS for annual financial statements and therefore should be read in conjunction with the Company’s annual consolidated financial statements for the year ended December 31, 2017. The share issuance costs have been reclassified and netted against the issue of common shares on the interim condensed consolidated statement of cash flows.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors on May 23, 2018.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)

As at and for the three month periods ending March 31, 2018 and 2017

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**c) Basis of measurement**

These interim condensed consolidated financial statements are prepared using the same accounting policies and methods of computation as disclosed in the Company's annual consolidated financial statements for the year ended December 31, 2017. There have been no changes in the application or use of estimates or judgments since December 31, 2017.

**d) Functional and presentation currency**

These financial statements are presented in Canadian dollars, the Company's functional currency.

### 3. Significant accounting policies

**a) Financial instruments**

**Cash and cash equivalents**

Cash and cash equivalents include cash on hand and other short-term highly liquid investments that are readily convertible to cash and which are subject to an insignificant risk of changes in value, with a maturity of 3 months or less.

**Forward commodity sales contracts**

The Company has accounted for its forward pledged delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items, in accordance with its expected purchase, sale or usage requirements. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair values on the interim condensed consolidated balance sheet. Realized gains or losses from commodity physical delivery sales contracts are recognized in petroleum and natural gas sales as the contracts are settled.

**Convertible debentures**

The convertible debentures are a compound financial instrument, separated into liability and equity components. The liability component is recognized initially at the fair value of a similar liability that does not have an equity conversion option and the equity component is recognized as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component. Any transaction costs are allocated to the liability and equity component in proportion to their initial carrying amounts. Subsequent to initial recognition, the liability component of the convertible debentures is measured at amortized cost and is accreted to the original principal balance using the effective interest method. The equity component is not remeasured subsequent to initial recognition.

Convertible debentures can be converted to share capital at the option of the holder and the number of shares to be issued does not vary with changes in the fair value. The equity component and the accreted liability component will be reclassified to share capital upon conversion. Any balance in the equity component of convertible debentures that remains after the settlement of the liability will be transferred to contributed surplus.

**b) Revenues recognition – IFRS 15**

On January 1, 2018, the Company adopted IFRS 15 "Revenue from Contracts with Customers" IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue from contracts with customers is recognized. The Company's revenue relates to the sale of petroleum and natural gas to customers at specified delivery points at benchmark prices.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)

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The Company adopted IFRS 15 using the modified retrospective approach. Under this transitional provision, the cumulative effect of initially applying IFRS 15 is recognized on the date of initial application as an adjustment to retained earnings. No adjustment to retained earnings was required upon adoption of IFRS 15.

IFRS 15 requires additional disclosure relating to the disaggregation of revenue - this additional disclosure is included in Financial Statement Note 12. In addition, as a result of this adoption, The Company has revised the description of its accounting policy for revenue recognition as follows:

### *Revenue recognition*

Revenue associated with the sale of crude oil, natural gas and natural gas liquids is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when or as the Company satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. The transfer of control of oil, natural gas, natural gas liquids usually coincides with title passing to the customer and the customer taking physical possession. The Company principally satisfies its performance obligations at a point in time and the amounts of revenue recognized relating to performance obligations satisfied over time are not significant.

### **c) Financial instruments – IFRS 9**

Effective January 1, 2018, the Company retrospectively adopted IFRS 9, as well as consequential amendments to IFRS 7 “Financial Instruments: Disclosures.” The standard supersedes earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 “Financial Instruments: Recognition and Measurement.” The adoption of IFRS 9 did not result in any adjustments to the amounts recognized in the Company’s interim condensed consolidated financial statements for the quarter ended March 31, 2018.

On January 1, 2018, the Company determined the appropriate classification category and measurement of its financial assets and liabilities under IFRS 9 and compared each to their original classification and measurement under IAS 39. Under IFRS 9, financial instruments are classified as amortized cost, fair value through other comprehensive income or fair value through profit and loss. No adjustments were made to the carrying amounts of financial instruments as a result of the adoption of IFRS 9.

<b>Financial Instrument</b>	<b>Measurement Category (IAS 39)</b>	<b>Measurement Category (IFRS 9)</b>
Cash and cash equivalents	Fair value through profit or loss	Fair value
Trade and other receivables	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Convertible debentures – debt component	Other financial liabilities	Amortized cost
Risk management contracts	Fair value through profit or loss	Fair value

The standard also provides a simplified approach to measuring expected credit losses using a lifetime expected loss allowance for all trade receivables and contract assets. The credit loss model groups receivables based on similar credit risk characteristics and days past due in order to estimate bad debts. The adoption of IFRS 9 did not result in a material impact to the Company’s consolidated financial statements due to the high credit quality of its customers.



# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)

As at and for the three month periods ending March 31, 2018 and 2017

## d) Future accounting policy changes

In January 2016, the IASB issued IFRS 16 “Leases,” which replaces IAS 17 “Leases.” For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 “Revenue from Contracts with Customers.” The standard is required to be adopted either retrospectively or using a modified retrospective approach. IFRS 16 will be applied by the Company on January 1, 2019 and the Company is currently evaluating the impact of the standard on the Company's financial statements.

## 4. Term deposits

The Company has term deposits with a chartered bank for \$4.5 million (December 31, 2017 - \$4.5 million), all of which are pledged as collateral for outstanding letters of credit.

## 5. Asset disposition

On February 28, 2018, the Company sold its entire working interest in the Western United States for a total cash consideration of \$0.1 million.

(\$000)	March 31, 2018
Property, plant and equipment net book value	\$ 18
Decommissioning obligations on assets sold	(22)
Gain on disposition of assets	131
Purchase price paid in cash	\$ 127

## 6. Exploration and evaluation (“E&E”) assets

(\$000)	March 31, 2018	December 31, 2017
Opening balance	\$ 9,651	\$ 14,438
E&E expenditures	-	106
E&E transfer to Property, plant and equipment	-	(1,407)
E&E impairment	-	(2,900)
Amortization for the period	(119)	(586)
Closing balance	\$ 9,532	\$ 9,651

## 7. Property, plant, and equipment (“PPE”)

(\$000)	D&P assets	Office	Total
Carrying value before accumulated depletion, depreciation and impairment			
As at December 31, 2017	\$ 528,716	\$ 1,178	\$ 529,894
Additions	9,161	-	9,161
Dispositions	(3,745)	-	(3,745)
Change in decommissioning costs	77	-	77
As at March 31, 2018	\$ 534,209	\$ 1,178	\$ 535,387

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)

As at and for the three month periods ending March 31, 2018 and 2017

<b>(\$000)</b>			
<b>Accumulated depletion, depreciation and impairment</b>	<b>D&amp;P assets</b>	<b>Office</b>	<b>Total</b>
As at December 31, 2017	\$ 373,617	\$ 1,169	\$ 374,786
Depreciation and depletion	3,928	4	3,932
Dispositions	(3,727)	-	(3,727)
Depreciation and depletion capitalized to inventory	(10)	-	(10)
<b>As at March 31, 2018</b>	<b>\$ 373,808</b>	<b>\$ 1,173</b>	<b>\$ 374,981</b>

  

<b>(\$000)</b>			
<b>Net carrying value</b>	<b>D&amp;P assets</b>	<b>Office</b>	<b>Total</b>
As at December 31, 2017	\$ 155,099	\$ 9	\$ 155,108
<b>As at March 31, 2018</b>	<b>\$ 160,401</b>	<b>\$ 5</b>	<b>\$ 160,406</b>

Following the disposition of the US assets, all of the Company's development and production assets are located within Canada. The cost of PPE includes the provision for decommissioning obligations. For the three month period ended March 31, 2018, \$0.3 million of general and administrative expenses related to technical office staff that are directly involved in the Company's capital spending programs were capitalized to PPE (\$0.3 million for the three month period ended March 31, 2017).

Future capital costs of \$149.3 million (March 31, 2017 - \$156.9 million) have been included in the depletable balance as at March 31, 2018. Major components costs – such as facilities and pipelines, which are depreciated separately, are \$59.3 million (March 31, 2017 - \$57.5 million) with a net carrying value of \$45.2 million (March 31, 2017 - \$46.8 million).

## 8. Decommissioning liabilities

Total future decommissioning liabilities are estimated based on the Company's net working interest in all wells and facilities, the estimated costs to abandon and reclaim the wells, pipelines and facilities and the estimated timing of the costs to be incurred in future periods. These costs are expected to be incurred over a range up to 34 years, depending on the estimated reserve life. The undiscounted amount of the estimated costs at March 31, 2018 were \$108.7 million (December 31, 2017 - \$101.5 million). The estimated costs have been discounted at a risk free rate from 1.80% to 2.25% (December 31, 2017 – 1.66% to 2.20%) and an inflation rate of 2% (December 31, 2017 – 2%) was applied.

The following table reconciles the changes to the Company's decommissioning liabilities:

<b>(\$000)</b>	<b>Three months ended March 31, 2018</b>	<b>Year ended December 31, 2017</b>
Balance beginning of the period	\$ 62,493	\$ 52,651
Liabilities incurred during the period	221	925
Disposition of decommissioning liabilities	(22)	-
Expenditures on existing liabilities	(2,515)	(2,333)
Revaluation on decommissioning liabilities	-	7,190
Change in estimated future cash flows	637	170
Change in discount rate	(781)	2,598
Accretion	377	1,292
Balance end of the period	\$ 60,410	\$ 62,493
Current	5,863	3,190
Long term	\$ 54,547	\$ 59,303

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
As at and for the three month periods ending March 31, 2018 and 2017

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## 9. Convertible Debentures

The Company has senior secured convertible debentures (“Debentures”) outstanding. The Debentures mature on February 28, 2021 and bear an annual interest rate of 8.0%, payable semi-annually in arrears, with an option for the Company to pay the interest in an equivalent principal amount of debentures for the first two years. The Debentures are convertible into common shares at various conversion prices, subject to adjustment in certain events. The Debentures can be called prior to the maturity date by the Company if either a) the 90-day weighted average trading price of Strategic common shares is over four times the conversion price, or b) anytime in the fifth year of the term. The convertible debentures have been classified as a financial liability, net of issue costs and net of the equity component.

On February 28, 2018, \$4.1 million of debentures were issued as payment of interest in kind. Of the \$4.1 million, \$3.1 million were issued to entities controlled or jointly controlled by directors of the Company and an additional \$0.2 million were issued to directors and officers of the Company. The carrying amount of the financial liability of these convertible debentures was determined by discounting the stream of future payments of interest and principal, using a rate of 11.40% the estimated rate for debt with similar terms without conversion features.

Below is a summary of the liability and equity components of the convertible debentures:

(\$000)	Liability Component	Equity Component	Total
Balance at December 31, 2017	\$ 94,323	\$ 10,247	\$ 104,570
Additional debentures issued as payment in kind of interest	3,721	335	4,056
Issuance costs	(19)	(1)	(20)
Deferred tax recovery (Note 14)	-	(90)	(90)
Debentures converted	(18)	(2)	(20)
Accretion expense	747	-	747
Balance at March 31, 2018	\$ 98,754	\$ 10,489	\$ 109,243

The liability component of all debentures issued is being accreted to the adjusted principal amount of \$110.1 million at maturity. Below is a summary of the debentures issued and the related conversion prices:

Issue Date	Principal Amount (\$000)	Conversion Price (\$/share)
February 29, 2016	94,827	1.80
August 31, 2016	3,617	3.30
February 28, 2017	3,724	2.70
August 31, 2017	3,864	2.03
February 28, 2018	4,056	1.08

## 10. Share capital

### a) Authorized

The Company is authorized to issue an unlimited number of common shares without par value.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
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## b) Issued and outstanding

(\$000)	Number of shares (000)	Three months ended	
		March 31, 2018	
Balance at December 31, 2017	46,391	\$	365,466
Debentures converted	11		20
Balance at March 31, 2018	46,402	\$	365,486

## c) Weighted average shares

(000)	Three months ended March 31	
	2018	2017
Weighted average shares (basic & diluted)	46,396	45,549

For the three months ended March 31, 2018, outstanding stock options and convertible debentures were excluded from the calculations as they were anti-dilutive.

## 11. Stock-based compensation

The outstanding number and weighted average exercise price of stock options are as follows:

	Number of options	Weighted average Exercise Price	
<b>Balance at December 31, 2017</b>	<b>2,308,816</b>	\$	3.50
Granted	928,000		1.05
Cancelled/Forfeited	(268,500)		3.05
Expired	(15,500)		25.84
<b>Balance at March 31, 2018</b>	<b>2,952,816</b>	\$	2.65

On May 23, 2018, the Company issued 1.0 million stock options to the Chief Executive Officer of the Company. A third of the options issued vest immediately while the remaining options vest over the subsequent two years. Each option entitles the holder to acquire one common share of the Company for a period of five years at a price of \$1.08 per share.

The following table sets out the outstanding and exercisable options as at March 31, 2018:

	Outstanding Options			Exercisable Options	
	Number of Options	Weighted Average Exercise Price	Weighted Average Life Years	Number of Options	Weighted Average Exercise Price
	928,000	\$ 1.05	4.90	309,345	\$ 1.05
	1,764,066	2.44	3.40	1,000,739	2.27
	232,750	8.39	1.43	232,750	8.39
	2,750	9.71	1.07	2,750	9.71
	1,500	19.13	0.55	1,500	19.13
	500	21.20	0.35	500	21.20
	19,500	22.74	0.15	19,500	22.74
	3,750	24.80	0.03	3,750	24.80
	2,952,816	\$ 2.65	3.68	1,570,834	\$ 3.28

# Strategic Oil & Gas Ltd.

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The fair value of options granted was estimated on the date of grant using a Black-Scholes option pricing model with the following weighted average inputs:

Assumptions	Three months ended March 31	
	2018	
Risk free interest rate (%)	1.23	
Expected life (years)	3.36	
Expected volatility (%)	106.97	
Forfeiture rate (%)	12.86	
Weighted average fair value of options granted	0.80	

There were no stock options issued in the three months ended March 31, 2017.

## 12. Revenue

The Company derives its revenue from contracts with customers primarily through the transfer of commodities at a point in time representing the following major product types:

(\$000)	Three months ended	
	March 31, 2018	March 31, 2017
Petroleum	\$ 9,516	7,893
Natural gas	565	995
Petroleum and natural gas sales	\$ 10,081	8,888

At March 31, 2018, receivables from contracts with customers, which are included in trade and other receivables, were \$3.2 million (March 31, 2017 - \$2.6 million).

## 13. Finance costs

(\$000)	Three months ended March 31	
	2018	2017
Interest	\$ 11	\$ 20
Interest expense on convertible debentures – paid in kind (“PIK”)	1,345	1,898
Interest expense on convertible debentures – non-PIK	810	102
Accretion of decommissioning liabilities	377	306
Accretion on debentures	747	683
Total finance costs	\$ 3,290	\$ 3,009

## 14. Deferred taxes

For the three months ended March 31, 2018, the Company recorded a deferred tax liability of \$0.1 million (three months ended March 31, 2017 - \$0.1 million) related to the temporary difference between accounting and tax values of the equity component of convertible debentures issued during the period. As a result, the Company was able to realize \$0.1 million (March 31, 2017 - \$0.1 million) of previously unrecognized deferred tax assets and a corresponding deferred tax recovery.

# Strategic Oil & Gas Ltd.

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## 15. Supplemental cash flow information

(\$000)	Three months ended March 31	
	2018	2017
Interest paid	\$ 196	\$ 122
Changes in non-cash working capital		
Trade and other receivables	(481)	(582)
Inventory	(7)	2
Accumulated depletion in inventory	(10)	1
Accounts payable and accrued liabilities	4,867	5,163
Accrued interest on convertible debentures	(2,088)	(1,939)
Interest paid in kind	(1,345)	(1,898)
Debentures issued as paid in kind interest (Note 9)	4,056	3,724
	\$ 4,992	\$ 4,471
Operating	1,730	(665)
Financing	-	(93)
Investing	3,262	5,229
	\$ 4,992	\$ 4,471

## 16. Transactions with related parties

For the three months ended March 31, 2018, legal fees in the amount of \$0.1 million (March 31, 2017 - \$0.1 million) were incurred with a legal firm of which a director is a partner, and these amounts are included as general and administrative expenses or share issue costs. Accounts payable and accrued liabilities at March 31, 2018 include \$nil (December 31, 2017 - \$nil) due to related parties. Accrued interest on convertible debentures at March 31, 2018 include \$0.6 million (December 31, 2017 - \$3.0 million) due to related parties. The above transactions were conducted in the normal course of operations and were recorded at exchange amounts which were agreed upon between the Company and the related parties.

## 17. Financial instruments and financial risk management

The Company's financial instruments include cash and cash equivalents, term deposits, trade and other receivables, accounts payable and accrued liabilities, share-based payment transactions, convertible debentures and derivative financial instruments. The carrying value of cash and cash equivalents, term deposits, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to their relatively short periods to maturity. The financial liability component of the convertible debentures has been recorded using the effective interest method based on interest at rates available to the Company.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

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The fair value of cash and cash equivalents is measured at level 1.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. The following presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing commodity risks. Further quantitative disclosures are included throughout these financial statements.

## a) Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks.

### Commodity price risk

Commodity price risk is the risk that the fair value of assets or liabilities or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar. The Company may, in certain circumstances, enter into forward oil or natural gas sales contracts to mitigate commodity price risk.

At March 31, 2018, the following risk management contracts were outstanding with a mark-to-market asset value of \$nil (March 31, 2017 - \$nil):

### Financial WTI crude oil contracts

Term	Contract Type	Volume (bbl/d)	Fixed Price (\$/bbl)	Index	
01-Mar-2018	31-Aug-2018	Swap	100	USD\$64.20	WTI - NYMEX

The Company does not apply hedge accounting to these risk management contracts and they are recorded as fair value with changes in fair value included in the condensed consolidated statement of loss.

### Interest rate risk

The Company is exposed to interest rate risk as changes in interest rates may affect future cash flows. The Company's cash balance and primary debt facility has a floating interest rate that will fluctuate based on prevailing market conditions. Cash flows are sensitive to changes in interest rates on this instrument. As at March 31, 2018, the Company did not hold any floating interest rate debt and therefore was not exposed to interest rate risk on its long-term debt.

### Foreign exchange risk

Prices for oil are determined in global markets and generally denominated in United States dollars. Natural gas and oil prices obtained by the Company are influenced by both US and Canadian demand and the corresponding North American supply, and recently, by imports of liquefied natural gas. The exchange

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rate effect cannot be quantified but generally an increase in the value of the \$CDN as compared to the \$US will reduce the prices received by the Company for its petroleum and natural gas sales. As at March 31, 2018 and December 31, 2017, the Company had no contracts in place to mitigate foreign exchange risk. As at March 31, 2018, the Company held \$0.2 million (December 31, 2017 - \$0.1 million) in US dollars.

## b) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

Typically the Company ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 30 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditure. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month.

## c) Credit risk

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Company's trade and other receivables are with customers in the oil and gas industry and are subject to normal credit risks. For the period ended March 31, 2018, 100% (December 31, 2017 – 100%) of the Company's oil and natural gas production is being sold through marketing companies and revenues are collected on the 25th day of the month following the month of production. In order to mitigate collection risk, the Company assesses the credit worthiness of customers and counter parties by assessing the financial strength of the customers and by routinely monitoring credit risk exposures.

The Company's most significant customer, a Canadian oil and natural gas marketer, accounts for 83% of the trade receivables at March 31, 2018 (December 31, 2017 – 84%) and 92% of revenues (March 31, 2017 – 86%).

The total accounts receivable 90 days past due amounted to \$0.2 million at March 31, 2018 (December 31, 2017 - \$0.1 million). The allowance for doubtful accounts at March 31, 2018 was \$0.1 million (December 31, 2017 - \$0.1 million).

## d) Physical sale contracts

Term	Contract Type	Volume (bbl/d)	Fixed Price (\$/bbl)	Index	
01-Feb-2018	30-Sept-2018	Swap	500	USD\$62.00	WTI - NYMEX



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## 18. Capital management

Strategic considers its capital structure to include shareholders' equity, convertible debentures and working capital. The objectives of the Company are to maintain a strong balance sheet affording the Company financial flexibility to achieve goals of continued growth and access to capital. In order to maintain or adjust the capital structure, the Company may issue new common shares, issue new debt, or adjust exploration and development expenditures.

The Company monitors its spending programs based on available funds, which is working capital excluding risk management contracts and term deposits which are pledged as collateral for outstanding letters of credit.

## 19. Commitments and contingencies

- a) The Company has lease agreements for office space and equipment and natural gas transportation resulting in the following commitments:

Year	Office	Gas transportation
2018	\$ 339	\$ 313
2019	409	392
2020	38	375
2021	-	332
2022	-	309
2023 and thereafter	-	81
	\$ 786	\$ 1,802

- b) By the 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 industry standard insurance coverage. The Company is currently remediating certain environmental spills in the Marlowe area. While the Company believes it has recorded its best estimate of the impact of these contingencies in these financial statements, the ultimate outcome of these matters is uncertain.