

Condensed Consolidated Interim Financial Statements of
SOUTHERN ENERGY CORP.

For the three and six months ended June 30, 2020 and 2019

(unaudited)

(Canadian Dollars)

SOUTHERN ENERGY CORP.



Condensed Consolidated Interim Statement of Financial Position (unaudited)

(\$000s of Canadian Dollars)	June 30, 2020	December 31, 2019
Assets		
Current assets		
Cash and cash equivalents	\$ 1,033	\$ 424
Accounts receivable	1,686	2,399
Prepaid expenses and deposits	525	371
Derivative assets (Note 8)	1,457	819
	<hr/> 4,701	<hr/> 4,013
Derivative assets (Note 8)	9	120
Property, plant and equipment (Note 3)	34,098	44,308
Right-of-use assets	543	735
Total assets	<hr/> \$ 39,351	<hr/> \$ 49,176
Liabilities and Equity		
Current liabilities		
Accounts payable and accrued liabilities	1,986	2,650
Royalties payable (Note 10)	5,769	5,589
Current portion of lease liabilities	371	382
Bank debt (Note 5)	19,079	-
Derivative liabilities (Note 8)	313	105
	<hr/> 27,518	<hr/> 8,726
Long-term liabilities		
Derivative liabilities (Note 8)	170	14
Convertible debentures	6,886	6,648
Lease liabilities	228	381
Bank debt (Note 5)	-	18,183
Decommissioning provisions (Note 4)	5,337	5,276
Total liabilities	<hr/> 40,139	<hr/> 39,228
Shareholders' equity (Note 6)		
Share capital	35,441	35,441
Equity component of convertible debenture	665	665
Warrants	1,195	1,195
Contributed surplus	4,286	4,095
Deficit	(43,049)	(30,962)
Accumulated other comprehensive income (loss)	674	(486)
	<hr/> (788)	<hr/> 9,948
Total liabilities and shareholders' equity	<hr/> \$ 39,351	<hr/> \$ 49,176

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

SOUTHERN ENERGY CORP.



Condensed Consolidated Interim Statement of Loss and Comprehensive Loss (unaudited)

(\$000s of Canadian Dollars, except for per share amounts)	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Revenues				
Petroleum and natural gas revenue (Note 11)	\$ 2,478	\$ 4,207	\$ 5,875	\$ 8,459
Royalties	(522)	(849)	(1,213)	(1,710)
	<u>1,956</u>	<u>3,358</u>	<u>4,662</u>	<u>6,749</u>
Expenses				
Production and operating	1,347	1,549	3,002	3,161
Transportation	23	81	65	170
Depletion, depreciation and amortization (Note 3)	1,129	1,163	2,454	2,195
Impairment (Note 3)	-	-	10,400	725
Gain on derivatives (Note 8)	(6)	(752)	(1,593)	(392)
Loss (gain) on dispositions (Note 3)	(338)	13	(338)	(120)
Financing (Note 12)	488	252	1,015	505
General and administrative	767	1,202	1,685	2,164
Share-based compensation	92	12	191	12
Transaction costs	-	223	-	388
Loss (gain) on foreign exchange	325	179	(132)	179
	<u>3,827</u>	<u>3,922</u>	<u>16,749</u>	<u>8,987</u>
Net loss from continuing operations before income tax	(1,871)	(564)	(12,087)	(2,238)
Income tax recovery	-	(210)	-	(210)
Net loss from continuing operations	(1,871)	(354)	(12,087)	(2,028)
Net earnings from discontinued operations (Note 13)	-	46	-	23
Total net loss for the period	(1,980)	(308)	(12,087)	(2,005)
Currency translation adjustment	55	(411)	1,160	(454)
Comprehensive loss for the period	<u>\$ (1,816)</u>	<u>\$ (719)</u>	<u>\$(10,927)</u>	<u>\$ (2,459)</u>
Basic and diluted (Note 7)				
Continuing operations	\$ (0.01)	\$ (0.00)	\$ (0.05)	\$ (0.01)
Discontinued operations	0.00	0.00	0.00	0.00
Net loss per share	<u>\$ (0.01)</u>	<u>\$ (0.00)</u>	<u>\$ (0.05)</u>	<u>\$ (0.01)</u>

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

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Condensed Consolidated Interim Statement of Changes in Shareholders' Equity (unaudited)

(\$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, 2018	204,356,973	\$ 33,860	\$ -	\$ 1,195	\$ 3,883	\$(20,089)	\$ 62	\$ 18,911
Shares issued on Rights Offering	19,413,306	1,892	-	-	-	-	-	1,892
Net Loss	-	-	-	-	-	(2,005)	-	(2,005)
Other Comprehensive Loss	-	-	-	-	-	-	(454)	(454)
Convertible Debentures issued	-	-	703	-	-	-	-	703
Share-based compensation	-	-	-	-	12	-	-	12
Balance, June 30, 2019	223,770,279	\$ 35,752	\$ 703	\$ 1,195	\$ 3,895	\$(22,094)	\$ (392)	\$ 19,059
Balance, December 31, 2019	220,770,279	\$ 35,441	\$ 665	\$ 1,195	\$ 4,095	\$(30,962)	\$ (486)	\$ 9,948
Share-based compensation	-	-	-	-	191	-	-	191
Net Loss	-	-	-	-	-	(12,087)	-	(12,087)
Other Comprehensive Income	-	-	-	-	-	-	1,160	1,160
Balance, June 30, 2020	220,770,279	\$ 35,441	\$ 665	\$ 1,195	\$ 4,286	\$(43,049)	\$ 674	\$ (788)

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

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Condensed Consolidated Interim Statement of Cash Flows (unaudited)



(\$000s of Canadian Dollars)	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Operating activities				
Total net loss for the period	\$ (1,871)	\$ (308)	\$(12,087)	\$ (2,005)
Changes in non-cash items:				
Depletion, depreciation and amortization (Note 3)	1,129	1,163	2,454	2,234
Impairment (Note 3)	-	-	10,400	725
(Gain) loss on dispositions (Note 3)	(338)	13	(338)	(120)
Financing expense	488	252	1,015	511
Unrealized loss (gain) on derivatives (Note 8)	927	(683)	(75)	(469)
Unrealized loss (gain) on foreign exchange	325	179	(132)	179
Share-based compensation	92	12	191	12
Deferred income tax recovery	-	(210)	-	(210)
Decommissioning provisions liabilities settled (Note 4)	(2)	(6)	(1)	(6)
Changes in non-cash working capital	(630)	(217)	(384)	(1,001)
Net cash provided (used) by operating activities	120	195	1,043	(150)
Investing activities				
Capital expenditures	5	(762)	(41)	(1,284)
Acquisitions	-	(20,875)	-	(20,875)
Proceeds from divestitures (Note 3)	338	504	338	504
Changes in non-cash working capital	56	(68)	(96)	380
Net cash provided (used) by investing activities	399	(21,201)	201	(21,275)
Financing activities				
Proceeds from share issuances, net	-	1,892	-	1,892
Issuance of convertible debentures, net	-	7,599	-	7,599
Proceeds from bank debt (Note 5)	-	10,638	-	134
Payment of interest	(524)	(177)	(768)	(408)
Finance lease payments	(81)	(102)	(185)	(207)
Changes in non-cash working capital	328	818	308	11,685
Net cash (used) provided by financing activities	(277)	20,668	(645)	20,695
Net increase (decrease) in cash and cash equivalents	242	(338)	599	(730)
Effect of foreign exchange rate changes	(41)	(28)	10	(59)
Cash and cash equivalents, beginning of period	832	1,911	424	2,334
Cash and cash equivalents, end of period	\$ 1,033	\$ 1,545	\$ 1,033	\$ 1,545

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

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Notes to the Condensed Consolidated Interim Financial Statements (unaudited)
Amounts in (\$000s of Canadian Dollars), except for per share amounts

1. Reporting Entity and Nature of Operations

Southern Energy Corp. (“Southern” or “Company”) 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.

Southern’s head office is located in Calgary, Alberta, Canada. Southern trades on the TSX Venture Exchange (“TSXV”) under the trading symbol “SOU”. The condensed consolidated interim financial statements were authorized for issue by the Board of Directors on August 27, 2020.

2. Basis of Presentation and Going Concern

a) Principles of Reporting and Consolidation

The condensed consolidated interim 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 condensed consolidated interim 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 consolidated interim financial statements use the accounting policies which the Company applied in its annual consolidated financial statements for the year ended December 31, 2019, 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, 2019, 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 balance sheet 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.

b) Going Concern

The Company prepared the condensed consolidated interim 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 condensed consolidated interim financial statements have been prepared on a historical cost basis, except certain financial instruments, which are measured at fair value.

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As at June 30, 2020, Southern had a working capital deficiency, as defined by its Senior Secured Bank Credit Facility (the "Credit Facility") of \$4.5 million, excluding derivative assets and liabilities, the current portion of the lease liability, and the US\$14.0 million (\$19.1 million) drawn on its Credit Facility, that was classified as a current liability at June 30, 2020 (see Note 5 "Bank Debt" for more information). On July 20, 2020, as part of a bank redetermination, Southern entered into the Amended and Restated Credit Facility Agreement ("Amended Credit Agreement"). Details of the Amended Credit Agreement include:

- Borrowing base limit set to US\$13.9 million; comprised of a US\$8.5 million conforming borrowing base facility (the "Conforming Facility") and a US\$5.4 million non-conforming borrowing base facility (the "Non-Conforming Facility").
- Non-Conforming Facility has a coupon 50 basis points above existing Credit Facility rates.
- Beginning July 26, 2020, and continuing every month, the Non-Conforming Facility will be reduced by the greater of US\$100 thousand or Bank EBITDAX (as defined in Note 5 – "Bank Debt", below) less maintenance capital expenditures.
- Upon execution of the Amended Credit Facility, Southern made a principal payment of US\$100 thousand.
- The Non-Conforming Facility has a maturity date of September 1, 2020, being the next redetermination date, and the Conforming Facility has a maturity date of February 1, 2021.
- Amendments to the Credit Facility financial covenants, which are summarized below:

Financial covenant	Jun 30, 2020	Sep 30, 2020	Dec 31, 2020	Mar 31, 2021
Leverage ratio (Debt / Bank EBITDAX)	4.60	4.00	3.75	3.50
Interest coverage ratio (Bank EBITDAX / Cash Interest)	2.75	2.75	2.75	2.75
Current ratio (Current Assets / Current Liabilities)	0.95	1.00	1.00	1.00

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 and continues cost saving measures by reducing corporate salaries by 20%, field salaries by 10%, and eliminating all non-essential business expenditures. On April 27, 2020, Southern entered into a buy-back swap for 75 Bbl/d of oil production. By entering into this transaction, in combination with the existing two oil swaps, Southern will realize proceeds of US\$68 thousand per month for the remainder of 2020. In addition to the cost saving measures noted, Southern will further manage liquidity by evaluating additional opportunities to reduce both operating and capital field expenditures, sale of non-core oil and gas assets, looking for alternative sources of financing and the continued support of the current lender. This material uncertainty may cast significant doubt with respect to the ability of the Company to continue as a going concern.

These condensed consolidated interim 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

Impact of COVID-19

The COVID-19 outbreak was declared a pandemic by the World Health Organization on March 11, 2020. This has resulted in significant economic uncertainty and governments worldwide are enacting emergency

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measures to contain the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Global financial markets have experienced significant volatility and weakness as a consequence of this economic uncertainty. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the effectiveness of interventions by governments and central banks. The outbreak presents uncertainty and risk with respect to the Company, its performance, and estimates and assumptions used by management in the preparation of its financial results.

A full list of the key sources of management judgements and estimation uncertainty can be found in the Company's Annual Consolidated Financial Statements for the year ended December 31, 2019. The outbreak and current market conditions have increased the complexity of estimates and assumptions used to prepare the interim condensed consolidated financial statements, particularly related to the following key source of estimation uncertainty:

Recoverable Amounts

Determining the recoverable amount of a cash-generating unit ("CGU") requires the use of estimates and assumptions, which are subject to change as new information becomes available. The severe drop in commodity prices, due to reasons noted above, have increased the risk of measurement uncertainty in determining the recoverable amounts, especially estimating economic crude oil and natural gas reserves and estimating forward commodity prices.

d) Government Grants

Government grants are recognized when the company has reasonable assurance that it has complied with the relevant conditions of the grant and that it will be received. The Company recognizes the grant against the financial statement line item that it is intended to compensate.

3. 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		Total
	Assets	Other	
Net book value as at December 31, 2019	\$ 44,304	\$ 4	\$ 44,308
Additions	41	-	41
Depletion and depreciation	(2,262)	-	(2,262)
Impairment	(10,400)	-	(10,400)
Change in decommissioning obligations	(182)	-	(182)
Effect of foreign exchange rate changes	2,593	-	2,593
Net book value as at June 30, 2020	\$ 34,094	\$ 4	\$ 34,098

The calculation of depletion expense for the six months ended June 30, 2020 included estimated future development costs of \$36.7 million (\$41.7 million at June 30, 2019) associated with the development of the Company's proved plus probable reserves.

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On May 28, 2020, Southern disposed of a non-core Canadian royalty asset, with a carrying value of \$nil, for net proceeds of \$338 thousand.

Impairment

At June 30, 2020, Southern did not identify any indicators of impairment or impairment reversal for any of its CGUs.

At March 31, 2020, Southern viewed the significant decrease in oil prices in March 2020 and Southern's market capitalization below the net assets of the Company as indications of impairment. Southern estimated the recoverable amount of all CGUs at March 31, 2020. Southern determined that the carrying value of the Central Mississippi ("CMS") and the Smackover ("SO") CGUs exceeded their recoverable amounts. A non-cash impairment charge of \$10.4 million was recorded in the condensed consolidated interim 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. The proved developed producing oil and gas reserves were based on reserves estimated by Southern's independent reserves evaluator at December 31, 2019, and revised price estimates at March 31, 2020.

The following table details the forward pricing used in estimating the recoverable amounts of Southern's CGUs at March 31, 2020:

Period Ending	West Texas Intermediate (\$US/bbl)	Henry Hub (\$US/MMBtu)	FX (USD/CAD)
12-31-2020	30.00	2.08	0.710
12-31-2021	41.18	2.54	0.731
12-31-2022	49.88	2.79	0.751
12-31-2023	55.87	2.92	0.760
12-31-2024	57.98	2.99	0.761
12-31-2025	59.22	3.05	0.763
12-31-2026	60.39	3.11	0.763
12-31-2027	61.60	3.18	0.763
12-31-2028	62.84	3.24	0.763
12-31-2029	64.09	3.30	0.763

Thereafter, WTI and HH prices escalated 2 percent on January 1 of each year and FX rates held constant at 0.763

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 March 31, 2020, a 1% increase in the assumed discount rate would reduce the estimated recoverable amounts of the impaired CGUs by \$0.8 million while a 5% decrease change in commodity price forecasts would reduce the estimated recoverable amounts by \$2.2 million.

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4. Decommissioning Provisions

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, 2019	\$	5,276
Liabilities settled		(1)
Change in estimates		(182)
Accretion expense		52
Effect of foreign exchange rate changes		192
Balance as at June 30, 2020	\$	5,337
Long term liability	\$	5,337

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 \$5.9 million at June 30, 2020 (\$6.2 million at December 31, 2019), which have been discounted using a risk-free interest rate of 1.3% at June 30, 2020 (1.7% to 1.9% at December 31, 2019).

5. Bank Debt

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

	As at Jun 30, 2020	As at Dec 31, 2019
Current Portion Senior Secured Bank Credit Facility	\$ 19,079	\$ -
Long Term Portion Senior Secured Bank Credit Facility	-	18,183
Total Bank Debt	\$ 19,079	\$ 18,183

Southern Energy Corp. (Delaware), one of the wholly-owned subsidiaries of Southern, continues to hold the existing Credit Facility. The Credit Facility is secured against the oil and gas properties of Southern. On July 20, 2020, as part of a bank redetermination, Southern entered into the Amended Credit Agreement. For additional details, see Note 2 – "Going Concern". With the execution of the Amended Credit Agreement, the maturity date for the Conforming Facility remains as February 1, 2021 and the maturity date for the Non-Conforming Facility is September 1, 2020. As these maturity dates are less than twelve months from June 30, 2020, the outstanding bank debt has been classified under current liabilities. The next redetermination is scheduled for September 1, 2020.

Interest on borrowings under the Credit Facility is determined by reference to the London Interbank Offered Rate ("LIBOR") plus a margin that ranges from 2.5% to 3.5%. Southern pays a commitment fee of 0.5% on the undrawn borrowing base. As part of the Amended Credit Facility, the interest reference rate

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of LIBOR will be replaced with the Eurodollar Rate. During the six months ended June 30, 2020, the effective interest rate, excluding commitment and other fees, was 4.6%.

The financial covenants of the Credit Facility, calculated quarterly, include covenants which relate to a maximum leverage ratio (Debt / Bank EBITDAX), minimum interest coverage ratio (Bank EBITDAX / Cash Interest) and minimum current ratio (Current Assets / Current Liabilities).

Below are the financial covenant calculations based on the Amended Credit Agreement for June 30, 2020:

Financial covenant	Limit	As at	As at
		Jun 30, 2020	Dec 31, 2019
Leverage ratio (Debt / Bank EBITDAX)	Maximum 4.60	4.56	3.32
Interest coverage ratio (Bank EBITDAX / Cash Interest)	Minimum 2.75	3.03	4.86
Current ratio (Current Assets / Current Liabilities)	Minimum 0.95	1.36	1.44

The financial covenants include financial measures defined within the Amended Credit Agreement that are not defined under IFRS. These financial measures are defined by the Amended Credit Agreement 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.

Subsequent to the debt repayment on July 20, 2020 (see Note 2 – “Going Concern”), Southern made an additional US\$200 thousand debt repayment on August 5, 2020. As a result, Southern currently has an outstanding bank debt balance of US\$13.7 million (CAD\$18.7 million).

6. 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 June 30, 2020 and December 31, 2019:

	Number of Shares	Share Capital
Balance as at December 31, 2019	220,770,279	\$ 35,441
Balance as at June 30, 2020	220,770,279	\$ 35,441

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Warrants

As at June 30, 2020, 19,306,667 performance-based Common Share purchase warrants (“Recap Warrants”) had vested as the 20-day volume weighted average trading price (“Market Price”) of the Common Shares had exceeded \$0.15.

Stock Option Plan

The following table reflects the Company’s outstanding common stock options at June 30, 2020 and December 31, 2019:

	Number of stock options	Weighted average exercise price
Balance at December 31, 2019	19,400,000	\$ 0.10
Balance at June 30, 2020	19,400,000	\$ 0.10

	Outstanding and Exercisable	
Exercise price	Number of stock options	Weighted average remaining life (years)
\$ 0.10	19,400,000	4.0
\$ 0.10	19,400,000	4.0

7. Loss Per Share

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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Net (loss) earnings from:				
Continuing operations	\$ (1,871)	\$ (354)	\$ (12,087)	\$ (2,028)
Discontinued operations	-	46	-	23
Net loss	\$ (1,871)	\$ (308)	\$ (12,087)	\$ (2,005)
Basic and diluted – weighted average number of shares	220,770,279	208,623,634	220,770,279	206,502,090
Basic and diluted loss per share from:				
Continuing operations	\$ (0.01)	\$ (0.00)	\$ (0.05)	\$ (0.01)
Discontinued operations	0.00	0.00	0.00	0.00
Net loss per share	\$ (0.01)	\$ (0.00)	\$ (0.05)	\$ (0.01)

The calculation of diluted loss per share for the three and six months ended June 30, 2020 and 2019 excludes the effect of all outstanding share options and warrants as they are anti-dilutive.

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8. 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 condensed consolidated interim 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 condensed consolidated interim statement of loss and comprehensive loss in the period of change.

Southern had the following commodity derivative contracts in place as at June 30, 2020:

Natural Gas	Volume	Pricing (US\$)
<i>Fixed Price Swap</i>		
July 1, 2020 – December 31, 2020	1,000 MMBtu/d	NYMEX – HH \$2.600/MMBtu
July 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH \$2.748/MMBtu
July 1, 2020 – December 31, 2020	2,000 MMBtu/d	NYMEX – HH \$2.575/MMBtu
July 1, 2020 – December 31, 2020	1,500 MMBtu/d	NYMEX – HH \$2.253/MMBtu
January 1, 2021 – December 31, 2021	1,500 MMBtu/d	NYMEX – HH \$2.575/MMBtu
January 1, 2021 – December 31, 2021	3,600 MMBtu/d	NYMEX – HH \$2.402/MMBtu
Crude Oil	Volume	Pricing (US\$)
<i>Fixed Price Swap</i>		
July 1, 2020 – December 31, 2020	50 bbl/d	WTI \$55.25/bbl
July 1, 2020 – December 31, 2020	25 bbl/d	WTI \$56.45/bbl

On April 27, 2020, Southern entered into a buy-back swap for 75 Bbl/d of oil production. By entering into this transaction, in combination with the existing two oil swaps, Southern will realize proceeds of US\$68 thousand per month for the remainder of 2020.

Financial Derivative Contracts Financial Statement Recognition

The Company's financial instruments that were accounted for at fair value as of June 30, 2020 and December 31, 2019 are presented below. The classification within the fair value hierarchy for these financial instruments is Level 2.

Comprised of:	As at Jun 30, 2020	As at Dec 31, 2019
Current derivative asset	\$ 1,457	\$ 819
Current derivative liability	(313)	(105)
Non-current derivative asset	9	120
Non-current derivative liability	(170)	(14)
Net fair value of contracts, end of period	\$ 983	\$ 820

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Below is a reconciliation of the gain on derivatives from the condensed consolidated interim statement of loss and comprehensive loss:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Realized (gain) loss on derivatives	\$ (933)	\$ (69)	\$ (1,518)	\$ 77
Unrealized loss (gain) on derivatives	927	(683)	(75)	(469)
Gain on derivative instruments	\$ (6)	\$ (752)	\$ (1,593)	\$ (392)

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

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 June 30, 2020 or December 31, 2019. During the six months ended June 30, 2020, four third party purchasers 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, royalties payable, lease liabilities, financial derivative liabilities, convertible

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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, and reducing capital spending. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing.

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 June 30, 2020, Southern has not entered any foreign exchange derivative contracts or fixed interest rate contracts. As at June 30, 2020, a 10% change in future commodity prices applied against these contracts would have a \$1.0 million impact on net income. At June 30, 2020, the Canadian dollar to US dollar foreign exchange rate was 1.3628 (December 31, 2019 – 1.2988).

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 six months ended June 30, 2020, 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 \$98 thousand.

9. 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.

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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.

10. Royalties Payable

As at June 30, 2020, Southern had \$5.8 million (\$5.6 million at December 31, 2019) 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. The increase was primarily due to the stronger US dollar at June 30, 2020 compared to December 31, 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 June 30, 2020, Southern removed \$5.5 million (December 31, 2019 - \$5.1 million) in royalty liabilities as they pertain to balances prior to June 30, 2019.

11. Oil and Natural Gas Sales

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Commodity sales from production, by product				
Crude oil	\$ 429	\$ 1,367	\$ 1,214	\$ 2,472
Natural gas liquids	7	137	67	283
Natural gas	2,042	2,703	4,594	5,704
Total Revenue from Continuing Operations	\$ 2,478	\$ 4,207	\$ 5,875	\$ 8,459

12. Financing

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Bank debt interest	\$ 201	\$ 177	\$ 445	\$ 408
Convertible debentures interest	160	30	322	30
Accretion	117	30	227	35
Interest on lease obligations	10	15	21	32
Total Financing Expenses from Continuing Operations	\$ 488	\$ 252	\$ 1,015	\$ 505

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13. 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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Revenues				
Petroleum and natural gas revenue	\$ -	\$ 115	\$ -	\$ 334
Royalties	-	(25)	-	(54)
	-	90	-	280
Expenses				
Production and operating	-	(9)	-	42
Transportation	-	3	-	19
Exploration evaluation	-	-	-	1
Depletion, depreciation and amortization	-	-	-	39
Finance	-	-	-	6
General and administrative	-	50	-	150
	-	44	-	257
Net earnings from discontinued operations	\$ -	\$ 46	\$ -	\$ 23

Cash Flows from Discontinued Operations

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Cash from operating activities	\$ -	\$ 117	\$ -	\$ 74
Cash from investing activities	-	504	-	504
Cash from financing activities	-	-	-	-
Net Cash Flows	\$ -	\$ 621	\$ -	\$ 578