

Consolidated Financial Statements of

SOUTHERN ENERGY CORP.

For the years ended December 31, 2020 and 2019

(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
April 30, 2021

(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 statement of financial position as at December 31, 2020 and 2019, 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, 2020 and 2019, 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 in the financial statements, which indicates that the Company incurred a net loss of \$9.9 million during the year ended December 31, 2020 and, as of that date, 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 of 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 Kyle Hawkins.

Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
April 30, 2021

SOUTHERN ENERGY CORP.
Consolidated Statement of Financial Position



(\$000s of Canadian Dollars)	December 31, 2020	December 31, 2019
Assets		
Current assets		
Cash and cash equivalents	\$ 1,158	\$ 424
Accounts receivable and other (Note 12)	2,143	2,399
Prepaid expenses and deposits	304	371
Derivative assets (Note 12)	8	819
	3,613	4,013
Derivative assets (Note 12)	-	120
Property, plant and equipment (Note 4)	34,682	44,308
Right-of-use assets (Note 5)	352	735
Total assets	\$ 38,647	\$ 49,176
Liabilities and Equity		
Current liabilities		
Accounts payable and accrued liabilities	2,241	2,650
Royalties payable (Note 13)	5,555	5,589
Current portion of lease liabilities (Note 5)	381	382
Bank debt (Note 7)	16,779	-
Derivative liabilities (Note 12)	473	105
	25,429	8,726
Long-term liabilities		
Derivative liabilities (Note 12)	-	14
Convertible debentures (Note 8)	7,468	6,648
Lease liabilities (Note 5)	-	381
Bank debt (Note 7)	-	18,183
Decommissioning provisions (Note 6)	5,439	5,276
Total liabilities	38,336	39,228
Shareholders' equity (Note 9)		
Share capital	35,441	35,441
Equity component of convertible debenture (Note 8)	665	665
Warrants	1,195	1,195
Contributed surplus	4,377	4,095
Deficit	(42,272)	(30,962)
Accumulated other comprehensive income (loss)	905	(486)
	311	9,948
Total liabilities and shareholders' equity	\$ 38,647	\$ 49,176

Commitments and contingencies (Note 20)
Going Concern (Note 2)
(See accompanying Notes to the Consolidated Financial Statements)

Approved by Board of Directors
(signed) "Michael G. Kohut"
Director

(signed) "Bruce Beynon"
Chairman

SOUTHERN ENERGY CORP.
Consolidated Statement of Loss and Comprehensive Loss



	Year ended December 31, 2020	Year ended December 31, 2019
(\$000s of Canadian Dollars, except for per share amounts)		
Revenues		
Petroleum and natural gas revenue (Note 14)	\$ 13,922	\$ 19,129
Royalties	(2,827)	(3,859)
	<u>11,095</u>	<u>15,270</u>
Expenses		
Production and operating	5,873	6,799
Transportation	220	368
Depletion, depreciation and amortization (Note 4 & 5)	5,019	5,741
Impairment, net (Note 4)	5,830	7,425
Gain on derivatives (Note 12)	(997)	(1,024)
Gain on dispositions (Note 4)	(338)	(98)
Financing (Note 15)	2,282	1,665
General and administrative	3,661	4,465
Share-based compensation (Note 9)	282	212
Transaction costs	184	588
Loss on foreign exchange	389	235
	<u>22,405</u>	<u>26,376</u>
Net loss from continuing operations before income tax	(11,310)	(11,106)
Income tax recovery	-	(210)
Net loss from continuing operations	(11,310)	(10,896)
Net earnings from discontinued operations (Note 19)	-	23
Total net loss for the year	(11,310)	(10,873)
Currency translation adjustment	1,391	(548)
Comprehensive loss for the year	<u>\$ (9,919)</u>	<u>\$ (11,421)</u>
Basic and diluted (loss) income (Note 10)		
Continuing operations	\$ (0.05)	\$ (0.05)
Discontinued operations	0.00	0.00
Net loss per share	<u>\$ (0.05)</u>	<u>\$ (0.05)</u>

(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, 2018	204,356,973	\$ 33,860	\$ -	\$ 1,195	\$ 3,883	\$(20,089)	\$ 62	\$ 18,911
Shares issued on Rights Offering	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
Share-based compensation	-	\$ -	\$ -	\$ -	\$ 282	\$ -	\$ -	\$ 282
Net Loss	-	-	-	-	-	(11,310)	-	(11,310)
Other Comprehensive Income	-	-	-	-	-	-	1,391	1,391
Balance, December 31, 2020	220,770,279	\$ 35,441	\$ 665	\$ 1,195	\$ 4,377	\$(42,272)	\$ 905	\$ 311

(See accompanying Notes to the Consolidated Financial Statements)

SOUTHERN ENERGY CORP.
Consolidated Statement of Cash Flows



(\$000s of Canadian Dollars)	Year ended December 31, 2020	Year ended December 31, 2019
Operating activities		
Total net loss for the year	\$ (11,310)	\$ (10,873)
Changes in non-cash items:		
Depletion, depreciation and amortization (Note 4 & 5)	5,019	5,780
Impairment (Note 4)	5,830	7,425
Gain on dispositions (Note 4)	(338)	(98)
Financing	2,282	1,671
Unrealized loss (gain) on derivatives (Note 12)	1,399	(705)
Unrealized loss on foreign exchange	389	235
Share-based compensation (Note 9)	282	212
Deferred income tax recovery	-	(210)
Decommissioning provisions liabilities settled (Note 6)	(6)	(23)
Changes in non-cash working capital (Note 16)	(92)	(269)
Net cash provided by operating activities	3,455	3,145
Investing activities		
Capital expenditures	(236)	(1,594)
Acquisitions (Note 4)	-	(21,349)
Proceeds from divestitures	338	484
Changes in non-cash working capital (Note 16)	(26)	152
Net cash provided (used) by investing activities	76	(22,307)
Financing activities		
Proceeds from share issuances, net (Note 9)	-	1,881
Issuance of convertible debentures, net (Note 8)	-	7,282
Advances of bank debt (Note 7)	720	12,688
Paydown of bank debt (Note 7)	(1,775)	(14,470)
Payment of interest	(1,389)	(1,334)
Finance lease payments (Note 5)	(400)	(415)
Changes in non-cash working capital (Note 16)	97	11,672
Net cash (used) provided by financing activities	(2,747)	17,304
Net increase (decrease) in cash and cash equivalents	784	(1,858)
Effect of foreign exchange rate changes	(50)	(52)
Cash and cash equivalents, beginning of year	424	2,334
Cash and cash equivalents, end of year	\$ 1,158	\$ 424

(See accompanying Notes to the Consolidated Financial Statements)

SOUTHERN ENERGY CORP.

Notes to the Consolidated Financial Statements

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 acquiring and developing conventional natural gas and light oil resources in the Southeast Gulf States of Mississippi, Louisiana, and East Texas.

Southern’s head office is located in Calgary, Alberta, Canada. Southern trades on the TSX Venture Exchange (“TSXV”) under the trading symbol “SOU”. The financial statements were authorized for issue by the Board of Directors on April 30, 2021.

2. Basis of Presentation and Going Concern

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”). 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 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 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 12.

At December 31, 2020, Southern had current liabilities that exceeded its current assets by \$21.8 million, including \$16.8 million of bank debt, that was classified as a current liability at December 31, 2020.

Southern entered into the Amended and Restated Credit Agreement in respect of the Credit Facility on July 20, 2020 (the “Amended Credit Agreement”). See Note 7 “Bank Debt” for more information.

Subsequent to December 31, 2020, Southern entered into the third amendment to the Amended Credit Agreement (the “Third Amendment”) on February 1, 2021. The Third Amendment extended the maturity

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of both the conforming borrowing base facility (the “Conforming Facility”) and non-conforming borrowing base facility (the “Non-Conforming Facility”) from February 1, 2021 to February 12, 2021. See Note 7 “Bank Debt” for more information.

Effective February 12, 2021, Southern entered into the fourth amendment to the Amended Credit Agreement (the “Fourth Amendment”). The Fourth Amendment included: (a) a waiver for the noncompliance of the leverage ratio financial covenant as at December 31, 2020; and (b) an extension of the maturity of the Conforming and Non-Conforming Facilities to April 30, 2021. See Note 7 “Bank Debt” for more information.

Southern made the following debt repayments to the Credit Facility subsequent to December 31, 2020:

Date of repayment	(US\$000s)	(\$000s)
January 13, 2021	\$ 150	\$ 191
February 2, 2021	200	254
March 9, 2021	100	126
April 7, 2021	100	126
Total amount repaid since December 31, 2020	\$ 550	\$ 697
Balance as at April 29, 2021	\$ 12,650	\$ 15,549

On April 30, 2021, Southern Energy Corp. (Delaware) closed a transaction to retire the existing Credit Facility with a cash settlement payment of US\$8.0 million, plus accrued interest. The US\$8.0 million settlement was financed through a new senior secured term loan of up to US\$8.5 million (the “New Facility”). The New Facility is secured against the oil and gas properties of Southern. Details of the New Facility include:

- Tranche A: US\$5.5 million at closing
- Tranche B: US\$3.0 million available up to December 31, 2021, in multiple advances of no less than US\$500 thousand each
- Maturity of 36 months from closing date
- Interest of 12% per annum, paid monthly in arrears on the last day of the month
- Issued 41,250,000 warrants equivalent to 30% of Tranche A with an exercise price of \$0.05 per share and an expiry date on the earlier of: (a) a liquidity event resulting in the sale of Southern Energy Corp. (Delaware); or (b) the maturity date of the New Facility
- Beginning on May 31, 2021, repayments of the principal amount outstanding under the New Facility will be computed as the sum of: (a) outstanding amount multiplied by 1/A, where A equals the number of whole or part months remaining to the maturity date plus 12 months; and (b) on the last day of the second month following each fiscal quarter, the amount by which 50% of positive free cash flow (“FCF”) (as described below) for the respective fiscal quarter. FCF is calculated as Earnings Before Interest, Taxes, Depreciation, Amortization, and Impairment (“EBITDAX”), less the aggregate of the New Facility principal and interest payments
- Beginning June 30, 2021 and as at each quarter-end thereafter, financial covenant calculation related to an asset coverage ratio (“ACR”) of at least 2:1. ACR is calculated as the ratio of the net present value of proved developed producing oil and gas properties as determined by an independent qualified engineer, using a price deck based on the forward commodity prices, discounted at 12% to the principle amount outstanding under the New Facility

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- Beginning September 30, 2021, and for each quarter-end thereafter, Southern Energy Corp. (Delaware) shall maintain a total debt service coverage ratio ("DSCR") of greater than 1.25:1. DSCR is the ratio of EBITDAX to scheduled principal payments and interest expense

Upon closing of the New Facility on April 30, 2021, Southern's outstanding first lien debt balance was reduced from US\$12.7 million (\$15.5 million) to US\$5.5 million (\$6.8 million). See Note 7 "Bank Debt" for more information.

Southern will continue to prioritize the deleveraging of the balance sheet through utilizing excess cash flow to repay the outstanding debt balance. Southern continues to manage liquidity by evaluating additional opportunities to reduce both operating and capital field expenditures, sale of non-core oil and natural gas assets, and looking for alternative sources of financing. There is no certainty that Southern will raise financing or generate sufficient cash flow to repay its debt obligations as they come due. This material uncertainty may cast significant doubt with respect to the ability of the Company 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.

3. Significant Accounting Policies

a) 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.

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 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.

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

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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.

b) 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.

c) 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 centered 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.

d) 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

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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.

e) 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.

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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.

f) 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.

g) 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.

h) 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.

i) 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

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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.

j) 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.

k) 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.

l) 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

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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.

m) 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. In 2020, Southern has obtained \$170 thousand through the Canada Emergency Wage Subsidy ("CEWS") & Canada Emergency Rent Subsidy ("CERS") programs in Canada, which were recognized against general and administrative expenses and US\$112 thousand from the Paycheck Protection Program ("PPP") in the United States, which were recognized against production and operating expenses.

n) 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

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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

o) 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.

p) 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.

q) 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.

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4. Property, Plant and Equipment

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

	Oil and Natural Gas Assets	Other	Total
Net book value as at December 31, 2018	\$ 38,199	\$ -	\$ 38,199
Additions	1,590	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)	-	(5,396)
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
Additions	221	15	236
Change in decommissioning provision (Note 6)	198	-	198
Depletion, depreciation and amortization	(4,635)	(1)	(4,636)
Impairment	(10,400)	-	(10,400)
Impairment reversal	4,570	-	4,570
Effect of foreign exchange rate changes	406	-	406
Net book value as at December 31, 2020	\$ 34,664	\$ 18	\$ 34,682

Depletion

For the year ended December 31, 2020, the Company recorded depletion expense of \$4.6 million (December 31, 2019 - \$5.4 million). In the calculation of depletion expense at December 31, 2020, an estimated \$36.4 million of future development costs associated with the proven plus probable reserves were included (\$36.7 million for 2019).

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.

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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 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.

December 2019

At 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 related to the CMS CGU 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 7% discount rate (equivalent to 10% pre-tax), 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

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March 2020

At March 31, 2020, Southern determined that the significant decrease in oil prices in March 2020 and Southern’s market capitalization falling below the net assets of the Company were indications of impairment. Southern estimated the recoverable amount of all CGUs at March 31, 2020 and determined that the carrying value of the CMS and the Smackover (“SO”) CGUs exceeded their recoverable amounts. A non-cash impairment charge of \$10.3 million related to the CMS CGU and \$0.1 million related to the SO CGU 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 7% discount rate (equivalent to 10% pre-tax). 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

December 2020

At December 31, 2020, Southern viewed the increase in the forward benchmark commodity prices as an indication of impairment reversal. Southern estimated the recoverable amount of all CGUs at December 31, 2020. Southern determined that the recoverable amounts of the CMS and SO CGUs exceeded their carrying values. A non-cash impairment recovery of \$4.5 million related to the CMS CGU and \$0.1 million related to the SO CGU 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 7% discount rate (equivalent to 10% pre-tax), based on reserves estimated by Southern’s independent reserves evaluator at December 31, 2020.

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

Period Ending	West Texas Intermediate (\$US/bbl)	Henry Hub (\$US/MMBtu)	FX (USD/CAD)
12-31-2021	46.88	2.80	0.769
12-31-2022	51.14	2.86	0.769
12-31-2023	54.83	2.93	0.773
12-31-2024	56.48	2.99	0.773
12-31-2025	57.62	3.05	0.773
12-31-2026	58.77	3.11	0.773
12-31-2027	59.94	3.17	0.773
12-31-2028	61.14	3.24	0.773
12-31-2029	62.36	3.30	0.773
12-31-2030	63.61	3.37	0.773

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, March 31, 2020 and December 31, 2020, 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 3 "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. The table below shows the estimated impact of a 1% increase in the assumed discount rate or a 5% decrease in commodity price forecasts to the estimated recoverable amounts as at December 31, 2020:

CGU	1% increase in discount rate	5% decrease in commodity forecast
Central Mississippi	\$ (1,091)	\$ (2,432)
Smackover	(9)	(38)

5. Right-of-Use Assets and Lease Liabilities

Right-of-use Assets

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

	Total
Carrying value as at December 31, 2019	\$ 735
Depreciation	(383)
Carrying value as at December 31, 2020	\$ 352

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Lease Liabilities

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

		Total
As at December 31, 2019	\$	763
Interest expense		18
Lease payments		(400)
As at December 31, 2020	\$	381

At December 31, 2020, Southern had future commitments relating to lease liabilities as follows:

		Total
Less than 1 year	\$	392
1 – 3 years		-
Total undiscounted future lease payments	\$	392
Amounts representing interest		(11)
Present value of net lease payments	\$	381
Less current portion of lease liabilities		(381)
Non-current portion of lease liabilities	\$	-

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

6. Decommissioning Provisions

The Company's decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites, 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 December 31, 2020 (December 31, 2019 - \$6.2 million), which have been discounted using a risk-free interest rate of 1.0% at December 31, 2020 (December 31, 2019 – 1.7% to 1.9%). 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.

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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,	
	2020	2019
Balance, beginning of year	\$ 5,276	\$ 6,740
Acquisitions	-	210
Changes in estimates	198	20
Liabilities settled	(6)	(23)
Property disposal	-	(1,420)
Accretion expense	82	35
Effect of foreign exchange rate changes	(111)	(286)
Balance, end of year	\$ 5,439	\$ 5,276
Long term liability	\$ 5,439	\$ 5,276

7. Bank Debt

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

	Year ended December 31,	
	2020	2019
Current Portion Senior Secured Bank Credit Facility	\$ 16,806	\$ -
Long Term Portion Senior Secured Bank Credit Facility	-	18,183
Unamortized transaction costs	(27)	-
Total Bank Debt	\$ 16,779	\$ 18,183

Southern Energy Corp. (Delaware), one of the wholly-owned subsidiaries of Southern, held the existing Credit Facility at December 31, 2020. The Credit Facility is secured against the oil and gas properties of Southern. At December 31, 2020, Southern had US\$13.2 million (\$16.8 million) drawn on the Credit Facility, which has been paid down by US\$550 thousand (\$697 thousand) subsequent to year end, as described above in Note 2 "Going Concern".

On July 20, 2020, as part of a bank redetermination, Southern entered into the 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 Facility and a US\$4.8 million 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 is reduced by the greater of US\$100 thousand or Bank EBITDAX less maintenance capital expenditures.
- Upon execution of the Amended Credit Facility, Southern made a principal repayment 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:

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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

On October 6, 2020, Southern entered into the first amendment to the Amended Credit Agreement (the "First Amendment"). The First Amendment postponed the next redetermination and the maturity of the Non-Conforming Facility to November 1, 2020.

On November 24, 2020, Southern entered into the second amendment to the Amended Credit Agreement (the "Second Amendment"). The Second Amendment included: (a) a waiver for the non compliance of the leverage ratio financial covenant as at September 30, 2020; (b) an extension of the maturity of the Non-Conforming Facility to February 1, 2021, which is the same date as the maturity of the Conforming Facility; and (c) redetermined the borrowing base limit at US\$13.3 million (US\$8.5 million Conforming Facility and US\$4.8 million Non-Conforming Facility) to account for debt repayments made during the year.

With the execution of the Amended Credit Agreement, interest on borrowings under the Credit Facility is determined by reference to the Eurodollar Rate, and includes a minimum rate of 1.0%, plus a margin that ranges from 2.5% to 3.5%. As part of the Amended Credit Agreement, Southern will pay an additional 0.5% per annum on balances that exceed the Conforming Facility. The Second Amendment includes an additional 2.0% per annum on all outstanding borrowings. During the year ended December 31, 2020, the effective interest rate, excluding commitment and other fees, was 4.7%.

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 December 31, 2020:

Financial covenant	Limit	As at Dec 31, 2020	As at Dec 31, 2019
Leverage ratio (Debt / Bank EBITDAX)	Maximum 3.75	4.72	3.32
Interest coverage ratio (Bank EBITDAX / Cash Interest)	Minimum 2.75	4.26	4.86
Current ratio (Current Assets / Current Liabilities)	Minimum 1.00	1.63	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.

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- 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.

Southern was not in compliance with the leverage ratio covenant of its Credit Facility for the period ended September 30, 2020 and December 31, 2020 but has obtained written waivers for non-compliance of these covenant violations from its lender.

8. Convertible Debentures

	Number of Convertible Debentures	Liability Component (\$000s)	Equity Component (\$000s)
Balance at December 31, 2018	-	\$ -	\$ -
Issuance of convertible debentures	8,069	7,099	970
Issue costs	-	(692)	(95)
Deferred income tax liability	-	-	(210)
Accretion of discount	-	241	-
Balance at December 31, 2019	8,069	6,648	665
Issuance of convertible debentures	320	320	-
Accretion of discount	-	500	-
Balance at December 31, 2020	8,389	\$ 7,468	\$ 665

On June 14, 2019, Southern closed the sale of 8,069 convertible debentures (the “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”). 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.

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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 accrued interest payment due on December 31, 2020, was settled in-kind through the issuance of 320 additional Debentures. The additional Debentures have the same terms as the outstanding Debentures, with interest beginning to accrue on the additional Debentures on December 31, 2020.

The fair value of the Debentures at December 31, 2020 was \$8.4 million.

9. Shareholders' Equity

Share capital

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

The following table reflects the Company's outstanding common shares at December 31, 2020 and 2019:

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

On April 22, 2021, Southern initiated a non-brokered private placement of up to 150.0 million units of the Company (the "Units") at a price of \$0.04 per Unit, for aggregate gross proceeds of up to \$6.0 million. Each Unit is comprised of one Common Share and one Common Share purchase warrant (a "Unit Warrant").

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Warrants

As at December 31, 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

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, 2019	19,400,000	\$ 0.10
Balance at December 31, 2020	19,400,000	\$ 0.10

Exercise price	Outstanding and Exercisable	
	Number of stock options	Weighted average remaining life (years)
\$ 0.10	19,400,000	3.5
\$ 0.10	19,400,000	3.5

Southern recognized \$282 thousand of share-based compensation expense relating to stock options during 2020 (\$212 thousand in 2019). There were no options granted in 2020. The fair value of the June 20, 2019 stock option grant was estimated on the date of grant using the Black-Scholes pricing model with the following assumptions:

Risk free interest rate	2019 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

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10. Loss Per Share

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

	Year ended December 31,	
	2020	2019
Net (loss) earnings from:		
Continuing operations	\$ (11,310)	\$ (10,896)
Discontinued operations	-	23
Net loss	<u>\$ (11,310)</u>	<u>\$ (10,873)</u>
Basic and diluted – weighted average number of shares	<u>220,770,279</u>	<u>215,207,150</u>
Basic and diluted (loss) earnings per share from:		
Continuing operations	\$ (0.05)	\$ (0.05)
Discontinued operations	0.00	0.00
Net loss per share	<u>\$ (0.05)</u>	<u>\$ (0.05)</u>

The calculation of diluted loss per share for the year ended December 31, 2020 and 2019 excludes the effect of all outstanding share options and warrants as they are anti-dilutive.

11. 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 24.0% as a result of the following:

	Year ended December 31,	
	2020	2019
Net (loss) before tax	\$ (11,310)	\$ (11,083)
Statutory income tax rate	24.0%	26.5%
Expected income tax (recovery)	<u>(2,714)</u>	<u>(2,937)</u>
Effect on income tax of:		
Tax rate changes – opening balance	-	804
Tax rate changes – current year movement	(89)	186
Unrecognized deferred tax asset	2,569	1,705
Prior year true-up adjustment	143	193
Issuance of convertible debentures	-	(210)
Other	91	49
Deferred tax recovery	<u>\$ -</u>	<u>\$ (210)</u>

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Notes to the Consolidated Financial Statements

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

	Year ended December 31,	
	2020	2019
Property and equipment and exploration	\$ 11,042	\$ 8,291
ROU asset	(352)	(735)
Decommissioning provisions	5,439	98
Unamortized share issuance costs	285	879
Lease obligation	381	763
Convertible debenture – debt portion	(921)	(693)
Convertible debenture – equity portion	(95)	(95)
Derivative liability	465	-
Non-capital losses	28,297	21,624
Total	\$ 44,541	\$ 30,132

Non-capital tax losses of approximately \$16.9 million at December 31, 2020 (December 31, 2019 - \$15.7 million) will expire in future years ranging from 2027 – 2040. US net operating losses of approximately \$11.4 million at December 31, 2020 (approximately \$6.6 million at December 31, 2019) can be carried forward unlimited years.

12. 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, 2020:

Natural Gas	Volume	Pricing (US\$)
<i>Fixed Price Swap</i>		
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

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Financial Derivative Contracts Financial Statement Recognition

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

Comprised of:	Year ended December 31,	
	2020	2019
Current derivative asset	\$ 8	\$ 819
Current derivative liability	(473)	(105)
Non-current derivative asset	-	120
Non-current derivative liability	-	(14)
Net fair value of contracts, end of year	\$ (465)	\$ 820

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

	Year ended December 31,	
	2020	2019
Realized gain on derivatives	\$ (2,396)	\$ (319)
Unrealized loss (gain) on derivatives	1,399	(705)
Gain on derivative instruments	\$ (997)	\$ (1,024)

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

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

Cash and cash equivalents

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

Accounts receivable and other

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

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

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Southern had no provision for doubtful accounts as at December 31, 2020 or 2019. During the year ended December 31, 2020, four third party purchasers each marketed more than 10% of the Company's oil and natural gas revenue.

	Year ended December 31,	
	2020	2019
Accrued receivables	\$ 1,788	\$ 2,031
Accounts receivable – joint venture	355	368
Total accounts receivable and other	\$ 2,143	\$ 2,399
0 to 30 days	\$ 1,842	\$ 2,146
31 to 60 days	26	33
61 to 90 days	22	17
Greater than 90 days	253	203
Total accounts receivable	\$ 2,143	\$ 2,399

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 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,	
	2020	2019
Accrued payables	\$ 1,408	\$ 1,782
Accounts payables – trade	833	868
Royalties payables	5,555	5,589
Convertible debentures (face value)	8,389	8,069
Bank loan (excluding unamortized transaction costs)	16,806	18,183
Total	\$ 32,991	\$ 34,491

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.

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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, 2020, Southern has not entered any foreign exchange derivative contracts or fixed interest rate contracts. As at December 31, 2020, a 10% change in future commodity prices applied against these contracts would have a \$0.6 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, 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 \$0.2 million.

13. Royalties Payable

As at December 31, 2020, Southern had \$5.6 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 royalty payable account is made up of balances due to approximately 5,500 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, 2020, Southern removed \$5.6 million (December 31, 2019 - \$5.1 million) in royalty liabilities as they pertain to balances prior to December 31, 2019 (prior to December 31, 2018).

14. 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:

Commodity sales from production, by product	Year ended December 31,	
	2020	2019
Crude oil	\$ 2,706	\$ 5,356
Natural gas liquids	181	499
Natural gas	11,035	13,274
Total Oil and Natural Gas Sales	\$ 13,922	\$ 19,129

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Notes to the Consolidated Financial Statements

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15. Financing

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

	Year ended December 31,	
	2020	2019
Bank debt interest	\$ 885	\$ 981
Convertible debentures interest	647	355
Accretion	732	270
Interest on lease obligations	18	59
Total Financing Expenses	\$ 2,282	\$ 1,665

16. Supplemental Cash Flow Information

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

	Year ended December 31,	
	2020	2019
Changes in:		
Accounts receivable and other	\$ 256	\$ 11,345
Deposits and prepaid expenses	67	(71)
Accounts payables	(409)	(335)
Royalties payable	(34)	522
Foreign exchange	99	94
Changes in non-cash working capital	\$ (21)	\$ 11,555
 Related to:		
Operating activities	\$ (92)	\$ (269)
Investing activities	(26)	152
Financing activities	97	11,672
	\$ (21)	\$ 11,555
 Interest paid	\$ 1,389	\$ 1,334
Income taxes paid	\$ -	\$ -

17. 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 will continue to take a cautionary approach to future expenditures in order to ensure capital preservation.

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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.

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.

18. Related Party Disclosures

There were no related party transactions in 2020 or 2019.

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, 2020 and 2019:

	Year ended December 31,	
	2020	2019
Short-term benefits	\$ 1,184	\$ 1,375
Long-term benefits	224	168
Total	\$ 1,408	\$ 1,543

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.

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19. 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,	
	2020	2019
Revenues		
Petroleum and natural gas revenue	\$ -	\$ 334
Royalties	-	(54)
	-	280
Expenses		
Production and operating	-	42
Transportation	-	19
Exploration evaluation	-	1
Depletion, depreciation and amortization	-	39
Finance	-	6
General and administrative	-	150
	-	257
Net earnings from discontinued operations	\$ -	\$ 23

Cash Flows from Discontinued Operations

	Year ended December 31,	
	2020	2019
Cash from operating activities	\$ -	\$ 14
Cash from investing activities	-	484
Cash from financing activities	-	-
Net Cash Flows	\$ -	\$ 498

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 5 – Right-of-Use Assets and Lease Liabilities for additional information on Southern’s lease liabilities.