Condensed Consolidated Interim Financial Statements of

SOUTHERN ENERGY CORP.

For the three and nine months ended September 30, 2019 and 2018

(unaudited)

(Canadian Dollars)

SOUTHERN ENERGY CORP.

Condensed Consolidated Interim Statement of Financial Position (unaudited)

($000s of Canadian Dollars)	September 30, 2019	December 31, 2018
Assets		
Current assets		
Cash and cash equivalents	$ 1,560	$ 2,334
Accounts receivable and other	2,482	13,744
Prepaid expenses and deposits	369	300
Derivative assets (Note 11)	602	332
	5,013	16,710
Derivative assets (Note 11)	203	20
Property, plant and equipment (Note 4)	53,555	38,199
Right-of-use assets (Note 5)	831	-
Total assets	$ 59,602	$ 54,929
Liabilities and Equity		
Current Liabilities		
Accounts payable and accrued liabilities	2,893	2,985
Royalties payable (Note 12)	5,714	5,067
Current portion of lease liabilities (Note 5)	388	-
Bank debt (Note 7)	19,865	21,009
Derivative liabilities (Note 11)	8	166
	28,868	29,227
Long-term Liabilities		
Derivative liabilities (Note 11)	19	51
Convertible debentures (Note 8)	6,535	-
Lease liabilities (Note 5)	466	-
Decommissioning provisions (Note 6)	5,473	6,740
Total liabilities	41,361	36,018
Shareholders' equity (Note 9)		
Share capital	35,741	33,860
Equity component of convertible debenture (Note 8)	665	-
Warrants	1,195	1,195
Contributed surplus	3,995	3,883
Deficit	(23,175)	(20,089)
Accumulated other comprehensive income	(180)	62
	18,241	18,911
Total liabilities and shareholders' equity	$ 59,602	$ 54,929

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

($000s of Canadian Dollars, except for per share amounts)	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Revenues				
Petroleum and natural gas revenue (Note 13)	$ 5,340	$ -	$ 14,147	$ -
Royalties	(1,002)	-	(2,621)	-
	4,338	-	11,526	-
Expenses				
Production and operating	1,880	-	5,043	-
Transportation	350	-	957	-
Depletion, depreciation and amortization (Notes 4 & 5)	1,794	-	3,989	-
Impairment (Note 4)	-	-	725	-
Gain on derivatives (Note 11)	(461)	-	(853)	-
Gain on dispositions (Note 4)	-	-	(120)	-
Finance	597	-	1,102	-
General and administrative	1,056	-	3,220	-
Share-based compensation	100	-	112	-
Transaction costs	192	-	580	-
Unrealized foreign exchange (gain) / loss	(89)	-	90	-
	5,419	-	14,845	-
Net (loss) from continuing operations before income tax	(1,081)	-	(3,319)	-
Income tax recovery	-	-	(210)	-
Net (loss) from continuing operations	(1,081)	-	(3,109)	-
Net (loss) earnings from discontinued operations (Note 14)	-	(134)	23	(327)
Total net (loss) for the period	(1,081)	(134)	(3,086)	(327)
Currency translation adjustment	212	-	(242)	-
Comprehensive loss for the period	$ (869)	$ (134)	$ (3,328)	$ (327)
Basic and diluted (Note 10)				
Continuing operations	$ (0.00)	$ -	$ (0.01)	$ -
Discontinued operations	-	(0.01)	0.00	(0.01)
Net loss per share	$ (0.00)	$ (0.01)	$ (0.01)	$ (0.01)

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

($000s of Canadian Dollars, except share amounts)	Common Shares	Shareholders' Capital	Equity Component of Convertible Debentures	Warrants	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income / (Loss)	Shareholders' Equity
Balance, December 31, 2017	24,246,973	$ 15,923	$ -	$ -	$ 3,883	$(17,394)	$ -	$ 2,412
Net Loss	-	-	-	-	-	(327)	-	(327)
Balance, September 30, 2018	24,246,973	$ 15,923	$ -	$ -	$ 3,883	$(17,721)	$ -	$ 2,085
Balance, December 31, 2018	204,356,973	$ 33,860	$ -	$ 1,195	$ 3,883	$(20,089)	$ 62	$ 18,911
Shares issued on Rights Offering (Note 9)	19,413,306	1,881	-	-	-	-	-	1,881
Net Loss	-	-	-	-	-	(3,086)	-	(3,086)
Other Comprehensive Loss	-	-	-	-	-	-	(242)	(242)
Convertible Debentures issued	-	-	665	-	-	-	-	665
Share-based compensation	-	-	-	-	112	-	-	112
Balance, September 30, 2019	223,770,279	$ 35,741	$ 665	$ 1,195	$ 3,995	$(23,175)	$ (180)	$ 18,241

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

	Three months ended September 30,		Nine months ended September 30,	
($000s of Canadian Dollars)	**2019**	**2018**	**2019**	**2018**
Operating activities				
Total net loss for the period	$ (1,081)	$ (134)	$ (3,086)	$ (327)
Changes in non-cash items:				
Depletion, depreciation and amortization (Notes 4 & 5)	1,794	100	4,028	283
Impairment (Note 4)	-	-	725	-
Gain on dispositions (Note 4)	-	-	(120)	-
Net finance expense	597	5	1,108	15
Unrealized gain on derivatives (Note 11)	(178)	-	(647)	-
Unrealized (gain) / loss on foreign exchange	(89)	-	90	-
Share-based compensation	100	-	112	-
Deferred income tax recovery	-	-	(210)	-
Decommissioning provisions liabilities settled (Note 6)	(5)	(1)	(11)	(12)
Changes in non-cash working capital	1,175	37	174	39
Net cash provided / (used) by operating activities	2,313	7	2,163	(2)
Investing activities				
Capital expenditures (Note 4)	(146)	-	(1,430)	-
Acquisitions (Note 4)	(449)	-	(21,324)	-
Proceeds from divestitures (Note 4)	-	-	504	-
Changes in non-cash working capital	(297)	(2)	83	13
Net cash (used) / provided by investing activities	(892)	(2)	(22,167)	13
Financing activities				
Proceeds from share issuances, net (Note 9)	(11)	-	1,881	-
Issuance of convertible debentures, net (Note 8)	(317)	-	7,282	-
Repayment of bank debt (Note 7)	(595)	-	(461)	-
Payment of interest	(303)	-	(711)	-
Finance lease payments	(104)	-	(311)	-
Changes in non-cash working capital	(92)	-	11,593	-
Net cash (used) / provided by financing activities	(1,422)	-	19,273	-
Net (decrease) / increase in cash and cash equivalents	(1)	5	(731)	11
Effect of foreign exchange rate changes	16	-	(43)	-
Cash and cash equivalents, beginning of period	1,545	925	2,334	919
Cash and cash equivalents, end of period	$ 1,560	$ 930	$ 1,560	$ 930

(See accompanying Notes to the Condensed Consolidated Interim Financial Statements)

1. Reporting Entity and Nature of Operations

Southern Energy Corp. ("Southern" or "Company") (formerly Standard Exploration Ltd. ("Standard")) is an oil and natural gas exploration and production company. Southern has a primary focus on developing conventional natural gas and light oil resources in the Southeast Gulf States of Mississippi and Alabama. On November 13, 2018, Standard announced and subsequently closed on December 19, 2018, a definitive reorganization and investment agreement with a new management team and board of directors in addition to a non-brokered private placement (collectively, the "Recapitalization"). Concurrent with the Recapitalization the Company closed the acquisition of Gulf Pine Energy Partners, LP ("Gulf Pine").

On December 31, 2018, Southern completed a consolidation of the Common Shares on the basis of one post-consolidated Common Share for every five pre-consolidated Common Shares. On January 2, 2019 Southern changed its name from "Standard Exploration Ltd." to "Southern Energy Corp." and on January 7, 2019, the Common Shares commenced trading on the TSX Venture Exchange ("TSXV") under the new name and new trading symbol "SOU". All information related to issued and outstanding common shares, stock options and warrants, has been restated to reflect the share consolidation for all periods present.

Southern's head office is located in Calgary, Alberta, Canada. The condensed interim consolidated financial statements were authorized for issue by the Board of Directors on November 27, 2019.

2. Basis of Preparation

The condensed consolidated financial statements of Southern include the accounts of all domestic and foreign subsidiaries. Wholly-owned subsidiaries included in the Company's accounts include Southern Energy Corp (DE), Southern Energy Operating, LLC, Southern Energy CMS, LLC, Southern Energy BWB, LLC and Southern Energy SO, LLC. Southern accounts for joint operations by recognizing the Company's share of assets, liabilities, income and expenses. All intercompany balances and transactions have been eliminated.

These financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting of the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The condensed financial statements use the accounting policies which the Company applied in its annual consolidated financial statements for the year ended December 31, 2018, with the exception of the changes in accounting policies described below. These condensed consolidated interim financial statements should be read in conjunction with Southern's consolidated financial statements for the year ended December 31, 2018, which are available on SEDAR at www.sedar.com or on Southern's website at www.southernenergycorp.com. These Condensed Consolidated Interim Financial Statements are presented in Canadian dollars. All financial information presented has been rounded to the nearest thousand unless otherwise indicated.

The Company's presentation and functional currency is the Canadian dollar. The functional currency of the Company's United States ("US") subsidiaries is the US dollar, and its results and Condensed Consolidated Interim Statement of Financial Position items are translated to Canadian dollars for the purposes of these Condensed Consolidated Interim Financial Statements, in accordance with the Company's foreign currency translation accounting policy.

3. Change in Accounting Policies:

Assets held for sale and discontinued operations

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition.

Non-current assets classified as held for sale are tested for impairment prior to transfer and measured at the lower of the carrying amount and fair value less costs to sell, with impairments recognized in the profit or loss in the period measured. Non-current assets and disposal groups held for sale are presented in current assets and liabilities on the statement of financial position.

Individual non-current assets or disposal groups are classified and presented as discontinued operations if the assets or disposal groups are disposed of or classified as held-for-sale. The results of discontinued operations are shown separately in the Condensed Consolidated Interim Statement of Loss and Comprehensive Loss with comparative figures restated. Detailed disclosure of revenue, expenses and net earnings (loss) are disclosed in the notes. Cash flows and comparative figures are disclosed in Note 14.

Convertible debentures

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

Amendments to IFRS 3 "Business Combinations" – Definition of a Business ("IFRS 3")

Southern elected to early adopt the amendments to IFRS 3 effective January 1, 2019, which will be applied retrospectively to acquisitions that occur on or after January 1, 2018. The amendments introduce an optional concentration test, narrow the definitions of a business and outputs, and clarify that an acquired set of activities and assets must include an input and a substantive process that together significantly contribute to the ability to create outputs. These amendments do not result in changes to the application of the acquisition method. The Company retrospectively adopted the amendments to IFRS 3, which did not result in any adjustments to the prior issued financial statements.

Amounts in ($000s of Canadian Dollars), except for per share amounts

Adoption of IFRS 16 — Leases ("IFRS 16")

Effective January 1, 2019, the Company adopted IFRS 16. The Company has applied the new standard using the modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it recognized the cumulative effect as an adjustment to opening retained earnings and applies the standard prospectively.

On adoption, Southern elected to use the following practical expedients permitted under the standard:

- Account for leases with a remaining term of less than 12 months at January 1, 2019 as short-term leases;
- Account for lease payments as an expense and not recognize a right-of-use ("ROU") asset if the underlying asset is of a lower dollar value (less than $5 thousand); and
- Recognize lease liabilities at the present value of the remaining lease payments, discounted using the interest rate implicit in the lease or the Company's incremental borrowing rate as at January 1, 2019. The associated ROU assets will be measured at the amount equal to the lease liability on date of transition.

As a result of the adoption of IFRS 16 as at January 1, 2019, Southern recorded a current lease liability of $405 thousand and a long-term lease liability of $714 thousand with an associated ROU Asset of $1.1 million. The difference in operating lease commitments disclosed as at December 31, 2018 and lease liabilities recognised in the statement of financial position at January 1, 2019 is primarily due to the discounting of the future lease payments using Southern's incremental borrowing rate.

4. Property, Plant and Equipment

The following table presents the reconciliation of the beginning and ending amounts of our PP&E balances including accumulated depletion, depreciation, amortization and impairment:

	Oil and Natural Gas Assets	Other	Total
Net book value as at December 31, 2018	**$ 38,199**	**$ -**	**$ 38,199**
Additions	1,426	4	1,430
Acquisitions, including decommissioning costs	21,534	-	21,534
Dispositions	(1,951)	-	(1,951)
Change in decommissioning provision (Note 6)	95	-	95
Depletion, depreciation and amortization	(3,740)	-	(3,740)
Impairment	(725)	-	(725)
Effect of foreign exchange rate changes	(1,287)	-	(1,287)
Net book value as at September 30, 2019	**$ 53,551**	**$ 4**	**$ 53,555**

Depletion, depreciation and amortization

For the three months ended September 30, 2019, the Company recorded depletion expense of $1.7 million relating to the US assets. For the period ending September 30, 2019, an estimated $42.2 million of future development costs associated with the proven plus probable reserves were included for the US assets.

For the nine months ended September 30, 2019, the Company recorded depletion expense of $3.7 million relating to the US assets and $39 thousand relating to the Canadian assets. For the period ending September 30, 2019, an estimated $42.2 million of future development costs associated with the proven plus probable reserves were included for the US assets.

Asset Acquisition

On June 14, 2019, Southern closed the previously announced Acquisition with an arm's length private company to acquire assets in the State of Mississippi for cash consideration of US$14.7 million ($19.7 million), including customary adjustments of US$1.8 million ($2.4 million) for the period between February 1, 2019 to June 14, 2019 and the royalty suspense obligations relating to the assets.

Canadian Disposition

On May 2, 2019, the Company closed the sale of all its remaining Canadian oil and natural gas assets for $0.5 million.

At March 31, 2019, the Canadian assets were classified as held for sale and recorded at the lesser of their carrying amount and their fair value based on the observed selling price, less customary purchase price adjustments, resulting in an impairment of $725 thousand.

Impairment

At the end of each reporting period, the Company performs an assessment to determine whether there are any indications of impairment for the CGUs that comprise oil and natural gas properties. The assessment of indicators is subjective in nature and requires management to make judgments based on the information available at the reporting date. The market capitalization of the Company continued to deteriorate in the third quarter and was again below the net assets of the Company. The current and forward commodity price for natural gas has decreased since December 31, 2018. Management identified these as impairment indicators and estimated the recoverable amount of all cash generating units at September 30, 2019 to be greater than the net book value of the CGUs.

Amounts in ($000s of Canadian Dollars), except for per share amounts

5. Right-of-Use Assets and Lease Liabilities

Right-of-use Assets

The following table presents the reconciliation of the beginning and ending amounts of our ROU balances including accumulated depreciation:

		Total
Carrying value as at January 1, 2019 (Note 3)	**$**	**1,119**
Depreciation		(288)
Carrying value as at September 30, 2019	**$**	**831**

Lease Liabilities

Southern had the following lease obligations outstanding as at the dates indicated:

		Total
As at January 1, 2019 (Note 3)	**$**	**1,119**
Interest expense		46
Lease payments		(311)
As at September 30, 2019	**$**	**854**
Less: Current portion		388
Lease liability	$	466

The Company has lease liabilities for contracts related to office space. The lease labilities were discounted using the Company's incremental borrowing rate at January 1, 2019 of 6.0%.

6. Decommissioning Provisions

The Company's decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites and gathering systems. The total decommissioning provision 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 total estimated, inflated undiscounted risked cash flows required to settle the provision, is approximately $7.3 million at September 30, 2019 ($8.7 million at December 31, 2018), which have been discounted using a risk-free interest rate of 2.4% at September 30, 2019 (2.2% - 2.7% at December 31, 2018). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 28 years into the future and will be funded from general corporate resources at the time of abandonment.

Amounts in ($000s of Canadian Dollars), except for per share amounts

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of legal obligations associated with the retirement of property, plant and equipment:

	Total
Balance as at December 31, 2018	**$ 6,740**
Acquisitions and additions	210
Property disposal	(1,420)
Changes in estimates	95
Liabilities settled	(11)
Accretion expense	30
Effect of foreign exchange rate changes	(171)
Balance as at September 30, 2019	**$ 5,473**
Long term liability	**$ 5,473**

7. Bank Debt

Southern had the following bank debt obligations outstanding as at the dates indicated:

	As at Sep 30, 2019	As at Dec 31, 2018
Current Portion Senior Secured Bank Credit Facility	$ 19,865	$ 21,009
Total Bank Debt	**$ 19,865**	**$ 21,009**

On June 14, 2019, Southern Energy Corp. (Delaware) ("Southern Delaware") entered into a fourth amendment (the "Fourth Amendment") to the Senior Secured Bank Credit Facility (the "Credit Facility"). The Fourth Amendment included an increase to the borrowing base related to the closing of the Acquisition from US$12.5 million ($16.4 million) to US$17.0 million ($22.2 million), a quarterly borrowing base reduction beginning September 1, 2019 of US$0.9 million ($1.2 million) and amendments to the covenant calculations. The February 1, 2021, maturity date of the Credit Facility remained the same with the execution of the Fourth Amendment.

Interest on borrowings under the Credit Facility is determined by reference to the London Interbank Offered Rate ("LIBOR") plus a margin that ranges from 2.50% to 3.50%, based on utilization. Southern pays a commitment fee of 0.50% on the undrawn borrowing base. During the nine months ended September 30, 2019, the effective interest rate, excluding commitment and other fees, was 5.65%.

As part of the Fourth Amendment, for the test period ending September 30, 2019, Bank EBITDAX and Cash Interest was annualized by taking the results of the quarter ended September 30, 2019 and multiplying them by four. For the test period of December 31, 2019, Bank EBITDAX and Cash Interest will be annualized by taking the results of the two fiscal quarters ending December 31, 2019 and multiplying them by two. For the test period of March 31, 2020, Bank EBITDAX and Cash Interest will be annualized by taking the results of the three fiscal quarters ending March 31, 2020 and multiplying them by four and dividing them by three.

Amounts in ($000s of Canadian Dollars), except for per share amounts

As at September 30, 2019, the Credit Facility was subject to the following financial covenants, calculated quarterly:

Financial covenant	Limit	As at Sep 30, 2019	As at Dec 31, 2018
Leverage ratio (Debt / Bank EBITDAX)	Maximum 3.5	3.7	4.1
Interest coverage ratio (Bank EBITDAX / Cash Interest)	Minimum 3.0	4.4	4.2
Current ratio (Current Assets / Current Liabilities)	Minimum 1.0	0.7	2.1

The financial covenants include financial measures defined within the Credit Facility that are not defined under IFRS. These financial measures are defined by the Credit Facility as follows:

- Debt includes only the Credit Facility drawings at the period end
- Bank EBITDAX is defined as Earnings before Interest, Taxes, Depreciation, Depletion, Amortization, Exploration Expenses and other non-cash charges such as, Impairment, Unrealized (gain) / loss on derivatives, Stock-based compensation and Foreign exchange (gain) / loss
- Current Assets is calculated by taking the total current assets from the consolidated statement of financial position less the current derivative asset and adding the unused portion of the available credit facility
- Current Liabilities is calculated by taking the total current liabilities from the consolidated statement of financial position less the current derivative liability, the current portion of the lease liability, and the current bank debt.

As at September 30, 2019, the Company was not compliant with the current ratio covenant or the leverage ratio covenant of the Credit Facility. As at December 31, 2018, the Company was not compliant with the leverage ratio covenant of the Credit Facility. As such, all outstanding bank debt as at September 30, 2019 and December 31, 2018 has been classified under current liabilities. Southern has identified various options to improve the financial position of the Company. Strategies to manage liquidity include, having adequate sources of financing available through its Credit Facilities, estimating future cash flows generated from operations based on reasonable production and pricing assumptions, reducing capital spending and utilizing equity to settle interest payments on Debentures. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing. Subsequent to September 30, 2019, Southern Delaware has obtained written waivers for non-compliance for the period ended September 30, 2019 and December 31, 2018.

Subsequent to September 30, 2019, as part of the October borrowing base review, Southern Delaware Subsequent to September 30, 2019, as part of the semi-annual borrowing base review, Southern Delaware entered into a Fifth amendment (“Fifth Amendment”) to the Credit Facility reducing the borrowing base to US$15.0 million ($19.9 million). Beginning January 1, 2020, the borrowing base will be reduced monthly by US$250 thousand ($330 thousand) until the completion of the next borrowing base review scheduled for March 1, 2020. The February 1, 2021, maturity date of the Credit Facility remained the same with the execution of the Fifth Amendment.

As part of the Fifth Amendment, the current ratio covenant calculation, beginning with the test period ending December 31, 2019 and ending with the test period of December 31, 2020, will exclude royalty suspense balances that are at least one year old, as at the test period date.

As at September 30, 2019, the borrowing base was US$16.1 million ($21.3 million) and Southern had US$15.0 million ($19.9 million) drawn. In Q3 2019, the Company voluntarily paid down US$0.5 million ($0.7 million) on the credit facility. As at December 31, 2018, the borrowing base was US$16.0 million ($21.8 million) and Southern had US$15.4 million ($21.0 million) drawn.

As of November 27, 2019, Southern had US$14.7 million ($19.5 million) drawn.

8. Convertible Debentures

	Number of Convertible Debentures	Liability Component ($000s)	Equity Component ($000s)
Balance at December 31, 2018	-	$ -	$ -
Issuance of convertible debentures	8,069	7,099	970
Issue costs	-	(692)	(95)
Deferred income tax liability	-	-	(210)
Accretion of discount	-	128	-
Balance at September 30, 2019	**8,069**	**$ 6,535**	**$ 665**

On June 14, 2019, Southern closed the sale of 8,069 Debentures at a price of $1,000 per Debenture. The Debentures will mature and be repayable on June 30, 2022 (the "Maturity Date") and accrue interest at the rate of 8.00% per annum payable semi-annually in arrears on December 31 and June 30 of each year (each an "Interest Payment Date"), with the first such payment to be made December 31, 2019. At the Company's election, interest on the Debentures, on the date it is payable can be settled a) in cash; b) by delivering freely tradeable, treasury common shares ("Shares") of the Company to a trustee for sale, in which event holders of the Debentures will be entitled to receive a cash payment equal to the interest payable from the proceeds of the sale of such Shares; or c) any combination of a) and b) above. At the holder's option, the Debentures are convertible into Common Shares at any time prior to the close of business on the earlier of the business day immediately preceding (i) the Maturity Date, or (ii) if called for redemption, the date specified for redemption by the Company, at a conversion price of $0.125 per Common Share, subject to adjustment in certain events. This represents a conversion rate of approximately 8,000 Common Shares for each $1,000 principal amount of Debentures, subject to the operation of certain anti-dilution provisions contained in the indenture governing the Debentures. Holders who convert their Debentures will receive accrued and unpaid interest for the period from the date of the last Interest Payment Date prior to the date of conversion to the date of conversion.

The Debentures are direct, subordinated unsecured obligations of the Company, subordinated to any senior indebtedness of the Company, including the Credit Facility, and ranking equally with one another and with all other existing and future subordinated unsecured indebtedness of the Company to the extent subordinated on the same terms.

Amounts in ($000s of Canadian Dollars), except for per share amounts

The Debentures will not be redeemable by the Company prior to June 30, 2020. On or after June 30, 2020 and prior to June 30, 2021, the Debentures will be redeemable by the Company, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to 105% of their principal amount plus accrued and unpaid interest, if any. On or after June 30, 2021 and prior to the Maturity Date, the Debentures will be redeemable by the Company, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to 102.5% of their principal amount plus accrued and unpaid interest, if any. The securities issued and sold in the Debenture Financing will be subject to a four month hold period under applicable securities legislation.

The liability component of the Debentures was initially recognized at the fair value of a similar liability which does not contain an equity conversion option, based on a market interest rate of 12.8%. The difference between the $8.1 million principal amount of the Debentures and the fair value of the liability component was recognized in Shareholder's equity, net of deferred income taxes. Total transaction costs directly attributable to the offering of $0.8 million were allocated proportionately to the liability and equity components of the Debentures.

Accretion of the liability component and accrued interest payable on the Debentures are included in financing expense in the Consolidated Statements of Loss and Comprehensive Loss.

The fair value of the convertible debentures at September 30, 2019 was $8.1 million.

9. Shareholders' Equity

Share capital

The authorized share capital of the Company consists of an unlimited number of voting Common Shares and an unlimited number of preferred shares.

The following table reflects the Company's outstanding Common Shares at September 30, 2019 and December 31, 2018:

	Number of Shares	Share Capital
Balance as at December 31, 2018	204,356,973	$ 33,860
Issuance of common shares by rights offering, net of issue costs	19,413,306	1,881
Balance as at September 30, 2019	**223,770,279**	**$ 35,741**

On December 19, 2018, Southern completed a non-brokered private placement of 122,190,000 common shares of the Company (the "Common Shares") at a price of $0.10 per Common Share and 57,920,000 units of the Company (the "Recap Units") at a price of $0.10 per Recap Unit, for aggregate gross proceeds of $18.0 million (the "Private Placement"). Each Recap Unit is comprised of one Common Share and one performance-based Common Share purchase warrant (a "Recap Warrant").

Amounts in ($000s of Canadian Dollars), except for per share amounts

Warrants

The Company issued 57,920,000 Recap Warrants in conjunction with the December 19, 2018 Private Placement. The Recap Warrants vest and become exercisable as to one-third upon the 20-day volume weighted average trading price of the Common Shares (the “Market Price”) equaling or exceeding $0.15, an additional one-third upon the Market Price equaling or exceeding $0.20 and a final one-third upon the Market Price equaling or exceeding $0.25. In addition, in the event the Market Price equals or exceeds $0.40, each Recap Warrant shall be exercisable for 1.5 Common Shares, provided that, at the time of exercise in respect of the additional 0.5 of a Common Share per Recap Warrant, the Common Shares are listed on the facilities of a recognized stock exchange (other than the TSXV), the Common Shares are acquired for cash or for the securities of a company listed on a recognized stock exchange (other than the TSXV). As at September 30, 2019, 19,306,667 Recap Warrants had vested as the Market Price had exceeded $0.15.

Rights Offering

On June 7, 2019, the Company closed the previously announced Rights Offering (the “Rights Offering”). Under the Rights Offering, Shareholders subscribed for and purchased an aggregate of 19,413,306 Common Shares at a price of $0.10 per Common Share, resulting in approximately $1.9 million of proceeds to the Company, net of issuance costs.

Shareholders of record on the Record Date (the “Eligible Holders”) received one transferable right (a “Right”) for every Common Share held. Four Rights entitled the Eligible Holder to purchase one Common Share at a price of $0.10 per Common Share.

Stock Option Plan

On June 20, 2019, pursuant to the Company’s Stock Option Plan, Southern granted 19,400,000 stock options to purchase common shares of the Company (“Options”) to directors, officers and employees of Southern. The Options expire in five years from the date of grant and are exercisable at a price of $0.10 per common share. The Options vest in equal instalments annually over three years from the date of grant.

	Number of stock options	Weighted average exercise price
Balance at December 31, 2018	-	$ -
Granted	19,400,000	0.10
Balance at September 30, 2019	**19,400,000**	**$ 0.10**

	Outstanding and Exercisable	
Exercise price	**Number of stock options**	**Weighted average remaining life (years)**
$ 0.10	19,400,000	4.7
$ 0.10	**19,400,000**	**4.7**

Amounts in ($000s of Canadian Dollars), except for per share amounts

10. Loss Per Share

The following table presents the Company's net loss per share:

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Net (loss) earnings from:				
Continuing operations	$ (1,081)	$ -	$ (3,109)	$ -
Discontinued operations	-	(134)	23	(327)
Net loss	$ (1,081)	$ (134)	$ (3,086)	$ (327)
Basic and diluted – weighted average number of shares	223,770,279	24,246,973	212,321,406	24,246,973
Basic and diluted loss per share from:				
Continuing operations	$ (0.00)	$ -	$ (0.01)	$ -
Discontinued operations	-	(0.01)	0.00	(0.01)
Net loss per share	$ (0.00)	$ (0.01)	$ (0.01)	$ (0.01)

The calculation of diluted loss per share for the three and nine months ended September 30, 2019 excluded 57,920,000 performance warrants and 19,400,000 stock options (three and nine months ended September 30, 2018 – nil performance warrants and 8,500,000 stock options) as they were anti-dilutive.

11. Financial Instruments and Financial Risk Management

Financial Derivative Contracts

Southern utilizes oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future oil and natural gas production. Typical derivative contracts could consist of options, in the form of price floors, collars or three-way collars and fixed-price swaps. The derivative financial instruments are recorded on the Consolidated Statement of Financial Position as either an asset or a liability measured at fair value. Southern does not apply hedge accounting to its commodity derivative contracts; accordingly, changes in the fair value of these instruments are recognized in the Consolidated Statement of Loss and Comprehensive Loss in the period of change.

Amounts in ($000s of Canadian Dollars), except for per share amounts

Southern had the following commodity derivative contracts in place as at September 30, 2019:

Natural Gas	Volume	Pricing (US$)
Fixed Price Swap		
October 1, 2019 – December 31, 2019	3,900 MMBtu/d	NYMEX – HH $2.840/MMBtu
January 1, 2020 – December 31, 2020	1,000 MMBtu/d	NYMEX – HH $2.600/MMBtu
January 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH $2.748/MMBtu
January 1, 2020 – December 31, 2020	2,000 MMBtu/d	NYMEX – HH $2.575/MMBtu
January 1, 2021 – December 31, 2021	1,500 MMBtu/d	NYMEX – HH $2.575/MMBtu
Costless Collar		
October 1, 2019 – December 31, 2019	1,000 MMBtu/d	NYMEX – HH $2.10 - $2.98/MMBtu

Crude Oil	Volume	Pricing (US$)
Fixed Price Swap		
October 1, 2019 – December 31, 2019	50 bbl/d	WTI $55.25/bbl

Subsequent to September 30, 2019, Southern entered into the following commodity derivative contracts:

Natural Gas	Volume	Pricing (US$)
Fixed Price Swap		
January 1, 2020 – March 31, 2020	1,000 MMBtu/d	NYMEX – HH $2.700/MMBtu

Crude Oil	Volume	Pricing (US$)
Fixed Price Swap		
January 1, 2020 – December 31, 2020	50 bbl/d	WTI $55.25/bbl

Financial Derivative Contracts Financial Statement Recognition

The Company's financial instruments that were accounted for at fair value as of September 30, 2019 and December 31, 2018 are presented below. The classification within the fair value hierarchy for these financial instruments is Level 2.

Comprised of:	**As at Sep 30, 2019**	**As at Dec 31, 2018**
Current derivative asset	$ 602	$ 332
Current derivative liability	(8)	(166)
Non-current derivative asset	203	20
Non-current derivative liability	(19)	(51)
Net fair value of contracts, end of period	**$ 778**	**$ 135**

Amounts in ($000s of Canadian Dollars), except for per share amounts

Below is a reconciliation of the (gain) / loss on derivatives from the Consolidated Statements of Loss and Comprehensive Loss:

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Realized gain on derivatives	$ (283)	$ -	$ (206)	$ -
Unrealized gain on derivatives	(178)	-	(647)	-
Gain on derivative instruments	**$ (461)**	**$ -**	**$ (853)**	**$ -**

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 carrying amount of the Company's cash and cash equivalents and accounts receivable and the positive fair value of any financial derivatives represent the maximum credit exposure.

Cash and cash equivalents

The Company manages the credit exposure related to cash and cash equivalents by selecting financial institutions with high credit ratings and monitors all short-term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

Accounts receivable and other

Substantially all of the Company's accounts receivable are due from purchasers of the Company's petroleum and natural gas production, joint interest partners and government agencies, and are subject to normal industry credit risk.

Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Management of the Company believes the risk is mitigated by the size and reputation of the companies to which they extend credit.

Southern had no provision for doubtful accounts as at September 30, 2019 or December 31, 2018. During the three and nine months ended September 30, 2019, there were four and three third party purchasers, respectively, that each marketed more than 10% of the Company's oil and natural gas revenue.

Liquidity Risk

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its current and future liquidity requirements. The financial liabilities in the statement of financial position consist of accounts payable, lease liabilities, financial derivative liability and the Credit Facility. As described above (Bank Debt - Note 7), the Company was not compliant with certain financial covenants at September 30, 2019. Southern has obtained a waiver for the period ended September 30, 2019, in addition to identifying various options to improve the financial position of the Company. Strategies to manage liquidity include, having adequate sources of financing available through its Credit Facilities, estimating future cash flows generated from operations based on reasonable production and pricing assumptions, adding additional commodity derivative contracts, reducing capital spending and utilizing equity to settle interest payments on Convertible Debentures. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing.

Amounts in ($000s of Canadian Dollars), except for per share amounts

Market Risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its asset and liabilities. The object of market risk management is to manage and control market risk exposure within acceptable parameters.

To partially mitigate exposure to commodity price risk, Southern enters into various financial derivative instruments. The instruments currently outstanding are described above. As at September 30, 2019, Southern has not entered into any foreign exchange derivative contracts or fixed interest rate contracts. As at September 30, 2019, a 10% change in future commodity prices applied against these contracts would have a $0.8 million impact on net income.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. The Company's interest rate risk arises from its floating rate senior loan. The impact of a 5% increase in the interest rate associated with the senior loan would increase net loss by approximately $0.6 million for the nine months ended September 30, 2019.

12. Royalties Payable

As at September 30, 2019, Southern had $5.7 million ($5.1 million at December 31, 2018) of non-interest bearing royalty payables related to unresolved title or ownership issues not expected to be settled within the operating cycle unless claimants demand repayment and provide proof of ownership. $0.8 million of this liability was acquired as a part of the Acquisition. The royalty payable account is made up of balances due to approximately 5,000 royalty holders with over 96% of the balances outstanding for greater than 120 days. The royalty holders have deficiencies with their accounts that precludes Southern from making payments.

13. Oil and Natural Gas Sales

The following table presents Southern's oil and natural gas sales disaggregated by revenue source:

	Three months ended September 30,		Nine months ended September 30,	
Commodity sales from production, by product	**2019**	**2018**	**2019**	**2018**
Crude oil	$ 1,483	$ -	$ 4,094	$ -
Natural gas liquids	123	-	470	-
Natural gas	3,734	-	9,583	-
Total Revenue from Continuing Operations	**$ 5,340**	**$ -**	**$ 14,147**	**$ -**

Amounts in ($000s of Canadian Dollars), except for per share amounts

14. Discontinued Operations

On May 2, 2019, Southern disposed of all of its Canadian oil and natural gas assets for $0.64 million, prior to customary purchase price adjustments. The results of operations from the Canadian segment have been reported as a discontinued operation.

Results of Discontinued Operations

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Revenues				
Petroleum and natural gas revenue	$ -	$ 276	$ 334	$ 741
Royalties	-	(71)	(54)	(140)
	-	205	280	601
Expenses				
Production and operating	-	74	42	184
Transportation	-	11	19	35
Exploration evaluation	-	28	1	42
Depletion, depreciation and amortization	-	100	39	283
Finance	-	3	6	8
General and administrative	-	123	150	376
	-	339	257	928
Net (loss) earnings from discontinued operations	**$ -**	**$ (134)**	**$ 23**	**$ (327)**

Cash Flows from Discontinued Operations

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Cash (used in) from operating activities	$ (60)	$ 7	$ 14	$ (2)
Cash (used in) from investing activities	-	(2)	504	13
Cash from financing activities	-	-	-	-
Net Cash Flows	**$ (60)**	**$ 5**	**$ 518**	**$ 11**