Consolidated Financial Statements of

SOUTHERN ENERGY CORP.

For the years ended December 31, 2019 and 2018

(Canadian Dollars)

Management's Report

Management's Responsibility for the Financial Statements

The accompanying consolidated financial statements of Southern Energy Corp. are the responsibility of management and have been approved by the Board of Directors of Southern Energy Corp. The consolidated financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto. In Management's opinion, the consolidated financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, have been prepared within acceptable limits of materiality, and have utilized supportable, reasonable estimates.

Management ensures the integrity of the consolidated financial statements by maintaining high-quality systems of internal control. We also ensure our organizational structure provides appropriate delegation of authority and division of responsibilities.

The Board of Directors approves the consolidated financial statements. The Board carries out this responsibility primarily through the Audit Committee. The Audit Committee is composed entirely of independent directors. The Audit Committee meets periodically with Management and the external auditors to discuss reporting and control issues. The Audit Committee also considers the independence of the external auditors and reviews their fees.

The consolidated financial statements have been audited by Deloitte LLP, Chartered Professional Accountants, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders.

(signed) "*Ian Atkinson*"

Ian Atkinson
President & Chief Executive Officer
May 4, 2020

(signed) "*Calvin Yau*"

Calvin Yau
VP Finance & Chief Financial Officer

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Independent Auditor's Report

To the Shareholders and the Board of Directors of
Southern Energy Corp.

Opinion

We have audited the consolidated financial statements of Southern Energy Corp. (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2019 and 2018, and the consolidated statement of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2019 and 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

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

Material Uncertainty related to Going Concern

We draw attention to Note 2 to the financial statements, which indicates that the Company's current liabilities exceeds its current assets. As stated in Note 2, these events or conditions, along with other matters as set forth in Note 2, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Other Information

Management is responsible for the other information. The other information comprises Management's Discussion and Analysis.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
May 4, 2020

SOUTHERN ENERGY CORP.

Consolidated Statement of Financial Position

($000s of Canadian Dollars)		December 31, 2019		December 31, 2018
Assets				
Current assets				
Cash and cash equivalents	$	424	$	2,334
Accounts receivable and other (Note 13)		2,399		13,744
Prepaid expenses and deposits		371		300
Derivative assets (Note 13)		819		332
		4,013		16,710
Derivative assets (Note 13)		120		20
Property, plant and equipment (Note 4 & 5)		44,308		38,199
Right-of-use assets (Note 6)		735		-
Total assets	$	49,176	$	54,929
Liabilities and Equity				
Current liabilities				
Accounts payable and accrued liabilities		2,650		2,985
Royalties payable (Note 14)		5,589		5,067
Current portion of lease liabilities (Note 6)		382		-
Bank debt (Note 8)		-		21,009
Derivative liabilities (Note 13)		105		166
		8,726		29,227
Long-term liabilities				
Derivative liabilities (Note 13)		14		51
Convertible debentures (Note 9)		6,648		-
Lease liabilities (Note 6)		381		-
Bank debt (Note 8)		18,183		-
Decommissioning provisions (Note 7)		5,276		6,740
Total liabilities		39,228		36,018
Shareholders' equity (Note 10)				
Share capital		35,441		33,860
Equity component of convertible debenture (Note 9)		665		-
Warrants		1,195		1,195
Contributed surplus		4,095		3,883
Deficit		(30,962)		(20,089)
Accumulated other comprehensive income		(486)		62
		9,948		18,911
Total liabilities and shareholders' equity	$	49,176	$	54,929

Commitments and contingencies (Note 20)

(See accompanying Notes to the Consolidated Financial Statements)

Approved by Board of Directors

(signed) "*Michael G. Kohut*"
Director

(signed) "*Bruce Beynon*"
Chairman

($000s of Canadian Dollars, except for per share amounts)	Year ended December 31, 2019	Year ended December 31, 2018
Revenues		
Petroleum and natural gas sales (Note 15)	$ 19,129	$ 806
Royalties	(3,859)	(148)
	15,270	658
Expenses		
Production and operating	6,799	265
Transportation	368	30
Depletion, depreciation and amortization (Note 5)	5,741	127
Impairment (Note 5)	7,425	-
Gain on derivatives (Note 13)	(1,024)	(325)
Gain on dispositions (Note 5)	(98)	-
Financing (Note 16)	1,665	45
General and administrative	4,465	333
Share-based compensation (Note 10)	212	1,195
Transaction costs	588	1,148
Loss on foreign exchange	235	-
	26,376	2,818
Net loss from continuing operations before income tax	(11,106)	(2,160)
Income tax recovery	(210)	-
Net loss from continuing operations	(10,896)	(2,160)
Net earnings (loss) from discontinued operations (Note 21)	23	(535)
Total net loss for the year	(10,873)	(2,695)
Currency translation adjustment	(548)	62
Comprehensive loss for the year	**$ (11,421)**	**$ (2,633)**
Basic and diluted (loss) income (Note 11)		
Continuing operations	$ (0.05)	$ (0.07)
Discontinued operations	0.00	(0.02)
Net loss per share	**$ (0.05)**	**$ (0.09)**

(See accompanying Notes to the Consolidated Financial Statements)

SOUTHERN ENERGY CORP.

Consolidated Statement of Changes in Shareholders' Equity

($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
Shares Issued, net	180,110,000	17,937	-	-	-	-	-	17,937
Warrants Issued	-	-	-	1,195	-	-	-	1,195
Net Loss	-	-	-	-	-	(2,695)	-	(2,695)
Other Comprehensive Income	-	-	-	-	-	-	62	62
Balance, December 31, 2018	204,356,973	$ 33,860	$ -	$ 1,195	$ 3,883	$(20,089)	$ 62	$ 18,911
Shares issued on Rights Offering (Note 10)	19,413,306	1,881	-	-	-	-	-	1,881
Share redemption	(3,000,000)	(300)	-	-	-	-	-	(300)
Convertible Debentures issued	-	-	665	-	-	-	-	665
Share-based compensation	-	-	-	-	212	-	-	212
Net Loss	-	-	-	-	-	(10,873)	-	(10,873)
Other Comprehensive Income	-	-	-	-	-	-	(548)	(548)
Balance, December 31, 2019	220,770,279	$ 35,441	$ 665	$ 1,195	$ 4,095	$(30,962)	$ (486)	$ 9,948

(See accompanying Notes to the Consolidated Financial Statements)

($000s of Canadian Dollars)	Year ended December 31, 2019	Year ended December 31, 2018
Operating activities		
Total net loss for the year	$ (10,873)	$ (2,695)
Changes in non-cash items:		
Depletion, depreciation and amortization (Note 5)	5,780	469
Impairment (Note 5)	7,425	-
Gain on dispositions (Note 5)	(98)	-
Net finance expense	1,671	64
Unrealized gain on derivatives (Note 13)	(705)	(436)
Unrealized loss on foreign exchange	235	-
Share-based compensation (Note 10)	212	1,195
Deferred income tax recovery	(210)	-
Decommissioning provisions liabilities settled (Note 7)	(23)	(14)
Changes in non-cash working capital (Note 17)	(269)	(174)
Net cash provided (used) by operating activities	3,145	(1,591)
Investing activities		
Capital expenditures	(1,594)	(1)
Acquisition, net of cash acquired (Note 4 & 5)	(21,349)	(3,329)
Proceeds from divestitures	484	-
Changes in non-cash working capital (Note 17)	152	(7)
Net cash used by investing activities	(22,307)	(3,337)
Financing activities		
Proceeds from share issuances, net (Note 10)	1,881	17,937
Issuance of convertible debentures, net (Note 9)	7,282	-
Paydown of bank debt (Note 8)	(1,782)	-
Payment of interest	(1,334)	(40)
Finance lease payments (Note 6)	(415)	-
Changes in non-cash working capital	11,672	(11,569)
Net cash provided by financing activities	17,304	6,328
Net increase (decrease) in cash and cash equivalents	(1,858)	1,400
Effect of foreign exchange rate changes	(52)	15
Cash and cash equivalents, beginning of year	2,334	919
Cash and cash equivalents, end of year	$ 424	$ 2,334

(See accompanying Notes to the Consolidated 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 financial statements were authorized for issue by the Board of Directors on May 4, 2020.

2. Basis of Presentation and Significant Accounting Policies

a) Principles of Reporting and Consolidation

The 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., Southern Energy Corp (Delaware), 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 International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). These Consolidated 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 US subsidiaries is the US dollar, and its results and balance sheet items are translated to Canadian dollars for purposes of these consolidated financial statements, in accordance with the Company’s foreign currency translation accounting policy.

b) Going Concern

The Company prepared the Consolidated Financial Statements on a going concern basis, which contemplates the realization of assets and liabilities in the normal course of business as they become due. Accordingly, the Consolidated Financial Statements have been prepared on a historical cost basis, except certain financial instruments, which are measured at fair value. The method used to measure fair value is discussed further in Note 13.

Due to the current low commodity price environment and COVID-19 pandemic, Southern is currently reviewing all options to improve the financial strength of the Corporation. The Company implemented cost saving measures to reduce corporate salaries by 20%, field salaries by 10%, and eliminate all non-essential business expenditures. In addition to the cost saving measures noted, Southern can further manage liquidity by looking for additional opportunities to reduce both operating and capital field expenditures, unwinding of in the money derivative contracts, utilizing equity to settle interest payments on Convertible Debentures, sale of non-core oil and gas assets and looking for alternative sources of financing.

Subsequent to December 31, 2019, as a result of the March 1, 2020 bank redetermination, Southern will enter into the sixth amendment (the "Sixth Amendment") to the Credit Facility. Details of the Sixth Amendment include:

- Borrowing base reduction to US$14.0 million from US$14.25 million at March 31, 2020, separated into two tranches;
- Tranche A (conforming) – US$8.5 million lending value with the same financial covenants as the current Credit Facility (See Note 8 – Bank Debt for more details on the financial covenants) and a minimum interest rate of 4.5%;
- Tranche B (Non-conforming) – US$5.5 million lending value and the same interest rate as above;
- Tranche B will replace the Monthly Credit Reductions (described in Note 8 – Bank Debt) with cash flow repayments. Beginning on May 26, 2020, and continuing on the 26th day of every month until the July 2020 redetermination, any available cash balances in excess of US$0.4 million held with the lender will be utilized to paydown the owing balance on Tranche B;
- Increased hedging requirements of 80% of projected PDP volumes on a rolling 24 months and 50% of projected PDP volumes for months 25 to 36;
- Additional non-financial covenants primarily related to financial reporting;
- Next redetermination scheduled for July 1, 2020.

As at December 31, 2019, Southern had a working capital deficiency of $5.0 million, excluding derivative assets and liabilities and the current portion of the lease liability, and US$14 million ($18.2 million) drawn on its Senior Secured Bank Credit Facility. Southern was in compliance with all financial covenants on its Senior Secured Bank Credit Facility as of December 31, 2019. Based on the Company's projections using current strip pricing and the execution of the Sixth Amendment and related covenant changes, Southern does not anticipate to be in any covenant violations for the next twelve months. Management forecasts may change materially based upon actual prices received during the year, changes in future strip pricing and its future business plan. This material uncertainty may cast significant doubt with respect to the ability of the Corporation to continue as a going concern.

These financial statements do not reflect the adjustments and classifications of assets, liabilities, revenues and expenses which would be necessary if the Company were unable to continue as a going concern.

c) Use of Estimates

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Key areas where management has made judgements, estimates, and assumptions include:

- Decommissioning provision: The calculation of decommissioning provisions depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures and the timing of these expenditures.
- Determination of Cash Generating Units ("CGUs"): The Company's petroleum and natural gas assets are grouped into CGUs based on the ability of these assets to generate separately identifiable independent cash inflows. The classification of assets into CGUs requires significant judgement and interpretation. Management considers factors such as integration among assets, shared infrastructure, common sales points, geography and how management makes decision about the Company's operations.
- Assessment of impairments or recovery of previous impairments: Management applies judgment in assessing the existence of indicators of impairment or impairment reversal based on various internal and external factors. The calculation of the recoverable amount of a CGU is based on market factors (including estimate future commodity prices) and estimates of reserves and resources. Reserve and resource estimates are based on: engineering data, estimated future commodity prices, expected future rates of production, and assumptions regarding the timing and amount of future expenditures. Changes in these judgments, estimates and assumptions can directly impact the calculated recoverable amount of a CGU and the recorded impairment loss or recovery.
- Measurement of right-of-use ("ROU") assets and lease liabilities are subject to management's judgment of the applicable incremental borrowing rate when the rate implicit in a lease is not readily determinable. Applicable incremental borrowing rates are based on management's judgements of the economic environment, term, the underlying risk inherent to the asset (which may vary due to changes in the market conditions) and the expected lease term.

d) Cash and Cash Equivalents

Southern considers all highly liquid investments to be cash equivalents if they have original maturities of three months or less at the date of purchase.

e) Business Combinations

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

As part of the assessment to determine if the acquisition constitutes a business, Southern may elect to apply the concentration test on a transaction by transaction basis. The test is met if substantially all of the fair value related to the gross assets acquired is concentered in a single identifiable asset (or group of similar assets) resulting in the acquisition not being deemed a business and recorded as an asset acquisition.

f) Property, Plant and Equipment

Exploration and evaluation assets - Pre-licence expenditures incurred before the Company has obtained legal rights to explore an area are expensed as exploration and evaluation expenditures.

Exploration and evaluation assets may include the costs of acquiring licences, exploratory drilling, geological and geophysical activities, acquisition of mineral and surface rights and technical studies. Exploration and evaluation costs are capitalized as exploration and evaluation assets when the technical feasibility and commercial viability of extracting petroleum and natural gas reserves have yet to be determined. Exploration and evaluation assets are measured at cost and are not depleted or depreciated. Exploration and evaluation assets, net of any impairment loss, are transferred to property and equipment when proved and/or probable reserves are determined to exist.

Property and equipment of the Company consists of development and production assets and office furniture and equipment.

All costs directly associated with the development and production of petroleum and natural gas interests are capitalized by components (i.e. by well, area or combination thereof) within cash generating units and are measured at cost less accumulated depletion and depreciation and impairment losses. These costs include expenditures for areas where technical feasibility and commercial viability have been determined. These costs include property acquisitions with proved and/or probable reserves, development drilling, completion, gathering and infrastructure, decommissioning liabilities and transfers from exploration and evaluation assets.

Gains or losses on disposal of assets are determined by comparing the proceeds from disposal with the carrying amount of the assets sold and are recognized separately in the statement of earnings.

Depletion, depreciation and amortization – Capital assets are grouped into depletion units, which are groups of assets within a specific production area that have similar economic lives. Depletion units represent the lowest level of disaggregation for which costs are accumulated for the purposes of calculating depletion and depreciation.

Petroleum and natural gas interests are depleted using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development costs. Production and reserves of natural gas are converted to equivalent barrels of crude petroleum on the basis of six thousand cubic feet of gas to one barrel of petroleum. Changes to estimates used in prior periods, such as proved and probable reserves, that affect the unit-of-production calculations do not give rise to prior period adjustments and are dealt with on a prospective basis.

Well and production equipment and facilities are depleted using the unit-of-production method along with the related reserves when the assets have a life similar to the reserves of the related wells and little to no residual value. Where costs of facilities and equipment, including major components, are significant in relation to the total costs of the assets and have differing useful lives, they are depreciated separately on a straight-line basis over the estimated useful life of the facilities and equipment and other related components.

Office furniture and equipment, referred to as corporate and other, are depreciated on a declining balance basis at a rate of 30% approximating their estimated useful lives.

g) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets are reviewed for indicators of impairment at each reporting date. If indicators of impairment exist, the recoverable amount of the asset is estimated.

For the purposes of assessing impairment, property and equipment are grouped into CGUs, defined as the lowest levels for which there are separately identifiable independent cash inflows. Any goodwill is allocated to the CGUs that are expected to benefit from the synergies of the business combination creating the goodwill.

The recoverable amount of a CGU is the greater of its fair value less costs of disposal and its value in use. Fair value is determined to be the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties. Fair value less estimated costs of disposal may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs and including future development costs. These cash flows are discounted at an appropriate discount rate which would be applied by a market participant. Value in use is determined by estimating the present value of the future net cash flows to be derived from the continued use of the cash-generating unit in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its recoverable amount. An impairment loss recognized in respect of a CGU is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis. Impairment losses are recognized in net profit or loss in the period determined.

Exploration and evaluation assets are assessed for impairment when they are reclassified to property and equipment and if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. Exploration and evaluation assets are tested for impairment separately. If, at any time, it is determined that the Company has no future exploration plans and commercial production cannot be achieved in relation to an area, the associated costs are written down to the estimated recoverable amount and the amount of the write-down is expensed.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, as if no impairment loss had been recognized. A goodwill impairment loss is not reversed.

h) Lease obligations and right-of-use assets

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. At the lease commencement date, a lease obligation is recognized at the present value of future lease payments, typically using the applicable incremental borrowing rate. A corresponding ROU asset is recognized at the amount of the lease obligation. Short-term leases and leases of low-value assets are not recognized on the balance sheets and lease payments are instead recognized in the financial statements as incurred.

Payments are applied against the lease obligation and interest expense is recognized on the lease obligations using the effective interest rate method. Depreciation is recognized on the ROU asset over the lease term.

i) 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.

j) Decommissioning provisions

Decommissioning provisions are recognized for decommissioning and restoration obligations associated with the Company's exploration and evaluation assets and property and equipment. The best estimate of the expenditure required to settle the present obligation at the reporting date is recorded on a discounted basis using a pre-tax risk-free interest rate at each reporting date. The future cash flow estimates are adjusted to reflect the risks specific to the liability. The value of the obligation is added to the carrying amount of the associated asset and is depleted or amortized over the useful life of the asset. The provision is accreted over time through charges to finance expense. Changes in the future cash flow estimates resulting from revisions to the estimated timing, amount of undiscounted cash flows or the discount rate are recognized as changes in the decommissioning provision and related asset. Actual decommissioning expenditures, up to the recorded liability recorded at the time, are charged against the provision as the costs are incurred.

k) Fair Value Measurement

On initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods depends on the classification of the financial instrument as described below:

- Fair value through profit or loss - Financial instruments under this classification include cash and cash equivalents and derivative assets and liabilities.

- Amortized cost - Financial instruments under this classification include accounts receivable, accounts payable and accrued liabilities, and long-term debt.

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 company uses various methods, including the income approach and market approach, to determine the fair values of our financial instruments that are measured at fair value on a recurring basis, which depend on a number of factors, including the availability of observable market data over the contractual term of the underlying instrument. For some of our instruments, the fair value is calculated based on directly observable market data or data available for similar instruments in similar markets. For other instruments, the fair value may be calculated based on these inputs as well as other assumptions related to estimates of future settlements of these instruments. Financial instruments are separated into three levels (levels 1, 2 and 3) based on our assessment of the availability of observable market data and the significance of non-observable data used to determine the fair value of our instruments. The assessment of an instrument can change over time based on the maturity or liquidity of the instrument, which could result in a change in the classification of the instruments between levels.

Each of these levels and our corresponding instruments classified by level are further described below:

- Level 1 Inputs— unadjusted quoted market prices in active markets for identical assets or liabilities.
- Level 2 Inputs—quotes which are derived principally from or corroborated by observable market data.
- Level 3 Inputs—unobservable inputs for the asset or liability, such as discounted cash flow models or valuations, based on various assumptions and future commodity prices.

l) 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.

m) Revenue Recognition

Revenue associated with 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 Southern 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. Southern 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.

The revenue is typically collected the month following production.

n) Foreign Currency Translation

The Company's consolidated financial statements are reported in Canadian dollars, which is the Company's presentation currency. Transactions of the Company's US subsidiaries are recorded in US dollars, as this is the primary economic environment in which these subsidiaries operate. The US subsidiaries have a US dollar functional currency. In translating the financial results from US dollars to Canadian dollars, the Company uses the following method: assets and liabilities are translated at the exchange rate in effect as at the date of the consolidated statement of financial position; revenues and expenses are translated at the rate effective at the time of the transaction or the average rate for the period; and changes in shareholders' equity are translated at the rate effective at the time of the transaction. Unrealized gains and losses resulting from the translation to the Canadian dollar presentation currency are included in other comprehensive income.

Transactions of the US subsidiaries that are denominated in a currency other than the US dollar are translated to the US dollar using the following method: monetary assets and liabilities are translated at the exchange rate in effect at the date of the consolidated statement of financial position; non-monetary assets and liabilities are translated at the exchange rate on the date such assets or liabilities are assumed; and revenues and expenses are translated at the average rate for the period. Realized gains and losses resulting therefrom are reflected in the statements of operations as foreign exchange gain or loss.

o) Income Taxes

Tax expense is comprised of current and deferred tax. Current tax expense is recognized in the statement of loss and comprehensive loss except to the extent that it relates to items recognized directly in equity or other comprehensive income (loss).

Current tax is the expected tax payable on the taxable income for the year and any adjustments to tax payable in respect of previous years.

Deferred tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities and the amounts used for taxation purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same taxation authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously

p) Commitments and Contingencies

The Company could be subject to audits for various taxes (income, sales and use, and severance) in the various states in which it operates, and from time to time receive assessments for potential taxes that it may owe. Currently, Southern has no material assessments for potential taxes, legal contingencies or other potential claims.

The Company could be subject to various possible contingencies that arise primarily from interpretation of federal and state laws and regulations affecting the oil and natural gas industry. Such contingencies include differing interpretations as to the prices at which oil and natural gas sales may be made, the prices at which royalty owners may be paid for production from their leases, environmental issues and other matters. Although Southern believes that it has complied with the various laws and regulations, administrative rulings and interpretations thereof, adjustments could be required as new interpretations and regulations are issued. In addition, production rates, marketing and environmental matters are subject to regulation by various federal and state agencies.

Provisions are recognized by the Company when it has a legal or constructive obligation as a result of past events, it is probable that an outflow of economic resources will be required to settle the obligation and a reliable estimate can be made of the amount of that obligation. Provisions are stated at the present value of the expenditure expected to settle the obligation. The obligation is not recorded and is disclosed as a contingent liability if it is not probable that an outflow will be required, if the amount cannot be estimated reliably or if the existence of the outflow can only be confirmed by the occurrence of a future event.

q) Share-based payments

Southern accounts for share-based transactions using fair value and recognize compensation expense over the vesting period. The fair value of each option or common share purchase warrant award is estimated using an option valuation model with various assumptions based on various estimates and market conditions of the instrument. The assumptions include expected volatility, expected term of option, risk-free interest rate and dividend yield.

r) Per Share Amounts

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as restricted and performance awards granted to employees.

3. Change in Accounting Policies:

Adoption of 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 prospectively to acquisitions that occur on or after January 1, 2019. 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.

Adoption of IFRS 16 — Leases (“IFRS 16”)

On January 1, 2019, Southern adopted IFRS 16 “Leases” as issued by IASB. IFRS 16 requires the recognition of right-of-use asset and lease liability on the balance sheet for most leases, where the entity is acting as a lessee. For lessees applying IFRS 16, the dual classification model of leases as either operating leases or finance leases no longer exists, effectively treating all leases as finance leases.

The Company used the modified retrospective approach on adoption of IFRS 16 including the following practical expedients permitted under the standard. Some of these expedients are on a lease-by-lease basis and others are applicable by class of underlying assets:

- 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 asset if the underlying asset is of a lower dollar value;
- Apply a single discount rate to a portfolio of leases with similar characteristics; 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 identified a ROU asset and lease liabilities relating to office space and recorded a current lease liability of $405 thousand and a long-term lease liability of $714 thousand with an associated Right-of-Use 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.

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

4. Business Combination

On December 19, 2018, Southern acquired all of the limited partnership units of Gulf Pine Energy Partners, LP ("Gulf Pine") for cash consideration of US$3.4 million ($4.6 million). The Gulf Pine assets consist of low decline production and high working interest in more than 59,000 net acres in Mississippi and Alabama. The Company has treated the transaction as a business combination and has accounted for it using the acquisition method to reflect the fair value of assets acquired and liabilities assumed. Financial performance from the assets acquired were included in the financial statements from the closing date of the transaction. The aggregate purchase price was allocated as follows:

Consideration - $4,641 (US$3,425)	**Fair Value**
Property, plant and equipment	$ 33,334
Cash	1,312
Working capital (1)	(5,987)
Bank loan	(20,713)
Decommissioning provisions	(3,305)
Fair value of net assets acquired	**$ 4,641**

(1) Working capital consists of accounts receivable, prepaid expenses or deposits, derivatives assets or liabilities and accounts payable.

Following the acquisition, property and equipment and the decommissioning liabilities were increased by $2.3 million, reflecting the calculation of decommissioning liabilities using a risk-free discount rate. The credit adjusted discount rate was used to determine fair value. Had the acquisition occurred on January 1, 2018, management estimates the following impact on the Statement of Consolidated Loss for the year ended December 31, 2018:

	Year ended December 31, 2018
Petroleum and natural gas sales, net	$ 17,015
Production and operating expenses	(9,538)
Operating income	**$ 7,477**

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

5. 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, 2017	$ 2,609	$ -	$ 2,609
Additions	1	-	1
Acquired in Business Combination (Note 4)	33,334	-	33,334
Change in decommissioning provision (Note 6)	2,252	-	2,252
Depletion, depreciation and amortization	(469)	-	(469)
Effect of foreign exchange rate changes	472	-	472
Net book value as at December 31, 2018	**38,199**	**-**	**38,199**
Additions	1,590	4	1,594
Acquisitions, including decommissioning costs	21,559	-	21,559
Dispositions	(1,953)	-	(1,953)
Change in decommissioning provision (Note 6)	20	-	20
Depletion, depreciation and amortization	(5,396)	-	(5,397)
Impairment	(7,425)	-	(7,425)
Effect of foreign exchange rate changes	(2,290)	-	(2,290)
Net book value as at December 31, 2019	**$ 44,304**	**$ 4**	**$ 44,308**

Depletion

For the year ended December 31, 2019, the Company recorded depletion expense of $5.4 million (December 31, 2018 - $469 thousand). In the calculation of depletion expense at December 31, 2019, an estimated $36.7 million of future development costs associated with the proven plus probable reserves were included ($40.9 million for 2018).

Asset Acquisition

On June 14, 2019, Southern closed an acquisition with an arm's length private company to acquire assets in the State of Mississippi for $21.6 million, including decommissioning costs associated with the acquired 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.

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

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. During the year ended December 31, 2019, Southern viewed the deterioration of current and future natural gas prices as well as the reduction of Southern's market capitalization below the net assets of the Company as indications of impairment. Southern estimated the recoverable amount of all CGUs at December 31, 2019. Southern determined that the carrying value of the Central Mississippi ("CMS") CGU exceeded its recoverable amount. A non-cash impairment charge of $6.7 million was recorded in the Consolidated Statements of Loss and Comprehensive Loss.

The Company estimated the recoverable amounts as fair value less costs of disposal, using the net present value of the cash flows from proved developed producing oil and gas reserves of each CGU, and a 10% discount rate, based on reserves estimated by Southern's independent reserves evaluator at December 31, 2019.

The following table details the forward pricing used in estimating the recoverable amounts of Southern's CGUs at December 31, 2019:

Period Ending	West Texas Intermediate ($US/bbl)	Henry Hub ($US/MMBtu)	FX (USD/CAD)
12-31-2020	60.25	2.57	0.760
12-31-2021	63.11	2.79	0.768
12-31-2022	66.02	2.99	0.784
12-31-2023	67.64	3.15	0.789
12-31-2024	69.16	3.22	0.789
12-31-2025	70.69	3.29	0.789
12-31-2026	72.25	3.35	0.789
12-31-2027	73.77	3.43	0.789
12-31-2028	75.25	3.49	0.789
12-31-2029	76.76	3.56	0.789

Thereafter, WTI and HH prices escalated 2 percent on January 1 of each year and FX rates held constant at 0.789

The fair value less costs of disposal values used to determine the recoverable amounts of Southern's CGUs at December 31, 2019, were classified as Level 3 fair value measurements as certain key assumptions are not based on observable market data, but rather, Management's best estimates. Refer to Note 2 "Significant Accounting Policies" for information on fair value hierarchy classifications.

Changes in any of the key judgements, such as a revision in reserves, changes in forecast commodity prices, foreign exchange rates, capital or operating costs would impact the estimated recoverable amount. As at December 31, 2019, a 1% increase in the assumed discount rate would reduce the estimated recoverable amount by $2.5 million while a 5% decrease change in commodity price forecasts would reduce the estimated recoverable amount by $4.8 million.

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

6. 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)	**$**	**1,119**
Depreciation		(384)
Carrying value as at December 31, 2019	**$**	**735**

Lease Liabilities

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

		Total
As at January 1, 2019 (Note 3)	**$**	**1,119**
Interest expense		59
Lease payments		(415)
As at December 31, 2019	**$**	**763**

At December 31, 2019, Southern had future commitments relating to lease liabilities as follows:

		Total
Less than 1 year	$	418
1 – 3 years		383
Total undiscounted future lease payments	$	801
Amounts representing interest		(38)
Present value of net lease payments	$	763
Less current portion of lease liabilities		(382)
Non-current portion of lease liabilities	**$**	**381**

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%.

7. Decommissioning Provisions

The Company's decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities. 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 $6.2 million at December 31, 2019 (December 31, 2018 - $8.7 million), which have been discounted using a risk-free interest rate of 1.7% to 1.9% at December 31, 2019 (December 31, 2018 – 2.2% to 2.7%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 50 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:

	Year ended December 31, 2019	2018
Balance, beginning of year	$ 6,740	$ 1,094
Acquired in Business Combination (Note 4)	-	3,305
Acquisitions	210	-
Changes in estimates	20	2,252
Liabilities settled	(23)	(14)
Property disposal	(1,420)	-
Accretion expense	35	24
Effect of foreign exchange rate changes	(286)	79
Balance, end of year	**$ 5,276**	**$ 6,740**
Long term liability	**$ 5,276**	**$ 6,740**

8. Bank Debt

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

	As at December 31, 2019	2018
Current Portion Senior Secured Bank Credit Facility	$ -	$ 21,009
Long Term Portion Senior Secure Bank Credit Facility	18,183	-
Total Bank Debt	**$ 18,183**	**$ 21,009**

As at December 31, 2019, Southern Energy Corp. (Delaware) ("Southern Delaware") one of the wholly owned subsidiaries of Southern continued to hold the existing Senior Secured Credit Facility (the "Credit Facility"). The Credit Facility is secured against the oil and gas properties of Southern. The borrowing base for the Credit Facility is reviewed semi-annually. Southern has the ability to request two additional redeterminations each year, at its sole election. Subsequent to December 31, 2019, as a result of the March 1, 2020 bank redetermination, Southern will enter into the Sixth Amendment. For additional details, see Note 2 - Going Concern.

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. For the year ending December 31, 2019, the effective interest rate, excluding commitment and other fees, was 5.58% (December 31, 2018 – 5.97%).

On March 1, 2019, Southern Delaware entered into the third amendment (the "Third Amendment") to Credit Facility. The Amendment included the assignment of the Credit Facility from Gulf Pine Energy, LP to Southern Energy Corp. (Delaware), replacement of "GAAP" with "IFRS" with respect to the covenant calculations and a borrowing base reduction to US$12.5 million ($17.1 million).

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

On June 14, 2019, Southern Delaware entered into a fourth amendment (the "Fourth Amendment") to 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.

On November 27, 2019, as part of the semi-annual borrowing base review, Southern Delaware entered into a fifth amendment (the "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 until March 1, 2020. The February 1, 2021, maturity date of the Credit Facility remained the same with the execution of the Fifth Amendment.

The covenants of the Company under the credit facility, calculated quarterly, include covenants which relate to a maximum leverage ratio of 3.5 to 1.0 (Debt / Bank EBITDAX), interest coverage ratio of at least 3.0 to 1.0 (Bank EBITDAX / Cash Interest) and minimum current ratio of 1.0 to 1.0 (Current Assets / Current Liabilities).

As part of the Fourth Amendment, for the test period ending December 31, 2019, Bank EBITDAX and Cash Interest was 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.

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 (See Note 14 - Royalties Payable for additional information).

As at December 31, 2019, the Credit Facility was subject to the following financial covenants, calculated quarterly:

		As at December 31,	
Financial covenant	**Limit**	**2019**	**2018**
Leverage ratio (Debt / Bank EBITDAX)	Maximum 3.5	3.3	4.1
Interest coverage ratio (Bank EBITDAX / Cash Interest)	Minimum 3.0	4.9	4.2
Current ratio (Current Assets / Current Liabilities)	Minimum 1.0	1.4	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, royalties payable balances greater than one year and the current bank debt.

As at December 31, 2019, the Company was in compliance with the above covenants. As at December 31, 2018, the Company was not in compliance with the leverage ratio covenant of the Credit Facility. As such, all outstanding debt as at December 31, 2018 was classified under current liabilities. The Company has obtained written waivers for non-compliance for the period ended December 31, 2018.

As at December 31, 2019, the borrowing base was US$15.0 million ($19.5 million) and Southern had US$14.0 million ($18.2 million) drawn. 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.

9. 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	-	241	-
Balance at December 31, 2019	**8,069**	**$ 6,648**	**$ 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 made in cash on 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.

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 December 31, 2019 was $8.1 million.

10. 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.

On December 31, 2018, the company completed a consolidation of the Common Shares on the basis of one post-consolidated Common Share for every 5 pre-consolidated Common Shares. These consolidated financial statements and all information related to issued and outstanding common shares, stock options and warrants, have been restated to reflect the share consolidation for all periods present.

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

The following table reflects the Company's outstanding common shares at December 31, 2019 and 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
Redemption of common shares from private placement	(3,000,000)	(300)
Balance as at December 31, 2019	220,770,279	**$ 35,441**

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").

On January 23, 2020, 3,000,000 of the Common Shares subscribed to in the Private Placement were redeemed by the Company. At December 31, 2019, Southern has reflected the redemption within shareholder's equity.

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 December 31, 2019, 19,306,667 Recap Warrants had vested as the Market Price had exceeded $0.15.

In 2018, Southern recognized $1.2 million of share-based compensation expense relating to the warrants.

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.

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

Stock Option Plan

Under the Company's share option plan, the Company may grant options to its directors, officers, employees and consultant up to a maximum of 10% of the issued and outstanding common shares at the time of the grant, with a maximum of 5% of the Company's issued and outstanding shares reserved for any one person on a yearly basis. The maximum option term is 10 years from the grant date with vesting terms set at the discretion of the board of directors.

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 December 31, 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	4.5
$ 0.10	**19,400,000**	**4.5**

Southern recognized $212 thousand of share-based compensation expense relating to stock options during 2019 ($nil in 2018). The fair value of the stock option grant was estimated on the date of grant using the Black-Scholes pricing model with the following assumptions:

	2019
Risk free interest rate	1.48%
Expected volatility	45%
Expected life	5.0 years
Dividend yield	nil
Expected forfeiture rate	10%
Stock price on grant date	$0.095
Fair value per option	$0.034

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

11. Loss Per Share

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

	Year ended December 31, 2019	2018
Net (loss) earnings from:		
Continuing operations	$ (10,896)	$ (2,160)
Discontinued operations	23	(535)
Net loss	$ (10,873)	$ (2,695)
Basic and diluted – weighted average number of shares	215,207,150	30,168,398
Basic and diluted (loss) earnings per share from:		
Continuing operations	$ (0.05)	$ (0.07)
Discontinued operations	0.00	(0.02)
Net loss per share	$ (0.05)	$ (0.09)

The calculation of diluted loss per share for the year ended December 31, 2019 and 2018 excludes the effect of all outstanding share options and warrants as they are anti-dilutive.

12. Income Taxes

The provision for income taxes recorded in the financial statements varies from the amount that would be computed by applying the Canadian statutory income tax rate of 26.5% as a result of the following:

	Year ended December 31, 2019	2018
Net (loss) before tax	$ (11,083)	$ (2,695)
Statutory income tax rate	26.5%	27.0%
Expected income tax (recovery)	(2,937)	(728)
Effect on income tax of:		
Tax rate changes – opening balance	804	-
Tax rate changes – current year movement	(334)	-
Unrecognized deferred tax asset	1,705	309
Prior year true-up adjustment	193	(56)
Issuance of convertible debentures	(210)	-
Adjustment for foreign tax rates	520	16
Non-deductible items	112	459
Other	(63)	-
Deferred tax recovery	**$ (210)**	**$ -**

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

The components of the Company's unrecognized deferred tax assets (liabilities) are as follows:

	Year ended December 31, 2019	2018
Property and equipment and exploration	$ 8,291	$ 3,780
ROU asset	(735)	-
Decommissioning provisions	98	1,099
Unamortized share issuance costs	879	332
Lease obligation	763	-
Convertible debenture – debt portion	(693)	-
Convertible debenture – equity portion	(95)	-
Eligible capital expenditure	-	-
Non-capital losses	21,624	15,694
Total	**$ 30,132**	**$ 20,905**

Non-capital tax losses of approximately $15.7 million at December 31, 2019 (December 31, 2018 - $14.9 million) will expire in future years ranging from 2027 – 2039. US net operating losses of approximately $6.6 million at December 31, 2019 (approximately $6.0 million at December 31, 2018) can be carried forward unlimited years.

13. 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.

Southern had the following commodity derivative contracts in place as at December 31, 2019:

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

Crude Oil	Volume	Pricing (US$)
Fixed Price Swap		
January 1, 2020 – December 31, 2020	50 Bbl/d	WTI $55.25/Bbl
January 1, 2020 – December 31, 2020	25 Bbl/d	WTI $56.45/Bbl

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

Hedging update

Subsequent to December 31, 2019, Southern entered into the following commodity derivative contracts:

Natural Gas	Volume	Pricing (US$)
Fixed Price Swap		
February 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH $2.253/MMBtu
January 1, 2021 – December 31, 2021	3,600 MMBtu/d	NYMEX – HH $2.402/MMBtu

Crude Oil	Volume	Pricing (US$)
Fixed Price Swap		
May 1, 2020 – December 31, 2020	75 Bbl/d	WTI $26.11/Bbl

On April 27, 2020, Southern entered a buy-back swap for 75 Bbl/d of oil where Southern will pay a fixed price of WTI US$26.11/Bbl. This transaction enables Southern to lock in a hedge gain of US$543 thousand for the remainder of 2020 on the two oil fixed price swaps above.

Financial Derivative Contracts Financial Statement Recognition

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

	Year ended December 31,	
Comprised of:	**2019**	**2018**
Current derivative asset	$ 819	$ 332
Current derivative liability	(105)	(166)
Non-current derivative asset	120	20
Non-current derivative liability	(14)	(51)
Net fair value of contracts, end of year	**$ 820**	**$ 135**

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

	Year ended December 31,	
	2019	**2018**
Realized (gain) loss on derivatives	$ (319)	$ 111
Unrealized gain on derivatives	(705)	(436)
Gain on derivative instruments	**$ (1,024)**	**$ (325)**

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.

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

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 December 31, 2019 or 2018. During the year ended December 31, 2019, four third party purchasers each marketed more than 10% of the Company's oil and natural gas revenue.

	Year ended December 31, 2019	2018
Subscription receipts held in trust	$ -	$ 7,106
Accrued receivables	2,031	5,507
Accounts receivable – joint venture	368	1,131
Total accounts receivable and other	**$ 2,399**	**$ 13,744**

0 to 30 days	$ 2,146	$ 13,374
31 to 60 days	33	43
61 to 90 days	17	18
Greater than 90 days	203	309
Total accounts receivable	**$ 2,399**	**$ 13,744**

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, royalties payable, lease liabilities, financial derivative liabilities, convertible debentures and the senior secured credit facility. 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

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

Convertible Debentures. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing.

The Company has the following financial liabilities:

	Year ended December 31, 2019	2018
Accrued payables	$ 1,782	$ 1,504
Accounts payables – trade	868	1,481
Royalties payables	5,589	5,067
Convertible debentures (face value)	8,069	-
Bank loan	18,183	21,009
Total	**$ 34,491**	**$ 29,061**

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 entered into various financial derivative instruments. The instruments currently outstanding are described above. As at December 31, 2019, Southern has not entered any foreign exchange derivative contracts or fixed interest rate contracts. As at December 31, 2019, a 10% change in future commodity prices applied against these contracts would have a $0.9 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 Credit Facility. For the year ended December 31, 2019, the Company did not enter any interest rate derivative contracts. The impact of a 1% increase in the interest rate associated with the Credit Facility would increase net loss by approximately $0.2 million.

14. Royalties Payable

As at December 31, 2019, Southern had $5.6 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 that closed on June 14, 2019. 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. For the calculation of the Current Ratio covenant as at December 31, 2019, Southern removed $5.1 million in royalty liabilities as they pertain to balances prior to December 31, 2018.

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

15. Oil and Natural Gas Sales

Southern sells its production pursuant to variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for the quality, location and other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contract, Southern is required to deliver a fixed or variable volume of crude oil, natural gas liquids or natural gas to the contract counterparty. Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed transaction price. Revenues are typically collected in the month following production.

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

	Year ended December 31,	
Commodity sales from production, by product	**2019**	**2018**
Crude oil	$ 5,356	$ 173
Natural gas liquids	499	17
Natural gas	13,274	616
Total Oil and Natural Gas Sales	**$ 19,129**	**$ 806**

16. Financing

The following table presents a breakdown of Southern's financing expenses:

	Year ended December 31,	
	2019	**2018**
Bank debt interest	$ 981	$ 40
Convertible debentures interest	355	-
Accretion of convertible debentures	241	-
Accretion of decommissioning obligations (Note 7)	29	5
Interest on lease obligations (Note 6)	59	-
Total Financing Expenses	**$ 1,665**	**$ 45**

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

17. Supplemental Cash Flow Information

The changes in non-cash working capital was comprised of the following:

	Year ended December 31, 2019	2018
Changes in:		
Accounts receivable and other	$ 11,345	$ (13,646)
Deposits and prepaid expenses	(71)	(176)
Accounts payables	(335)	2,741
Royalties payable	522	5,067
Working capital assumed in acquisitions	-	(5,689)
Foreign exchange	94	(47)
Changes in non-cash working capital	**$ 11,555**	**$ (11,750)**
Related to:		
Operating activities	$ (269)	$ (174)
Investing activities	152	(7)
Financing activities	11,672	(11,569)
	$ 11,555	**$ (11,750)**
Interest paid	**$ 1,334**	**$ 40**
Income taxes paid	**$ -**	**$ -**

18. Capital Risk Management

The current challenging economic climate, due to the COVID-19 pandemic and volatile commodity prices, may lead to further adverse changes in cash flows, working capital levels and debt balances, which may also have a direct impact on the Company's operating result and financial position. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. While it is too early to know all of the impacts of the COVID-19 pandemic, Southern has taken a cautionary approach to future expenditures in order to ensure capital preservation.

The Company's officers are responsible for managing the Company's capital and do so through quarterly meetings and regular reviews of financial information. The Company's directors are responsible for overseeing this process. The Company considers its capital structure to include working capital.

The Company monitors its capital based on projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by or reviewed with the Company's Board of Directors. The budget results are regularly reviewed and updated as required.

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

In order to maintain or adjust the capital structure, the Company may issue shares, seek debt financing and adjust its capital spending to manage its current and projected capital structure. The Company's ability to raise additional debt or equity financing is impacted by external conditions, including future commodity prices and global economic conditions. The Company continually monitors business conditions including changes in economic conditions, the risk of its drilling programs, forecasted commodity prices, and potential corporate or asset acquisitions.

19. Related Party Disclosures

There were no related party transactions in 2019. In 2018, Southern paid professional fees of $86 thousand to a firm of which a previous officer and director of the Company is a partner and are included in transaction costs.

Key management personnel

Southern has determined that the key management personnel of Southern consists of its executive officers and directors. The following table summarizes the compensation of directors and other members of key management personnel during the years ended December 31, 2019 and 2018:

	Year ended December 31,	
	2019	**2018**
Short-term benefits	$ 1,375	$ 438
Long-term benefits	168	589
Total	**$ 1,543**	**$ 1,027**

Short-term benefits are comprised of salaries and director fees, annual bonuses and other benefits. Long-term benefits include share-based compensation expense from share awards under Southern's long-term incentive plans. In 2018, the short-term benefits amount includes $401 thousand from Southern's executive officers and directors prior to the Recapitalization transaction on December 19, 2018.

20. Commitments and Contingencies

On January 1, 2019, Southern adopted IFRS 16 which resulted in the recognition of lease liabilities related to operating leases on the balance sheet some of which were previously reported as commitments. See Note 3 – Changes in Accounting Policies for additional information on Southern's lease liabilities as at January 1, 2019.

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

21. Discontinued Operations

On May 2, 2019, Southern disposed of all of its Canadian oil and natural gas assets for $0.5 million. The results of operations from the Canadian segment have been reported as a discontinued operation.

Results of Discontinued Operations

	Year ended December 31, 2019	2018
Revenues		
Petroleum and natural gas revenue	$ 334	$ 840
Royalties	(54)	(158)
	280	682
Expenses		
Production and operating	42	247
Transportation	19	47
Exploration evaluation	1	86
Depletion, depreciation and amortization	39	342
Finance	6	8
General and administrative	150	487
	257	1,217
Net earnings (loss) from discontinued operations	**$ 23**	**$ (535)**

Cash Flows from Discontinued Operations

	Year ended December 31, 2019	2018
Cash from (used) operating activities	$ 14	$ (102)
Cash from investing activities	484	-
Cash from financing activities	-	-
Net Cash Flows	**$ 498**	**$ (102)**