PERPETUAL
ENERGY

2018

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S REPORT

The consolidated financial statements of Perpetual Energy Inc. ("the Company") are the responsibility of Management and have been approved by the Board of Directors of the Company. These consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the Interpretations of the IFRS Interpretations Committee.

The consolidated financial statements are audited and have been prepared using accounting policies in accordance with IFRS. The preparation of Management's Discussion and Analysis is based on the Company's financial results which have been prepared in accordance with IFRS. It compares the Company's financial performance in 2018 to 2017 and should be read in conjunction with the consolidated financial statements and accompanying notes.

Management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. Management believes that the system of internal controls that have been designed and maintained at the Company provide reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements. The internal accounting control process includes Management's communication to employees of policies which govern ethical business conduct.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Board of Directors has appointed an Audit Committee consisting of unrelated, non-management directors which meets at least four times during the year with Management and independently with the external auditors and as a group to review any significant accounting, internal control and auditing matters in accordance with the terms of the charter of the Audit Committee as set out in the Annual Information Form. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis before the consolidated financial statements are submitted to the Board of Directors for approval. The external auditors have free access to the Audit Committee without obtaining prior Management approval.

With respect to the external auditors, the Audit Committee approves the terms of engagement and reviews the annual audit plan, the Auditors' Report and results of the audit. It also recommends to the Board of Directors the firm of external auditors to be appointed by the shareholders.

The independent external auditors, KPMG LLP, have been appointed by the Board of Directors on behalf of the shareholders to express an opinion as to whether the consolidated financial statements present fairly, in all material respects, the Company's financial position, financial performance and cash flows in accordance with IFRS. The report of KPMG LLP outlines the scope of their examination and their opinion on the consolidated financial statements.

/s/ Susan L. Riddell Rose	*/s/ W. Mark Schweitzer*
Susan L. Riddell Rose	**W. Mark Schweitzer**
President &	Vice President, Finance &
Chief Executive Officer	Chief Financial Officer

March 27, 2019

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Perpetual Energy Inc.

Opinion

We have audited the consolidated financial statements of Perpetual Energy Inc. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017
- the consolidated statements of loss and comprehensive loss for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

Hereinafter referred to as the "financial statements".

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated 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. Our responsibilities under those standards are further described in the *"Auditors' Responsibilities for the Audit of the Financial Statements"* section of our auditors' 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.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditors' report thereon, included in a document entitled "2018 Annual Results".

Our opinion on the financial statements does not cover the other information and we do not and will 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 and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions and the information, other than the financial statements and the auditors' report thereon, included in a document entitled "2018 Annual Results" as at the date of this auditors' 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 the auditors' 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.

Auditors' 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 auditors' 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 generally accepted auditing standards 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 the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, 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 auditors' 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 auditors' 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.

- 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.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and 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 auditors' report is Gregory Ronald Caldwell.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada

March 27, 2019

PERPETUAL ENERGY INC.
Consolidated Statements of Financial Position

As at	December 31, 2018	December 31, 2017
(Cdn$ thousands)		
Assets		
Current assets		
Accounts receivable (note 21)	**$ 8,931**	$ 14,069
Tourmaline Oil Corp. ("TOU") share investment (note 4)	**28,132**	37,985
Prepaid expenses and deposits	**1,138**	937
Fair value of derivatives (note 21)	**7,012**	1,585
	45,213	54,576
Fair value of derivatives (note 21)	**3,906**	1,506
Property, plant and equipment (note 5)	**260,091**	262,784
Exploration and evaluation (note 6)	**25,879**	46,704
Total assets	**$ 335,089**	$ 365,570
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 16,612**	$ 31,410
TOU share margin demand loan (note 9)	**14,109**	18,406
Revolving bank debt (note 10)	**42,561**	–
Senior notes (note 12)	**14,536**	–
Fair value of derivatives (note 21)	**1,405**	7,885
Gas over bitumen royalty financing (note 13)	**680**	1,152
Provisions (note 14)	**1,933**	2,580
	91,836	61,433
Fair value of derivatives (note 21)	**894**	–
Revolving bank debt (note 10)	**–**	31,581
Term loan (note 11)	**43,729**	43,233
Senior notes (note 12)	**17,344**	31,680
Gas over bitumen royalty financing (note 13)	**472**	1,587
Provisions (note 14)	**39,431**	36,105
Total liabilities	**193,706**	205,619
Equity		
Share capital (note 16)	**1,338,369**	1,336,838
Warrants (note 16)	**923**	923
Contributed surplus	**44,433**	44,152
Deficit	**(1,242,342)**	(1,221,962)
Total equity	**141,383**	159,951
Total liabilities and equity	**$ 335,089**	$ 365,570

Contingencies (note 7)
Capital management (note 8)
Contractual obligations and lease commitments (note 15)

See accompanying notes to the consolidated financial statements.

/s/ Robert A. Maitland	*/s/ Geoffrey C. Merritt*
Robert A. Maitland	**Geoffrey C. Merritt**
Director	Director

PERPETUAL ENERGY INC.
Consolidated Statements of Loss and Comprehensive Loss

For the year ended		**December 31, 2018**		December 31 2017
(*Cdn$ thousands, except per share amounts*)				
Revenue				
Oil and natural gas (note 18)	**$**	**86,128**	$	81,722
Royalties		**(10,594)**		(11,973)
		75,534		69,749
Change in fair value of derivatives (note 21)		**8,818**		5,855
Gas over bitumen royalty credit and other		**1,046**		2,460
		85,398		78,064
Expenses				
Production and operating		**19,229**		16,299
Transportation		**6,068**		5,051
Exploration and evaluation (note 6)		**2,212**		3,283
General and administrative		**13,630**		11,943
Share-based payments (note 17)		**2,573**		4,310
Depletion and depreciation (note 5)		**34,946**		33,436
Loss on dispositions (notes 5a)		**223**		9,450
Impairment (note 6)		**7,200**		–
Net loss from operating activities		**(683)**		(5,708)
Finance expenses (note 19)		**(10,122)**		(7,592)
Change in fair value of TOU share investment (note 4)		**(9,575)**		(22,671)
Net loss and comprehensive loss		**(20,380)**		(35,971)
Loss per share (note 16)				
Basic	**$**	**(0.34)**	$	(0.62)
Diluted	**$**	**(0.34)**	$	(0.62)

See accompanying notes to the consolidated financial statements.

PERPETUAL ENERGY INC.
Consolidated Statements of Changes in Equity

	Share capital *(thousands)*	Share capital *($thousands)*	Warrants	Contributed surplus	Deficit	Total equity
(Cdn$ thousands, except share amounts)						
Balance at December 31, 2017	59,263	$ 1,336,838	$ 923	$ 44,152	$ (1,221,962)	$ 159,951
Net loss	–	–	–	–	(20,380)	(20,380)
Common shares issued (note 16)	1,191	1,200	–	(1,192)	–	8
Change in shares held in trust (note 16)	(214)	331	–	(656)	–	(325)
Share-based payments (note 17)	–	–	–	2,129	–	2,129
Balance at December 31, 2018	**60,240**	**$1,338,369**	**$ 923**	**$ 44,433**	**$ (1,242,342)**	**$ 141,383**

	Share capital *(thousands)*	Share capital *($thousands)*	Warrants	Contributed surplus	Deficit	Total equity
(Cdn$ thousands, except share amounts)						
Balance at December 31, 2016	53,421	$ 1,325,705	$ –	$ 42,999	$ (1,185,991)	$ 182,713
Net loss	–	–	–	–	(35,971)	(35,971)
Common shares and warrants issued (note 16)	6,030	10,696	923	(1,720)	–	9,899
Change in shares held in trust (note 16)	(188)	437	–	(1,437)	–	(1,000)
Share-based payments (note 17)	–	–	–	4,310	–	4,310
Balance at December 31, 2017	**59,263**	**$ 1,336,838**	**$ 923**	**$ 44,152**	**$ (1,221,962)**	**$ 159,951**

See accompanying notes to the consolidated financial statements.

PERPETUAL ENERGY INC.
Consolidated Statements of Cash Flows

For the year ended	December 31, 2018	December 31, 2017
(*Cdn$ thousands*)		
Cash flows from (used in) operating activities		
Net loss	**$ (20,380)**	$ (35,971)
Adjustments to add (deduct) non-cash items:		
Unrealized change in fair value of derivatives (note 21)	**(5,747)**	(2,550)
Exploration and evaluation (note 6)	**1,485**	2,602
Share based payments (note 17)	**2,573**	4,310
Depletion and depreciation (note 5)	**34,946**	33,436
Loss on dispositions (note 5a)	**223**	9,450
Impairment (note 6)	**7,200**	–
Finance expenses (income) (note 19)	**1,415**	(412)
Change in fair value of TOU share investment (note 4)	**9,575**	22,671
Expenditures on decommissioning obligations (note 14a)	**(1,969)**	(2,336)
Payments of restructuring costs (note 14b)	**(337)**	(2,550)
Change in non-cash working capital (note 20)	**2,541**	(9,480)
Net cash flows from (used in) operating activities	**31,525**	19,170
Cash flows from (used in) financing activities		
Change in revolving bank debt, net of issue costs (note 10)	**10,778**	31,523
Change in TOU share margin demand loan, net of issue costs (note 9)	**(4,425)**	(22,983)
Change in term loan, net of issue costs (note 11)	**–**	43,639
Change in senior notes, net of issue costs (note 12)	**–**	(28,580)
Change in gas over bitumen royalty financing (note 13)	**(1,135)**	(2,421)
Common shares and warrants issued (note 16)	**8**	9,130
Shares purchased and held in trust (note 16)	**(325)**	(1,000)
Change in non-cash working capital (note 20)	**–**	(216)
Net cash flows from (used in) financing activities	**4,901**	29,092
Cash flows from (used in) investing activities		
Capital expenditures	**(26,888)**	(73,035)
Acquisitions (note 5 and note 6)	**(1,871)**	(432)
Net proceeds (payments) on dispositions (note 5a)	**4,901**	(2,665)
Proceeds on sale of TOU share investment (note 4)	**278**	5,687
Restricted cash	**–**	2,000
Change in non-cash working capital (note 20)	**(12,846)**	17,306
Net cash flows from (used in) investing activities	**(36,426)**	(51,139)
Change in cash and cash equivalents	**–**	(2,877)
Cash and cash equivalents, beginning of year	**–**	2,877
Cash and cash equivalents, end of year	**$ –**	$ –

See accompanying notes to the consolidated financial statements.

1. REPORTING ENTITY

Perpetual Energy Inc. ("Perpetual" or the "Company") is a Canadian corporation engaged in the exploration, development and marketing of oil and natural gas based energy in Alberta, Canada. The Company operates a diversified asset portfolio that includes liquids-rich natural gas, shallow natural gas and conventional heavy oil producing properties, as well as undeveloped bitumen resource properties.

The address of the Company's registered office is 3200, 605 – 5 Avenue S.W., Calgary, Alberta, T2P 3H5.

The consolidated financial statements of the Company are comprised of the accounts of Perpetual Energy Inc. and its wholly owned subsidiaries: Perpetual Operating Corp. and Perpetual Operating Trust, which are incorporated in Canada.

2. BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements of the Company were approved and authorized for issue by the Board of Directors on March 27, 2019.

The consolidated financial statements have been prepared on a historical cost basis except for the TOU share investment (note 4), gas over bitumen royalty financing (note 13) and derivative financial instruments (note 21) that have been measured at fair value. The consolidated financial statements are presented in Canadian dollars which is the functional currency of the Company and its subsidiaries.

a) Critical accounting judgments and significant estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, revenue and expenses. These judgments, estimates, and assumptions are continuously evaluated and are based on management's experience and all relevant information available to the Company at the time of financial statement preparation. As the effect of future events cannot be determined with certainty, the actual results may differ from estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the critical judgments and significant estimates made by management are described below and in the relevant notes to the financial statements.

b) Critical accounting judgments:

The following are the critical judgments that management has made in the process of applying the Company's accounting policies. These judgments have the most significant effect on the amounts reported in the consolidated financial statements.

i) Cash-generating units ("CGUs")

The Company allocates its oil and natural gas properties to CGUs, identified as the smallest group of assets that generate cash inflows independent of the cash inflows of other assets or groups of assets. Determination of the CGUs is subject to management's judgement and is based on geographical proximity, shared infrastructure, and similar exposure to market risk.

ii) Identification of impairment indicators

Judgment is required to assess when indicators of impairment or reversals exist and whether calculation of the recoverable amount of an asset is necessary. Management considers internal and external sources of information including oil and natural gas prices, expected production volumes, anticipated recoverable quantities of proved and probable reserves and rates used to discount future cash flow estimates. Judgement is required to assess these factors when determining if the carrying amount of an asset is impaired, or in the case of a previously impaired asset, whether the carrying amount of the asset has been restored.

iii) Componentization

For the purposes of depletion, the Company allocates its oil and natural assets to components with similar useful lives and depletion methods. The grouping of assets is subject to management's judgment and is performed on the basis of geographical proximity and similar reserve life. The Company's oil and gas assets are depleted on a unit-of-production basis.

iv) Exploration and evaluation expenditures

Costs associated with acquiring oil and natural gas licenses and exploratory drilling are accumulated as exploration and evaluation ("E&E") assets pending determination of technical feasibility and commercial viability. Establishment of technical feasibility and commercial viability is subject to judgment and involves management's review of project economics, resource quantities, expected production techniques, production costs and required capital expenditures to confirm continued intent to develop and extract the underlying resources. Management uses the establishment of commercial reserves within the exploration area as the basis for determining technical feasibility and commercial viability. Upon determination of commercial reserves, E&E assets attributable to those reserves are tested for impairment and reclassified from E&E assets to a separate category within property, plant and equipment referred to as oil and natural gas properties.

v) Joint arrangements

Judgment is required to determine when the Company has joint control over an arrangement. In establishing joint control, the Company considers whether unanimous consent is required to direct the activities that significantly affect the returns of the arrangement, such as the capital and operating activities of the arrangement.

Once joint control has been established, judgment is also required to classify a joint arrangement. The type of joint arrangement is determined through analysis of the rights and obligations arising from the arrangement by considering its structure, legal form, and terms agreed upon by the parties sharing control. An arrangement where the controlling parties have rights to the assets and revenues, and obligations for the liabilities and expenses, is classified as a joint operation. Arrangements where the controlling parties have rights to the net assets of the arrangement are classified as joint ventures.

vi) Deferred taxes

Deferred tax assets (if any) are recognized only to the extent it is considered probable that those assets will be recoverable. This involves an assessment of when those deferred tax assets are likely to reverse and judgment as to whether there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

vii) Revenue – principal versus agent:

When determining if the Company acted as a principal or as an agent in transactions, management determines if the Company obtains control of the product. As part of this assessment, management considered if the Company obtained control of the goods or services more than momentarily, in advance of transferring those goods or services to the customer. In this assessment, the Company considered indicators that it controlled the goods or services, including whether the Company was primarily responsible for the goods and services, whether the Company had inventory risk and whether the Company had discretion in establishing prices for the goods or services. Where control was indicated, the Company has been determined to be the principal. In other cases, the Company has been determined to be the agent.

c) Significant estimates:

The following assumptions represent the key sources of estimation uncertainty at the end of the reporting period. As future confirming events occur the actual results may differ from estimated amounts.

i) Reserves

The Company uses estimates of natural gas, oil, and natural gas liquids ("NGL" or "liquids") reserves in the calculation of depletion and also for value in use ("VIU") and fair value less costs of disposal ("FVLCD") calculations of non-financial assets. Estimates of economically recoverable natural gas, oil, and NGL reserves and their future net cash flows are based upon a number of variable factors and assumptions, such as geological, geophysical, and engineering assessments of hydrocarbons in place on the Company's lands, historical production from the properties, production rates, future commodity prices, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by government agencies and future operating costs. The geological, economic and technical factors used to estimate reserves may change from period to period. Changes in the reported reserves could have a material impact on the carrying values of the Company's oil and natural gas properties, the calculation of depletion and depreciation and the timing of decommissioning expenditures.

Reserve engineers are engaged at least annually to independently evaluate or review the recoverable quantities and estimated future cash flows from the Company's interest in oil and natural gas properties. This evaluation of proved and proved plus probable reserves is prepared in accordance with the reserve definitions contained in National Instrument 51-101 and the COGE Handbook.

ii) Provisions for decommissioning obligations

Decommissioning, abandonment, and site reclamation expenditures for production facilities, wells, and pipelines are expected to be incurred by the Company over many years into the future. Amounts recorded for decommissioning obligations and the associated accretion are calculated based on estimates of the extent and timing of decommissioning activities, future site remediation regulations and technologies, inflation, liability specific discount rates and related cash flows. The provision represents management's best estimate of the present value of the future abandonment and reclamation costs required. Actual abandonment and reclamation costs could be materially different from estimated amounts.

iii) Derivative financial instruments

Derivatives are measured at fair value on each reporting date. Fair value is the price that would be received or paid to exit the position as of the measurement date. The Company uses estimated external forward market price curves available at period end and the contracted volumes over the contracted term to determine the fair value of each contract. Changes in market pricing between period end and settlement of the derivative contracts could have a material impact on financial results related to the derivatives.

iv) Gas over bitumen royalty financing

The gas over bitumen royalty financing is measured at fair value on each reporting date. Fair value is the price that would be paid to exit the position as of the measurement date.

The fair value of the gas over bitumen royalty financing is estimated by discounting future cash payments based on the forecasted Alberta gas reference price multiplied by the contracted deemed volume. Changes in market pricing between period end and settlement could have a material impact on financial results related to the gas over bitumen royalty financing.

v) Share-based payments

Share options, deferred share options, and long term incentive awards issued by the Company are recorded at fair value using the Black Scholes option pricing model. In assessing the fair value of share options and deferred share options, estimates have to be made regarding the expected volatility in share price, option life, dividend yield, risk-free rate and estimated forfeitures at the initial grant date.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these annual consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

a) Basis of consolidation

i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable are considered. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii) Business combinations

The acquisition method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued, and liabilities incurred or assumed at the date of acquisition of control. Identifiable assets acquired, and liabilities assumed in a business combination are measured at their recognized amounts (generally fair value) at the acquisition date. The excess of the cost of acquisition over the recognized amounts of the identifiable assets acquired and liabilities assumed is recorded as goodwill. If the cost of acquisition is less than the recognized amount of the net assets acquired, the difference is recognized as a bargain purchase gain in net loss.

iii) Jointly owned assets

Many of the Company's oil and natural gas activities involve jointly owned assets which are not conducted through a separate entity. The consolidated financial statements include the Company's proportionate share of these jointly owned assets, liabilities, revenues and expenses.

iv) Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

b) Accounting pronouncements adopted

IFRS 9 "Financial Instruments"

Effective January 1, 2018, the Company adopted IFRS 9, "Financial Instruments", which replaced IAS 39, "Financial Instruments: Recognition and Measurement". The Company applied the new standard retrospectively and, in accordance with the transitional provisions, comparative figures have not been restated. The adoption of IFRS 9 did not have a material impact on the Company's consolidated financial statements.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The previous IAS 39 categories of held to maturity, loans and receivables, and available for sale have been eliminated. The classification of financial assets under IFRS 9 is generally based on the contractual cash flow characteristics and the Company's business model for managing the financial asset. Additionally, embedded derivatives are not separated if the host contract is a financial asset within the scope of IFRS 9. Instead, the entire hybrid contract is assessed for classification and measurement.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' ("ECL") model. The new impairment model applies to all financial instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive, discounted at an approximation of the original effective interest rate. Under IFRS 9, credit losses will be recognized earlier than under IAS 39.

On January 1, 2018, the Company:

- Identified the business model used to manage its financial assets and classified its financial instruments into the appropriate IFRS 9 category; and
- Applied the ECL model to financial assets measured at amortized cost.

The classification and measurement of financial instruments under IFRS 9 did not result in any adjustment to the Company's opening retained earnings as at January 1, 2018. In addition, the application of the ECL model to financial assets classified as measured at amortized cost did not result in any adjustment on transition.

The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 as at January 1, 2018 for each class of the Company's financial assets and financial liabilities. The Company has no contract assets or debt investments measured at FVOCI.

	Measurement Category	
Financial Instrument	**IAS 39**	**IFRS 9**
Accounts receivable	Loans and receivables at amortized cost	Amortized cost
TOU share investment	Financial assets at FVTPL	FVTPL
Fair value of derivative assets and liabilities	Financial assets and liabilities at FVTPL	FVTPL
Accounts payable and accrued liabilities	Financial liabilities at amortized cost	Amortized cost
TOU share margin demand loan	Financial liabilities at amortized cost	Amortized cost
Revolving bank debt	Financial liabilities at amortized cost	Amortized cost
Term loan	Financial liabilities at amortized cost	Amortized cost
Senior notes	Financial liabilities at amortized cost	Amortized cost
Gas over bitumen royalty financing	Financial liabilities at FVTPL	FVTPL

In addition, IFRS 9 provides a hedge accounting model that is more in line with risk management activities. The Company does not currently apply hedge accounting to its derivative contracts nor does it intend to apply hedge accounting under IFRS 9 and as such, derivatives will continue to be FVTPL. In addition, the Company will continue to account for its forward physical delivery fixed price sales contracts as derivative financial instruments.

IFRS 15 "Revenue from Contracts with Customers"

The Company adopted IFRS 15 "Revenue from Contracts with Customers" with a date of initial application of January 1, 2018 as detailed in note 18, using the cumulative effect method. Under this method, prior year financial statements have not been restated and the cumulative effect on net loss of the application of IFRS 15 to revenue contracts in progress at January 1, 2018 was nil. The Company's management reviewed its revenue streams and major contracts with customers using the IFRS 15 five step model and there were no material changes to net loss or timing of oil and natural gas revenue recognized.

Under IFRS 15, revenue from the sale of commodities is calculated by reference to consideration specified in contracts with customers and recognized when control of the product is transferred to the buyer. The nature of each of its performance obligations, including roles of third parties and partners, are evaluated to determine if the Company acts as a principal, and therefore recognizes revenue on a gross basis, or as an agent, and therefore recognizes revenue on a net basis. The Company acts as the principal when it controls the product delivered before the control passes to its customer.

c) Recent pronouncements issued and not yet adopted

The Company will be required to adopt the following new standards and amendments as issued by the IASB. The Company has evaluated the impact on the consolidated financial statements as discussed below.

i) In January 2016, the IASB issued the complete IFRS 16 Leases ("IFRS 16") which replaces IAS 17, Leases. The effective date of IFRS 16 is for annual periods beginning on or after January 1, 2019 and early adoption is permitted. Under IFRS 16, a single recognition and measurement model will apply for lessees which will require recognition of assets and liabilities for most leases. The Company is in the final stages of analyzing identified contracts, developing business and accounting processes, making applicable changes to the Company's internal controls and calculating the impact that the adoption of this standard will have on its financial statements. Perpetual has elected to use the modified retrospective approach upon adoption and elected to apply the optional exemptions for short-term and low-value leases. The actual full impact of adoption will depend on the Company's incremental borrowing rate, lease liabilities, and practical expedients applied. However, the Company anticipates that the most significant impact of adopting IFRS 16 will be the recognition of the right-of-use ("ROU") assets and corresponding lease liabilities on its operating leases for office space.

Upon adoption of IFRS 16, the Company will recognize ROU assets and lease liabilities for all leases identified except for optional exemptions taken. The lease liability will be measured at the present value of the remaining lease payments, discounted using the

Company's incremental borrowing rate as at January 1, 2019. The ROU asset will be measured at the amount equal to the lease liability on January 1, 2019 with no impact on retained earnings.

Adoption of IFRS 16 will also result in an increase to depletion, depreciation and amortization expense due to the recognition of the ROU assets, increase in interest and financing charges, and a decrease to general and administrative and production and operating expenses, as applicable. Cash flow from operating activities will increase as a result of the decrease in general and administrative and production and operating expenses, as applicable, partially offset by interest and financing charges. Cash flow from financing activities will decrease due to the addition of principal payments included in lease payments for former operating leases.

d) Financial instruments

Financial instruments comprise accounts receivable, TOU share investment, fair value of derivative assets and liabilities, TOU share margin demand loan, accounts payable and accrued liabilities, revolving bank debt, term loan, gas over bitumen royalty financing, and senior notes. These financial instruments are recognized initially at fair value, net of any directly attributable transaction costs.

i) Classification and measurement of financial assets:

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at fair value through profit or loss ("FVTPL"):

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt investment is measured at fair value through other comprehensive income ("FVOCI") if it meets both of the following conditions and is not designated at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in other comprehensive income ("OCI"). This election is made on an investment-by-investment basis.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

A financial asset (unless it is a trade receivable without a significant financing component that is initially measured at the transaction price) is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition.

The following accounting policies apply to the subsequent measurement of financial assets:

a) Financial assets at FVTPL

These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognized in profit or loss.

b) Financial assets at amortized cost

These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss.

c) Debt investments at FVOCI

These assets are subsequently measured at fair value. Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment are recognized in profit or loss. Other net gains and losses are recognized in OCI. On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss.

ii) Classification and measurement of financial liabilities:

Financial liabilities are classified and measured at amortized cost or FVTPL. A financial liability is classified at FVTPL if it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognized in profit or loss. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in profit or loss. Any gain or loss on derecognition is also recognized in profit or loss.

The Company has classified accounts receivable, TOU share margin demand loan, accounts payable and accrued liabilities, revolving bank debt, term loan and senior notes as amortized cost. The TOU share investment and gas over bitumen royalty financing have been classified as FVTPL.

iii) Derivative assets and liabilities

The Company has entered into certain financial derivative contracts to manage the exposure to market risks from fluctuations in commodity prices and currency rates. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Company considers all commodity and currency contracts to be economic hedges. As a result, all financial derivative contracts are designated as fair value through profit or loss and recorded as derivatives on the statement of financial position at fair value. Changes in the fair value of the commodity price and currency rate derivatives are recognized in net loss.

The Company has accounted for its forward physical delivery fixed-price sales contracts as derivative financial instruments. Accordingly, such forward physical delivery fixed-price sales contracts are designated as fair value through profit or loss and recorded as derivatives on the statement of financial position at fair value.

Transaction costs on derivatives are recognized in net loss when incurred.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in net loss.

iv) Share capital and warrants

Incremental costs directly attributable to the issue of common shares, warrants and share options are recognized as a deduction from equity, net of any tax effects.

e) Property, plant and equipment

i) Production and development costs

Items of property, plant and equipment, which include oil and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. The initial cost of property, plant and equipment includes the purchase price or construction costs, costs that are directly attributable to bringing the asset into commercial operations, the initial estimate of decommissioning costs, and borrowing costs for qualifying assets.

Significant parts of an item of property, plant and equipment, including oil and natural gas properties, that have different useful lives from the life of the area or facility in general, are accounted for as separate items.

Gains and losses on disposition of an item of property, plant and equipment, including oil and natural gas properties, are determined by comparing the proceeds from disposition with the carrying amount of property, plant and equipment and are recognized in net loss. The carrying amount of any replaced or disposed item of property, plant and equipment is derecognized.

ii) Subsequent costs

Costs incurred after the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as property, plant and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in net loss as incurred. Such capitalized property, plant and equipment generally represent costs incurred in developing proved and/or probable reserves and bringing on or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The costs of the day-to-day servicing of property, plant and equipment are recognized in net loss as incurred.

iii) Depletion and depreciation

The net carrying amount of development or production assets is depleted using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves, considering estimated future development costs necessary to bring those reserves into production and future decommissioning costs. Future development and decommissioning costs are estimated considering the level of development required to produce the reserves. The future development cost estimates are reviewed by independent reserve engineers at least annually.

Costs associated with office furniture, information technology, and leasehold improvements are carried at cost and are depreciated on a straight-line basis over a period ranging from one to three years.

Depreciation methods, useful lives and residual values are reviewed at each period end date for all classes of property, plant, and equipment.

f) Exploration and evaluation ("E&E") expenditures

Pre-license costs, geological and geophysical costs and lease rentals of undeveloped properties are recognized in net loss as incurred.

E&E costs, consisting of the costs of acquiring oil and natural gas licenses, are capitalized initially as E&E assets according to the nature of the assets acquired. Costs associated with drilling exploratory wells in an undeveloped area are capitalized as E&E costs. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability. When technical feasibility and commercial viability are determined, the relevant expenditure is transferred to property, plant and equipment as oil and natural gas properties, after impairment is assessed and any applicable impairment loss is recognized in net loss.

The Company's E&E assets consist of undeveloped land, exploratory drilling assets, and bitumen evaluation assets. Gains and losses on disposition of E&E assets are determined by comparing the proceeds from disposition with the carrying amount and are recognized in net loss.

g) Assets held for sale

Non-current assets, or disposal groups consisting of assets and liabilities ("disposal groups"), are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. Assets and liabilities qualifying as held for sale must be available for immediate sale in their present condition subject to normal terms and conditions, and their sale must be highly probable.

Non-current assets, or disposal groups, are measured at the lower of the carrying amount and FVLCD, with impairments recognized in net loss. Non-current assets or disposal groups held for sale are presented in current assets and liabilities within the statement of financial position. Assets held for sale are not subject to depletion and depreciation.

h) Impairment

i) Financial assets

The Company has elected to measure loss allowances for trade receivables and contract assets at an amount equal to lifetime expected credit losses ("ECLs"). The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk.

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

Loss allowances for financial assets are deducted from the gross carrying amount of the assets. Impairment losses on financial assets are presented under "other expenses" in the statement of loss and comprehensive loss.

ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than E&E assets, are reviewed at each period end date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas properties, and if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together at a CGU level. The recoverable amount of an asset or a CGU is determined based on the higher of its FVLCD and its VIU. FVLCD is determined as the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. The FVLCD of oil and gas properties is generally determined as the net present value of estimated future cash flows expected to arise from the continued use of the CGU and its eventual disposition, using assumptions that an independent market participant may take into account. These cash flows are discounted by an appropriate discount rate which would be applied by such a market participant to arrive at a net present value of the CGU. In determining VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. VIU is generally determined by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

E&E assets are assessed for impairment both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to oil and natural gas properties in property, plant and equipment. If a test is required as a result of triggering facts and circumstances, the Company considers whether the combined recoverable amount of oil and natural gas properties and E&E assets at the total company level is sufficient to cover the combined carrying value of E&E and oil and natural gas assets.

An impairment is recognized if the carrying value of a CGU exceeds the recoverable amount for that CGU. The Company determines the recoverable amount by using the greater of FVLCD and the VIU. VIU is generally the future cash flows expected to be derived from production of proven and probable reserves estimated by the Company's third-party reserve evaluators. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amount of assets in the unit (group of units) on a pro rata basis. Impairment losses are recognized in net income or loss.

In respect of other assets, impairment losses recognized in prior years are assessed at each period end date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. 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, if no impairment loss had been recognized.

i) Share-based payments

Fixed equity awards granted under the equity-settled share-based payment plans and agreements are measured at grant-date fair value. Fair values are determined by means of an option pricing model using the exercise price of the equity instrument granted, the share price at the grant date, the expected life of the grant based on the vesting date and expiry date, estimates of volatility and interest rates over its expected life. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest.

The costs of the equity-settled share-based payments are recognized within general and administrative expense, production and operating expense or property, plant and equipment to the extent they are directly attributable, with a corresponding increase in contributed surplus over the vesting period. Upon exercise or settlement of an equity-based instrument, consideration received, and associated amounts previously recorded in contributed surplus are recorded to share capital.

Certain awards granted under the performance share rights plan and agreement may be settled in cash, in common shares of the Company, or a combination thereof at the discretion of the Board of Directors. Fixed value, equity-settled awards are accounted for as cash-settled share-based payment transactions and are expensed into profit and loss over the unit vesting period with an associated accumulation in liabilities, as a variable number of equity units will be required to settle the liability. At each reporting date commencing with the grant date, the fair value of the liability is re-measured with any changes in fair value recognized in profit or loss for the period. The revaluation continues until settlement.

j) Shares held in trust

The Company has share-based payment plans whereby employees may be entitled to receive shares of the Company purchased on the open market by a trustee controlled by the Company. Shares acquired and held by the trustee for the benefit of employees that have not yet been issued to employees, are a separate category of equity that are presented net of common shares outstanding in share capital on the statement of financial position (note 16). The balance of shares held in trust represents the cumulative cost of shares held by the trustee. Upon the issuance of shares to the employee, the amount attributable to an employee is deducted from the balance of shares held in trust and removed from contributed surplus.

k) Provisions

Provisions are recognized when the Company has a current legal or constructive obligation as a result of a past event, which can be reliably estimated, and will require the outflow of economic resources to settle the obligation. A non-current provision is determined using the estimated future cash flows discounted at a rate that reflects current market conditions and liability specific risks.

i) Decommissioning obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. A provision is recorded for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's estimate of the extent and timing of expenditures required to settle the obligation at the statement of financial position date, using a risk-free interest rate not adjusted for credit risk. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time, changes in the timing and estimate of future cash flows underlying the obligation and changes in the risk-free rate. The accretion of the provision due to the passage of time is recognized in net loss whereas changes in the provision arising from changes in estimated cash flows or changes in the risk-free rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

ii) Restructuring provisions

Restructuring provisions are recognized when the Company has developed a detailed formal plan for restructuring and has announced the plan's main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are not associated with the ongoing activities of the Company.

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

A provision for employee downsizing costs is recognized when the Company has announced the restructuring plan to those affected by it, and can no longer withdraw the offer of those benefits. The provision is measured on initial recognition at the Company's best estimate of the expenditure required to settle the obligation.

l) Revenue

Revenue from the sale of crude oil, natural gas and NGL is recognized based on the consideration specified in contracts with customers. The Company recognizes revenue when control of the product transfers to the buyer and collection is reasonably assured. This is generally at the point in time when the customer obtains legal title to the product which is when it is physically transferred to the pipelines or other transportation method agreed upon.

Revenues from processing activities are recognized over time as processing occurs and are generally billed monthly.

Royalty income is recognized monthly as it accrues in accordance with the terms of the royalty agreements.

When allocating the transaction price realized in contracts with multiple performance obligations, management is required to make estimates of the prices at which the Company would sell the product separately to customers. The Company does not currently have any contracts with multiple performance obligations.

The Company's entitlement to gas over bitumen royalty adjustments under the Natural Gas Royalty Regulation (2004) with respect to foregone production (deemed production) from gas wells shut-in for the benefit of bitumen producers in the Athabasca oil sands area, is recognized as gas over bitumen revenue in the period that deemed production occurs, to the extent that the revenue is expected to be recovered through gas Crown royalties otherwise payable.

m) Income tax

Income tax expense comprises current and deferred components. Income tax expense is recognized in net loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the period end date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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 period end 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 tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each period end date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

n) Loss per share amounts

Basic income or loss per share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the period. For the dilutive net income per share calculation, the weighted average number of shares outstanding is adjusted for the potential number of shares which may have a dilutive effect on net income.

Diluted income per share is calculated giving effect to the potential dilution that would occur if outstanding warrants, share options, restricted rights, performance share units, or deferred compensation awards were exercised or converted into common shares. The weighted average number of diluted shares is calculated in accordance with the treasury stock method for warrants, share options, restricted rights, deferred shares, deferred options, and performance share units. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the average market price.

4. TOURMALINE OIL CORP. ("TOU") SHARE INVESTMENT

	December 31, 2018		December 31, 2017	
	Shares *(thousands)*	**Amount *($thousands)***	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of year	**$ 1,667**	**$ 37,985**	$ 1,847	$ 66,343
Sold	**(11)**	**(278)**	(180)	(5,687)
Unrealized change in fair value	**–**	**(9,575)**	–	(22,671)
Balance, end of year	**$ 1,656**	**$ 28,132**	$ 1,667	$ 37,985

TOU is engaged in the acquisition, exploration, development and production of oil and natural gas properties situated in western Canada. TOU shares are listed on the Toronto Stock Exchange under the trading symbol "TOU".

At December 31, 2018, the Company held 1.66 million (December 31, 2017 – 1.67 million) TOU shares with a fair market value of $28.1 million (December 31, 2017 – $38.0 million) based on a December 31, 2018 closing price of $16.98 per share (December 31, 2017 – $22.78). Net loss for the year ended December 31, 2018 includes an unrealized loss of $9.6 million (2017 – unrealized loss of $22.7 million) representing the change in fair value of TOU shares held during the year.

At December 31, 2018, 1.66 million TOU shares (December 31, 2017 – 1.67 million TOU shares) were pledged as security for the TOU share margin demand loan (note 9).

At December 31, 2018, a $1.00 per share change in the market price of TOU shares would change the Company's net loss by $1.7 million.

5. PROPERTY, PLANT AND EQUIPMENT ("PP&E")

	Oil and Gas Properties	Corporate Assets	Total
Cost			
December 31, 2016	$ 611,046	$ 7,182	$ 618,228
Additions	71,008	79	71,087
Acquisitions	233	–	233
Change in decommissioning obligations related to PP&E (note 14a)	5,022	–	5,022
Dispositions	(8)	–	(8)
December 31, 2017	$ 687,301	$ 7,261	$ 694,562
Additions	26,073	353	26,426
Acquisitions	1,261	–	1,261
Change in decommissioning obligations related to PP&E (note 14a)	4,644	–	4,644
Transfers from exploration and evaluation (note 6)	770	–	770
Dispositions	(848)	–	(848)
December 31, 2018	**$ 719,201**	**$ 7,614**	**$ 726,815**
Accumulated depletion, depreciation and impairment losses			
December 31, 2016	$ (391,439)	$ (6,903)	$ (398,342)
Depletion and depreciation	(33,226)	(210)	(33,436)
December 31, 2017	$ (424,665)	$ (7,113)	$ (431,778)
Depletion and depreciation	(34,804)	(142)	(34,946)
December 31, 2018	**$ (459,469)**	**$ (7,255)**	**$ (466,724)**
Carrying amount			
December 31, 2017	$ 262,636	$ 148	$ 262,784
December 31, 2018	**$ 259,732**	**$ 359**	**$ 260,091**

At December 31, 2018, property, plant and equipment included $1.9 million (December 31, 2017 – $1.3 million) of costs currently not subject to depletion.

For the year ended December 31, 2018, $0.7 million (December 31, 2017 – $2.3 million) of direct general and administrative expenses were capitalized. Future development costs for the year ended December 31, 2018 of $346.0 million (December 31, 2017 – $348.4 million) were included in the depletion calculation.

a) Dispositions

Proceeds (payments) on dispositions

	December 31, 2018	December 31, 2017
Proceeds on dispositions of oil and gas properties	**$ 13,441**	$ 910
Proceeds on retained shallow gas marketing arrangements	**–**	869
Payments on retained shallow gas marketing arrangements	**(8,540)**	(3,769)
Payments on sale of gas storage facility investment	**–**	(675)
Net proceeds (payments) on dispositions	**$ 4,901**	$ (2,665)

Gain (loss) on dispositions

	December 31, 2018	December 31, 2017
Proceeds on dispositions of oil and gas properties	**$ 13,441**	$ 910
Carrying amount of PP&E disposed (note 5)	**(848)**	(8)
Carrying amount of E&E disposed (note 6)	**(12,442)**	–
Carrying amount of ARO disposed (note 14a)	**500**	–
Gain on disposition of oil and gas properties	**651**	902
Realized gain (loss) on retained shallow gas marketing arrangements	**(874)**	869
Unrealized loss on retained shallow gas marketing arrangements	**–**	(10,546)
Loss on disposition of gas storage facility investment	**–**	(675)
Gain (loss) on dispositions	**$ (223)**	$ (9,450)

Dispositions during the year ended December 31, 2018 included the sale of non-core royalty interests and exploration and evaluation properties for gross proceeds of $13.4 million (2017 – $0.9 million), resulting in a net gain on oil and gas properties of $0.7 million (2017 – $0.9 million). Included in the gain was $0.5 million (2017 – nil) in liabilities related to decommissioning obligations associated with the non-core properties that were sold.

On October 1, 2016, Perpetual sold mature, high cost shallow gas assets in east central and northeast Alberta for minimal cash consideration and the transfer of $128.0 million of associated decommissioning obligations to the purchaser (the "Shallow Gas Disposition"). The Shallow Gas Disposition also included marketing arrangements whereby the Company provided floor price protection at $2.58/GJ to the purchaser and retained price exposure to the extent average monthly AECO prices exceed $2.81/GJ on 33,611 GJ/d through to August 31, 2018. The Company entered into marketing arrangements prior to closing to fix the cost of the floor price protection through to March 31, 2018. Realized and unrealized gains and losses on these marketing arrangements have been recognized as adjustments to gains/losses on dispositions and included as cash flows from investing activities in the consolidated statement of cash flows. For the year ended December 31, 2018, the Company made total payments of $8.5 million (2017 – $3.8 million) related to the floor price protection obligation. The related marketing arrangements have since expired.

On May 25, 2016, the Company disposed of its 30% partnership interest in the WGS LP gas storage facility located in Alberta, Canada for net cash proceeds of $19.7 million, resulting in a net loss on disposition of $6.2 million. In 2017, the Company recorded a negative adjustment to the disposition of the gas storage facility of $0.7 million.

b) Cash-generating units, impairments and reversals

For the year ended December 31, 2018, the Company assessed impairment indicators for the Company's CGUs. There was no impairment or impairment reversals recognized in 2018 (2017 – nil).

6. EXPLORATION AND EVALUATION ("E&E")

	December 31, 2018	December 31, 2017
Balance, beginning of year	**$ 46,704**	$ 47,159
Additions	**462**	1,948
Acquisitions	**610**	199
Dispositions	**(12,442)**	–
Impairments	**(7,200)**	–
Non-cash exploration and evaluation expense	**(1,485)**	(2,602)
Transfers to property, plant and equipment	**(770)**	–
Balance, end of year	**$ 25,879**	$ 46,704

During the year ended December 31, 2018, $0.7 million (2017 – $0.7 million) in costs were charged directly to E&E expense in net loss.

Impairment of E&E assets

E&E assets are tested for impairment when there is an indication that a particular E&E project may be impaired. Examples of indicators of impairment include the decision to no longer pursue exploration and development of undeveloped lands, an expiry of the rights to explore in an area, or failure to receive regulatory approval. In addition, E&E assets are assessed for impairment upon their reclassification to producing assets (oil and natural gas interests in PP&E). In assessing the impairment of E&E assets, the carrying value of the assets are compared to their estimated recoverable amount and the impairment of E&E assets is recognized in the consolidated statements of loss and comprehensive loss.

In the third quarter of 2018, Perpetual determined that no additional capital would be spent to hold existing leases on its Waskahigan Duvernay prospect. As a result, the carrying value of the Waskahigan area was written down to its estimated recoverable amount of $1.3 million, resulting in an impairment charge of $7.2 million (2017 – nil) on E&E assets. On November 1, 2018, Perpetual sold its Waskahigan area interests to a third party for cash consideration of $1.3 million and retained a 1% gross overriding royalty on undeveloped land sold to maintain exposure to future drilling conducted by the purchaser.

7. CONTINGENCIES

On August 3, 2018, the Company received a Statement of Claim that was filed by PricewaterhouseCoopers Inc. LIT ("PwC"), in its capacity as trustee in bankruptcy of Sequoia, with the Alberta Court of Queen's Bench (the "Court"), against Perpetual. The claim relates to an over two-year-old transaction when, on October 1, 2016, Perpetual closed the Shallow Gas Disposition to an arm's length third party at fair market value at the time after an extensive and lengthy marketing, due diligence and negotiation process. This transaction was one of several completed by Sequoia. Sequoia assigned itself into bankruptcy on March 23, 2018. PwC is seeking an order from the Court to either set this transaction aside or declare it void, or damages of approximately $217 million. On August 27, 2018, Perpetual filed a Statement of Defence and Application for Summary Dismissal with the Court in response to the Statement of Claim. All allegations made by PwC have been denied and an application to the Court to dismiss all claims has been made on the basis that there is no merit to any of them. Perpetual's Application for Summary Dismissal was heard during the fourth quarter of 2018 (the "Sequoia Litigation"). The Court's decision is anticipated to be received in the second quarter of 2019. Management expects that the Company is more likely than not to be successful in defending against the claim such that no damages will be awarded against it, and therefore, no amounts have been accrued as a liability in these financial statements.

8. CAPITAL MANAGEMENT

Perpetual's strategy includes maintaining a strong capital base to retain investor, creditor and market confidence to support the execution of its business plans. The Company manages its capital structure and adjusts its capital spending in light of changes in economic conditions such as depressed commodity prices, declines in the fair value of the Company's investment in TOU shares, and the risk characteristics of its underlying oil and natural gas assets. The Company considers its capital structure to include share capital, senior notes, the term loan, revolving bank debt, TOU share margin demand loan and net working capital, with value and liquidity enhanced through the ownership of TOU shares. To manage its capital structure and available liquidity, the Company may from time to time issue equity or debt securities, sell its TOU shares or other assets and adjust its capital spending to manage current and projected debt levels. The Company will continue to regularly assess changes to its capital structure and repayment alternatives, with considerations for both short term liquidity and longer term financial sustainability.

On November 7, 2018, the revolving bank debt Borrowing Limit was reduced from $60 million to $55 million by the Company's lenders with the next Borrowing Limit redetermination scheduled on or prior to May 31, 2019 (See note 10). The term of the revolving bank debt was not extended and was set to mature on May 31, 2019.

On March 27, 2019, the $55 million Borrowing Limit was confirmed by the Company's lenders and the maturity was extended to November 30, 2020. The Credit Facility will revolve until May 31, 2020 and may be extended for a further 364-day period subject to approval by the Company's lenders. If not extended, the Credit Facility will cease to revolve, and all outstanding advances will be repayable on November 30, 2020. The next Borrowing Limit redetermination is scheduled on or prior to November 30, 2019. As part of the lender's agreement to extend the term of the Credit Facility, a significant shareholder has undertaken to support, if requested by the Company, the refinancing of the $14.6 million unsecured senior notes that mature on July 23, 2019 (the "2019 Senior Notes").

Perpetual had available liquidity at December 31, 2018 of $22.7 million, comprised of an unutilized Borrowing Limit of $8.7 million and the market value of its Tourmaline share investment net of the associated margin demand loan, of $14.0 million.

Perpetual is considering options to repay the 2019 Senior Notes including arranging replacement financing and the sale of its Tourmaline shares or other assets.

9. TOU SHARE MARGIN DEMAND LOAN

At December 31, 2018, Perpetual had a $14.1 million non-revolving TOU share margin demand loan secured by 1.66 million TOU shares. On July 31, 2018, the TOU share margin demand loan was entered into with the same lender, having similar terms and conditions as the previous TOU share margin term loan. Interest rates are based on 90-day Banker's Acceptance rates plus 1.25%. Perpetual may repay a portion or the entirety of the loan at any time. Any repayment is a permanent reduction to the loan. Perpetual is required to maintain a lending ratio of less than 55% of the TOU share margin demand loan compared to the market value of the pledged TOU shares (the "Lending Ratio"). If at any time the Lending Ratio exceeds 55%, Perpetual is obligated to pay down the TOU share margin demand loan to restore the Lending Ratio to 40%. As at December 31, 2018, the Lending Ratio was 50% of the closing market value of the pledged TOU shares. The TOU share margin demand loan is designated as a financial liability for accounting purposes and measured at amortized cost.

During the year ended December 31, 2018, Perpetual sold 10,700 TOU shares at $25.97 per share and used the proceeds of $0.3 million to partially repay the TOU share margin demand loan. Additional loan repayments of $4.0 million were made during 2018.

The effective interest rate on the TOU share margin demand loan as at December 31, 2018 was 3.6%. For the year ended December 31, 2018, if interest rates changed by 1%, with all other variables held constant, the annual impact on interest expense and net loss would be $0.1 million.

In addition to the Lending Ratio requirements, the TOU share margin demand loan is subject to customary non-financial covenants. The Company was in compliance with all TOU share margin demand loan covenants as at December 31, 2018.

10. REVOLVING BANK DEBT

As at December 31, 2018, the Company's reserve-based credit facility had a borrowing limit (the "Borrowing Limit") of $55.0 million (December 31, 2017 – $65.0 million) (the "Credit Facility") under which $42.6 million was drawn (December 31, 2017 – $31.6 million) and $3.7 million of letters of credit had been issued (December 31, 2017 – $3.9 million). Borrowings under the Credit Facility bear interest at its lenders' prime rate or Banker's Acceptance rates, plus applicable margins and standby fees. The applicable Banker's Acceptance rates range between 2.0% and 4.5%.

On November 7, 2018, the Borrowing Limit on the Credit Facility was reduced from $60.0 million to $55.0 million, following a reduction in the Borrowing Limit on May 7, 2018 from $65.0 million to $60.0 million, with the next semi-annual Borrowing Limit redetermination scheduled on or prior to May 31, 2019. As the Credit Facility matures in less than one year, it has been presented as a current liability on the consolidated statement of financial position as at December 31, 2018. On March 27, 2019, the $55.0 million Borrowing Limit was confirmed by the Company's lenders and the maturity was extended to November 30, 2020 (note 8).

The Credit Facility is secured by general, first lien security agreements covering all of the Company's assets, with the exception of the TOU shares that have been pledged as security for the TOU share margin demand loan (note 9) and certain lands pledged to the gas over bitumen royalty financing counterparty (note 13). The Credit Facility also contains provisions which restrict the Company's ability to repay second lien and unsecured debt and to pay dividends on or repurchase its common shares. At December 31, 2018, the Credit Facility was not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

The effective interest rate on the Credit Facility at December 31, 2018 was 6.2%. For the year ended December 31, 2018, if interest rates changed by 1% with all other variables held constant, the annual impact on interest expense and net loss would be $0.4 million.

11. TERM LOAN

On March 14, 2017, Perpetual entered into the term loan which included the issuance of 5.4 million warrants to purchase common shares (note 16c).

	December 31, 2018	December 31, 2017
Balance, beginning of year	**$ 43,233**	$ –
Principal amount of term loan issued	**–**	45,000
Value allocated to warrants issued	**–**	(769)
Issue costs	**–**	(1,361)
Amortization of issue costs	**496**	363
Balance, end of year	**$ 43,729**	$ 43,233

The term loan matures on March 14, 2021 and bears interest at 8.1% per annum with semi-annual interest payments due June 30 and December 31 of each year. The $45.0 million principal amount of the term loan was borrowed by an initial $35.0 million draw on March 14, 2017, and a second $10.0 million draw on October 5, 2017. Amounts borrowed under the term loan that are repaid are not available for re-borrowing. The Company may not repay the term loan prior to the second anniversary thereof, except with payment of a make whole premium.

The term loan has a cross-default provision with the revolving bank debt and contains substantially similar provisions and covenants as the revolving bank debt (note 10). The term loan is secured by a general security agreement over all present and future property of the Company and its subsidiaries on a second priority basis, subordinate only to liens securing loans under the revolving bank debt, TOU shares secured in favor of the TOU share margin demand loan lenders, and certain lands pledged to the gas over bitumen royalty financing counterparty.

At December 31, 2018, the term loan was not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

12. SENIOR NOTES

			December 31, 2018		December 31, 2017	
	Maturity date	**Interest rate**	**Principal**	**Carrying Amount**	Principal	Carrying amount
2019 senior notes	July 23, 2019	8.75%	**14,572**	**14,536**	14,572	14,476
2022 senior notes	January 23, 2022	8.75%(1)	**17,918**	**17,344**	17,918	17,204
Total senior notes			**$ 32,490**	**$ 31,880**	$ 32,490	$ 31,680

(1) Annual interest rate through to January 23, 2018 was 9.75% and 8.75% thereafter.

On January 23, 2017, the Company exchanged $8.4 million and $9.0 million aggregate principal amount of 2018 Senior Notes and 2019 Senior Notes respectively for $17.4 million new 8.75% senior notes with a maturity date of January 23, 2022 (the "2022 Senior Notes"). Included in the exchange were $3.7 million 2018 Senior Notes and $4.3 million 2019 Senior Notes held by directors and officers of the Company or entities controlled by them. The 2022 Senior Notes bear a fixed rate of 9.75% for the first year of issuance and 8.75% thereafter, and have identical covenants and rights as the 2019 Senior Notes.

On April 17, 2017, Perpetual completed the early redemption of $27.1 million aggregate outstanding principal amount of its 8.75% senior notes maturing March 15, 2018 and exchanged the remaining $0.5 million for an equal amount of 2022 Senior Notes. In mid-July 2017, $1.0 million face value of 2019 Senior Notes were purchased at 96.75% of face value and retired.

The senior notes are direct senior unsecured obligations of the Company, ranking pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company. At any time prior to three years before the senior note maturity date, the Company can redeem up to 35% of the principal amount of the senior notes at a premium to face value. Within three years of maturity, the Company may redeem up to 100% of the senior notes at a premium to face value. Within one year of maturity, the Company may redeem up to 100% of the senior notes at the principal amount.

The senior notes have a cross-default provision with the Company's Credit Facility (note 10). In addition, the senior notes indenture contains restrictions on certain payments including dividends, retirement of subordinated debt and stock repurchases. The permitted amount of any restricted payment is limited to:

i) To the extent the Company's Consolidated Debt (defined as the sum of the period end balance of revolving bank debt, the term loan, TOU share margin demand loan and gas over bitumen royalty financing) to trailing twelve months income before interest, taxes, depletion and depreciation and non-cash items ("TTM EBITDA") is less than 3.0 to 1.0 (the "Consolidated Debt Ratio"), the sum of 50% of TTM EBITDA from January 1, 2011 to the end of the most recently completed fiscal quarter plus 100% of the fair market value of any equity contributions made to the Company during that period less the sum of all restricted payments during that period; and

ii) To the extent the Company's Consolidated Debt Ratio is greater than or equal to 3.0 to 1.0 pro forma for the proposed restricted payment, $50 million plus 100% of the fair market value of any equity contributions made to the Company.

At December 31, 2018 the senior notes are presented net of $0.6 million in issue costs which are amortized using a weighted average effective interest rate of 9.6%.

At December 31, 2018, other than the restricted payment covenants noted above, the senior notes were not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

13. GAS OVER BITUMEN ROYALTY FINANCING

	December 31, 2018	December 31, 2017
Balance, beginning of year	**$ 2,739**	$ 8,344
Payments	**(1,135)**	(2,421)
Change in fair value	**(452)**	(3,184)
Balance, end of year	**$ 1,152**	$ 2,739
Gas over bitumen royalty financing – current	**$ 680**	$ 1,152
Gas over bitumen royalty financing – non-current	**472**	1,587
Total gas over bitumen royalty financing	**$ 1,152**	$ 2,739

In 2014, the Company entered into an agreement whereby the Company received cash proceeds of $21.3 million in exchange for an obligation to make a monthly cash payment equivalent to a portion of the Company's monthly gas over bitumen royalty adjustment entitlements until June 2021 when the entitlements expire. Monthly payments under the arrangement are due on the 25th day following the entitlement month.

At the inception of the arrangement, the estimated future payments were determined using the same formula as the Company's monthly gas over bitumen royalty adjustment entitlements under the Alberta Natural Gas Royalty Regulation based on a January 1, 2014 forecast for the Alberta gas reference price ("base cash payment"). In the event that the actual Alberta gas reference price for a month causes the actual monthly cash payment under the arrangement to differ from the base cash payment, the Company is required to (a) pay 65% of any increase from the base cash payment, or (b) deduct 100% of any decrease from the base cash payment. Security for the gas over bitumen royalty financing is provided by an interest in certain lands of the Company and by the Company's entitlement to future gas over bitumen royalty adjustments.

The gas over bitumen royalty financing is a hybrid financial instrument comprised of a debt host with an embedded derivative related to indexation of the future cash payments to changes in the future Alberta gas reference price. The Company has designated the gas over bitumen royalty financing as a financial liability which is measured at fair value through profit and loss. For the year ended December 31, 2018, an unrealized gain of $0.5 million (December 31, 2017 – unrealized gain of $3.2 million) is included in finance expense related to the change in fair value of the gas over bitumen royalty financing.

As at December 31, 2018, if future natural gas prices changed by $0.25 per GJ with all other variables held constant, the fair value of the gas over bitumen royalty financing and after tax net loss for the period would change by $0.4 million (December 31, 2017 – $0.6 million).

14. PROVISIONS

	December 31, 2018	December 31, 2017
Decommissioning obligations	**$ 40,097**	$ 37,081
Restructuring costs	**1,267**	1,604
Total provisions	**$ 41,364**	$ 38,685
Provisions – current	**$ 1,933**	$ 2,580
Provisions – non-current	**39,431**	36,105
Total provisions	**$ 41,364**	$ 38,685

a) Decommissioning obligations

The following significant assumptions were used to estimate decommissioning obligations:

	December 31, 2018	December 31, 2017
Obligations incurred, including acquisitions	**$ 632**	$ 1,554
Change in risk free interest rate	**(287)**	2,339
Change in estimates	**4,299**	1,129
Change in decommissioning obligations related to PP&E (note 5)	**4,644**	5022
Obligations settled	**(1,969)**	(2,336)
Obligations disposed (note 5a)	**(500)**	–
Accretion (note 19)	**841**	775
Change in decommissioning obligations	**3,016**	3,461
Balance, beginning of year	**37,081**	33,620
Balance, end of year	**$ 40,097**	$ 37,081
Decommissioning obligations – current	**$ 1,731**	$ 2,243
Decommissioning obligations – non-current	**38,366**	34,838
Total decommissioning obligations	**$ 40,097**	$ 37,081

Total future decommissioning obligations are 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 periods.

The Company adjusts the decommissioning obligations at each period end date for changes in the risk-free interest rate. Accretion is calculated on the adjusted balance after considering additions and dispositions to property, plant, and equipment. Decommissioning obligations are also adjusted for revisions to future cost estimates and the estimated timing of costs to be incurred in future years.

The following significant assumptions were used to estimate the Company's decommissioning obligations:

	December 31, 2018	December 31, 2017
Undiscounted obligations	**$ 41,171**	$ 38,525
Average risk-free rate	**2.2%**	2.3%
Inflation rate	**2.0%**	2.0%
Expected timing of settling obligations	**1 to 25 years**	1 to 25 years

b) Restructuring costs

	Employee downsizing costs	**Onerous office lease contract**	**Lease inducement**	**Total**
Balance, December 31, 2016	$ 1,606	$ 2,548	$ –	$ 4,154
Transferred	–	(1,764)	1,764	–
Payments	(1,606)	(650)	(294)	(2,550)
Balance, December 31, 2017	–	134	1,470	1,604
Payments	–	(134)	(203)	(337)
Balance, December 31, 2018	–	–	1,267	1,267
Restructuring costs – current	–	–	202	202
Restructuring costs – non-current	–	–	1,065	1,065
Total restructuring costs	$ –	$ –	$ 1,267	$ 1,267

As a result of the Company's disposition of the Shallow Gas Properties on October 1, 2016 (note 5a), the Company's employee base and office space requirements were significantly reduced. Restructuring costs of $5.6 million were expensed in 2016, comprised of employee downsizing costs of $2.9 million and office lease obligations associated with surplus office space of $2.7 million.

On February 1, 2017, Perpetual entered a new head office lease at its current location for a 98-month period expiring March 31, 2025. As consideration, the landlord agreed to release the Company from all obligations under its remaining lease term to March 31, 2018 and remaining payments of $1.8 million were deferred over the 98-month term of the new lease. This lease inducement was comprised of $1.8 million related to surplus office space which was recognized as an onerous contract provision in 2016. The lease inducement is being amortized on a straight-line basis over the 98-month term of the new head office lease.

Payments made in 2018 with respect to restructuring costs were $0.3 million (2017 – $2.6 million).

15. CONTRACTUAL OBLIGATIONS AND LEASE COMMITMENTS

The Company's minimum contractual obligations and lease commitments over the next five years and thereafter excluding estimated interest payments, at December 31, 2018 are as follows:

	2019	**2020**	**2021**	**2022**	**2023 and thereafter**	**Total**
Contractual obligations						
Accounts payable and accrued liabilities	16,612	–	–	–	–	16,612
Fair value of derivative liabilities	2,299	–	–	–	–	2,299
TOU share margin demand loan – principal	14,144	–	–	–	–	14,144
Revolving bank debt – principal	42,689	–	–	–	–	42,689
Term loan – principal	–	–	45,000	–	–	45,000
Senior notes – principal	14,572	–	–	17,918	–	32,490
Gas over bitumen royalty financing	680	286	186	–	–	1,152
Pipeline transportation commitments	3,774	2,639	1,008	1,008	1,008	9,437
	94,770	**2,925**	**46,194**	**18,926**	**1,008**	**163,823**
Lease commitments						
Office leases	962	994	1,055	1,070	2,408	6,489
Vehicle leases	110	85	25	–	–	220
Other leases	38	38	38	19	–	133
Total	**95,880**	**4,042**	**47,312**	**20,015**	**3,416**	**170,665**

16. SHARE CAPITAL

	December 31, 2018		December 31, 2017	
	Shares *(thousands)*	**Amount *($thousands)***	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of year	**59,263**	**$ 1,336,838**	53,421	$ 1,325,705
Issued pursuant to private placement (c)	**–**	**–**	5,143	8,968
Issued pursuant to share-based payment plans	**1,191**	**1,200**	887	1,728
Shares held in trust purchases (b)	**(633)**	**(325)**	(708)	(1,000)
Shares held in trust issued (b)	**419**	**656**	520	1,437
Balance, end of year	**60,240**	**$ 1,338,369**	59,263	$ 1,336,838

a) Authorized

Authorized capital consists of an unlimited number of common shares.

b) Shares held in trust

The Company has compensation agreements in place with employees whereby they may be entitled to receive shares of the Company purchased on the open market by a trustee (note 17d). Share capital is presented net of the number and cumulative purchase cost of shares held by the trustee that have not yet been issued to employees. As at December 31, 2018, 0.7 million shares were held in trust (December 31, 2017 – 0.4 million).

c) Private placement of common shares and warrants

On March 14, 2017, the Company completed a private placement of 5.1 million equity units for gross proceeds of $9.0 million, of which $8.9 million was allocated to share capital and $0.1 million to warrants. Each equity unit consisted of 1 common share and 0.21 warrants resulting in the issuance of 5,143,000 shares and 1,080,000 warrants. Included in the issuance were 1.6 million common shares and 0.4 million warrants issued to directors and officers of the Company or entities controlled by them, for proceeds of $2.9 million. In addition, 5.4 million warrants valued at $0.8 million were issued in connection with the term loan (note 11). Each warrant entitles the holder to acquire common shares on a one for one basis at an exercise price of $2.34 per share prior to expiry on March 14, 2020. If the volume weighted average price of Perpetual's common shares is greater than $2.34 per share for 60 consecutive calendar days, Perpetual has the option to require warrant holders to exercise all or any portion of the warrants prior to March 14, 2020.

The following summarizes the common shares and warrants issued:

	December 31, 2018			
	Shares (*thousands*)	**Amount (*$thousands*)**	**Warrants (*thousands*)**	**Amount (*$thousands*)**
Balance, December 31, 2016	–	$ –	–	$ –
Issued through term loan	–	–	5,400	769
Issued through private placement	5,143	8,968	1,080	154
Balance, December 31, 2017 and 2018	**5,143**	**$ 8,968**	**6,480**	**$ 923**

d) Per share information

For the year ended	**December 31, 2018**	December 31, 2017
(*thousands, except per share amounts*)		
Net loss – basic	**$ (20,380)**	$ (35,971)
Effect of dilutive securities	**–**	–
Net loss – diluted	**$ (20,380)**	$ (35,971)
Weighted average shares		
Issued common shares	**60,496**	58,370
Effect of shares held in trust	**(457)**	(353)
Weighted average common shares outstanding – basic and diluted	**60,039**	58,017
Net loss per share – basic and diluted	**$ (0.34)**	$ (0.62)

In computing per share amounts for the year ended December 31, 2018, 18.8 million potentially issuable common shares through the share-based compensation plans and warrants (2017 – 15.7 million) were excluded as the Corporation had a net loss.

17. SHARE-BASED PAYMENTS

The components of share-based payment expense are as follows:

	December 31, 2018	December 31, 2017
Share options (note a)	$ 779	$ 997
Restricted rights (note b)	–	73
Performance share rights (note c)	933	937
Deferred compensation awards (note d)	861	2,303
Share-based payments	**$ 2,573**	$ 4,310

a) Share option plan

Perpetual's share option plan provides a long-term incentive to employees and directors associated with the Company's long-term performance. The Board of Directors administers the share option plan and determines participants, number of share options and terms of vesting. The exercise price of the share options granted shall not be less than the value of the weighted average trading price for the Company's common shares for the five trading days immediately preceding the date of grant. Share options granted vest evenly over 4 years, with expiry occurring 5 years after issuance.

The following tables summarize information about share options outstanding:

	December 31, 2018		December 31, 2017	
	Average exercise price (*$/share*)	Share options (*thousands*)	Average exercise price (*$/share*)	Share options (*thousands*)
Balance, beginning of year	**1.67**	**3,987**	1.71	2,068
Granted	**0.25**	**903**	1.71	2,015
Cancelled/forfeited	**1.66**	**(83)**	–	–
Expired	**5.97**	**(83)**	3.23	(96)
Balance, end of year	**1.33**	**4,724**	1.67	3,987

As at December 31, 2018:

	Options outstanding			Options exercisable	
Range of exercise prices	**Number of share options (*thousands*)**	**Average contractual life (*years*)**	**Weighted average exercise price (*$/share*)**	**Number of share options (*thousands*)**	**Weighted average exercise price (*$/share*)**
$0.25 to $1.13	903	4.9	0.25	–	–
$1.14 to $1.57	1,805	2.5	1.41	930	1.42
$1.58 to $2.00	2,016	3.3	1.73	602	1.75
Total	4,724	3.3	1.33	1,532	1.55

The Company used the Black Scholes pricing model to calculate the estimated fair value of the outstanding share options at the date of grant. The following assumptions were used to arrive at the estimate of fair value as at the date of grant:

	2018	2017
Dividend yield (%)	**0.0**	0.0
Forfeiture rate (%)	**5.0**	5.0
Expected volatility (%)	**60.0**	60.0
Risk-free interest rate (%)	**2.2**	0.8
Expected life (years)	**3.2**	3.2
Vesting period (years)	**4.0**	4.0
Contractual life (years)	**5.0**	5.0
Weighted average grant date fair value	**$ 0.10**	$ 0.64

b) Restricted rights plan

The Company has a restricted rights plan for certain officers, employees and consultants. Restricted rights granted under the restricted rights plan may be exercised during a period (the "Exercise Period") not exceeding five years from the date upon which the restricted rights were granted. The restricted rights typically vest on a graded basis over two years. At the expiration of the Exercise Period, any restricted rights which have not been exercised shall expire. Upon vesting, the plan participant is entitled to receive one common share for each right held at a cost of $0.01 per share.

The fair value of an award granted under the restricted rights plan is assessed on the grant date by factoring in the weighted average common share trading price for the five days preceding the grant date. This fair value is recognized as share-based payment expense over the vesting period with a corresponding increase to contributed surplus. During the year ended December 31, 2018, the Company did not grant any restricted rights to employees, other than to settle performance share rights and deferred shares. The estimated weighted average fair value of restricted rights granted during the year ended December 31, 2017 was $1.58 per award.

Restricted rights granted upon the exercise of performance share rights (note 17c) vest on the grant date and have a 90-day exercise period. Restricted rights granted upon the exercise of deferred compensation awards (note 17d) vest on the grant date and have a 30-day exercise period. No value is assigned to restricted rights issued pursuant to those plans as the value and expense have been previously recognized pursuant to the grant date and expensed over the vesting period of the underlying performance share rights and deferred compensation awards.

The following table shows changes in the restricted rights outstanding under the restricted rights plan:

(*thousands*)	**December 31, 2018**	December 31, 2017
Balance, beginning of year	**–**	273
Granted to employees	**–**	44
Granted pursuant to exercise of performance share rights (c)	**1,008**	209
Granted pursuant to exercise of deferred shares (d)	**196**	369
Exercised for common shares [1]	**(1,204)**	(895)
Balance, end of year	**–**	–

[1] May not agree to common shares issued pursuant to share-based payment plans (note 16) due to cashless exercises.

c) Performance share rights plan

The Company has an equity-settled performance share rights plan for the Company's executive officers. Performance rights granted under the performance share rights plan vest two years after the date upon which the performance rights were granted. The performance rights that vest and become redeemable are a multiple of the performance rights granted dependent upon the achievement of certain performance metrics over the vesting period. Vested performance rights can be settled in cash or restricted rights (note 17b), at the discretion of the Board of Directors. Performance rights are forfeited if participants of the performance share rights plan leave the organization other than through retirement or termination without cause prior to the vesting date.

The fair value of a performance share rights award is determined at the date of grant by using the closing price of common shares multiplied by the estimated performance multiplier. As at December 31, 2018, performance multipliers of 0.6 and 1.0 have been assumed for those unvested awards granted in 2017 and 2018 respectively. Fluctuations in share-based payments may occur due to changes in estimates of performance outcomes. The amount of share-based payment expense is reduced by an estimated forfeiture rate of 5% (2017 – 5%) for outstanding awards. The estimated weighted average fair value of performance share rights granted during the year ended December 31, 2018 was $0.64 per award (2017 – $1.68).

The following table shows changes in the performance share rights outstanding under the performance share rights plan:

(*thousands*)	**December 31, 2018**	December 31, 2017
Balance, beginning of year	**1,060**	1,048
Granted	**1,035**	430
Exercised in exchange for restricted rights[1]	**(630)**	(418)
Balance, end of year	**1,465**	1,060

[1] In 2018, performance share rights were exercised in exchange for restricted rights based on a performance multiplier of 1.6 (2017 – 0.5).

In 2018, the Company introduced a performance-based long-term incentive awards plan (the "PLTI" plan) for the executive officers. The awards granted pursuant to the plan are tied to specific individual-based performance metrics established by the Board which can be based on "total shareholder return" or other metrics specifically designed to align with value creation for shareholders and to incentivize and retain key executive officers. The awards vest evenly over 4 years, with expiry occurring 5 years after issuance. Upon vesting, award holders may be entitled to receive, at the discretion of the Board of Directors, cash, a grant of restricted rights (note 17b), or a combination of cash and restricted rights. Awards granted pursuant to the PLTI plan are included in the table below (note 17d).

Certain awards granted under the PLTI plan contain monetary awards that may be settled in cash, in common shares of the Company, or a combination thereof at the discretion of the Board of Directors, equal to the monetary amount at the time of vesting. These awards are accounted for as cash-settled share-based compensation in which the fair value of the estimated amounts payable under the plan are recognized incrementally as an expense over the vesting period, with a corresponding change in liabilities. Upon exercise of these agreements in exchange for cash, the liability is reduced. Upon exercise of these awards in exchange for a variable number of shares, the value in liabilities pertaining to the exercise is recorded as share capital. As at December 31, 2018, $0.4 million had been accrued pursuant to cash-settled share-based compensation awards (December 31, 2017 – nil).

d) Deferred compensation awards

Deferred options

The Company has deferred option agreements in place with certain employees whereby they may be entitled to receive shares of the Company purchased on the open market by an independent trustee if they remain employees of the Company during such time and exercise their options. Deferred options generally vest evenly over 4 years, with expiry occurring 5 years after issuance. The shares purchased by the independent trustee are reported as shares held in trust (note 16b).

The following tables summarize information about the deferred options and performance-based long-term incentive awards:

	December 31, 2018		December 31, 2017	
	Average exercise price *($/share)*	**Deferred options *(thousands)***	Average exercise price *($/share)*	Deferred options *(thousands)*
Balance, beginning of year	**1.68**	**2,268**	1.69	1,072
Granted	**0.25**	**2,159**	1.72	1,380
Cancelled/forfeited	**1.68**	**(220)**	1.74	(120)
Expired	**4.73**	**(42)**	2.55	(64)
Balance, end of year	**0.91**	**4,165**	1.68	2,268

As at December 31, 2018:

	Deferred options outstanding			**Deferred options exercisable**	
Range of exercise prices	**Number of deferred options (*thousands*)**	**Average contractual life (*years*)**	**Weighted average exercise price (*$/share*)**	**Number of deferred options (*thousands*)**	**Weighted average exercise price (*$/share*)**
$0.25 to $1.13	2,159	4.9	0.25	–	–
$1.14 to $1.57	741	2.4	1.42	371	1.42
$1.58 to $3.16	1,265	3.3	1.73	337	1.75
Total	4,165	4.0	0.91	708	1.58

The Company used the Black Scholes pricing model to calculate the estimated fair value of deferred options at the date of grant. The following assumptions were used to arrive at the estimate of fair value as at the date of grant:

	2018	2017
Dividend yield (%)	**0.0**	0.0
Forfeiture rate (%)	**5.0-10.0**	10.0
Expected volatility (%)	**60.0**	60.0
Risk-free interest rate (%)	**2.2**	0.7
Expected life (years)	**2.6-3.2**	2.2
Vesting period (years)	**4.0**	4.0
Contractual life (years)	**5.0**	5.0
Weighted average grant date fair value	**$ 0.10**	$ 0.53

Deferred shares

The Company also has deferred share agreements in place with directors and certain employees whereby, in the case of directors, upon retirement from the Board of Directors, or in the case of employees, over a period of two years if they remain employees of the Company during such time, may be entitled to receive at the discretion of the Board of Directors, cash, a grant of restricted rights (note 17b) or shares of the Company purchased on the open market by an independent trustee. The shares purchased by the independent trustee are reported as shares held in trust (note 16b).

The fair value of these agreements is assessed on the grant date by factoring in the weighted average common share trading price for the five days preceding the grant date and is reduced by an estimated forfeiture rate of 5% (2017 – 5%). The fair value is recognized as share-based payment expense over the vesting period with a corresponding increase to contributed surplus. Upon exercise of these agreements in exchange for restricted rights, the value in contributed surplus pertaining to the exercise is recorded as share capital. Upon exercise of these agreements in exchange for shares held in trust, the shares held in trust account is reduced by the number of shares issued using the average cost base of purchased shares and offset to contributed surplus. The estimated weighted average fair value of these awards granted during the year ended December 31, 2018 was $0.23 per award (2017 – $1.60).

The following table shows changes to these awards:

(*thousands*)	**December 31, 2018**	December 31, 2017
Balance, beginning of year	**1,857**	2,197
Granted	**784**	684
Exercised in exchange for shares held in trust (note 16)	**(419)**	(520)
Exercised in exchange for restricted rights	**(196)**	(369)
Cancelled/forfeited	**(79)**	(135)
Balance, end of year	**1,947**	1,857

18. REVENUE

The Company sells its production pursuant to fixed or variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contracts, the Company is required to deliver fixed or variable volumes of natural gas, crude oil or NGL as may be applicable 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, whereby any variability in revenue relates specifically to the Company's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

With the exception of the natural gas market diversification contract detailed below, natural gas, crude oil and NGL are mostly sold under contracts of varying price and volume terms of up to one year. Revenues are typically collected on the 25th day of the month following production.

For the year ended December 31, 2018, the Company had sales to two customers which exceeded ten percent of oil and natural gas revenue. The largest customer represented 57% and $49.4 million (2017 – 56% and $45.5 million) of oil and natural gas revenue, and included $42.4 million (2017 – $5.6 million) related to the market diversification contract below. The second largest customer represented 18% and $15.4 million (2017 – 19% and $15.3 million) of oil and natural gas revenue.

Natural gas volumes sold pursuant to the Company's market diversification contract are sold at fixed volume obligations of 35,000 MMBtu/d commencing November 1, 2017, increasing to 40,000 MMBtu/d commencing April 1, 2018 delivered to AECO and are priced at daily index prices at each of the five market price points detailed below, less transportation costs from AECO to each market price point. The contract expires on October 31, 2022.

Market/Pricing Point	**Daily sales volume (*MMBtu/d*)**
Chicago	12,200
Malin	10,800
Dawn	8,000
Michcon	5,200
Empress	3,800
Total natural gas sales volume obligation delivered to AECO	**40,000**

All revenue generated by the Company is based on delivery of produced volumes to physical hubs in the province of Alberta.

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

	December 31, 2018	December 31, 2017
Oil and natural gas revenue		
Natural gas	**$ 54,769**	$ 54,444
Oil	**16,390**	16,139
NGL	**14,969**	11,139
Total oil and natural gas revenue	**$ 86,128**	$ 81,722

Included in accounts receivable at December 31, 2018 is $7.9 million of accrued oil and natural gas sales related to December 2018 production (December 31, 2017 – $8.0 million related to December 2017 production).

19. FINANCE EXPENSE

The components of finance expense are as follows:

	December 31, 2018	December 31, 2017
Cash interest expense and income		
Interest on revolving bank debt	**$ 2,226**	$ 1,078
Interest on TOU share margin demand loan	**570**	687
Interest on term loan	**3,665**	2,441
Interest on senior notes	**2,864**	3,798
Dividend income from TOU share investment	**(618)**	–
Total cash interest expense and income	**$ 8,707**	$ 8,004
Non-cash finance expense		
Amortization of debt issue costs	**1,026**	620
Accretion on decommissioning obligations (note 14a)	**841**	775
Change in fair value of gas over bitumen royalty financing (note 13)	**(452)**	(3,184)
Change in fair value of TOU share put option margin loans	**–**	1,377
Total non-cash finance expense	**$ 1,415**	$ (412)
Finance expenses recognized in net loss	**$ 10,122**	$ 7,592

20. CHANGES IN NON-CASH WORKING CAPITAL INFORMATION

For the year ended	**December 31, 2018**	December 31, 2017
Accounts receivable	**$ 5,138**	$ (2,596)
Prepaid expenses and deposits	**(201)**	53
Accounts payable and accrued liabilities	**(15,242)**	10,153
Change in non-cash working capital	**$ (10,305)**	$ 7,610

The change in non-cash working capital has been allocated to the following activities:

For the year ended	December 31, 2018	December 31, 2017
Operating	$ 2,541	$ (9,480)
Financing	–	(216)
Investing	(12,846)	17,306
Change in non-cash working capital	**$ (10,305)**	$ 7,610

21. FINANCIAL RISK MANAGEMENT

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

a) 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, and arises principally from the Company's receivables from joint venture partners, oil and natural gas marketers and derivative contract counterparties.

Receivables from oil and natural gas marketers are normally collected on the 25th day of the month following sales. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large, well established purchasers. The Company historically has not experienced any significant collection issues with its oil and natural gas marketing receivables. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are generally from participants in the oil and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling and oil and gas production; in addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from oil and natural gas marketers or joint venture partners, however, the Company does have the ability in some cases to withhold production or amounts payable to joint venture partners in the event of non-payment.

The Company manages the credit exposure related to derivatives by engaging in risk management transactions with credit worthy counterparties, and periodically monitoring counterparty credit assessments.

The combined carrying amount of accounts receivable and fair value of derivative assets as at December 31, 2018 was $19.8 million (December 31, 2017 – $17.2 million), representing the Company's maximum credit exposure. The Company's credit provisions are represented by its loss allowance based on lifetime expected credit losses as at December 31, 2018 of $1.1 million (December 31, 2017 – $1.1 million). The amount of the loss allowance was determined based on historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. The total amount of accounts receivables 90 days past due amounted to $1.1 million as at December 31, 2018 (December 31, 2017 – $2.1 million).

b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Company's reputation.

The Company anticipates that cash flows including cash flow from operating activities, proceeds from potential future asset dispositions and future disposition of its TOU share investment, and access to credit facilities will provide the required funds to discharge the Company's obligations, carry out exploration and development programs and fund ongoing operations for the foreseeable future.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas revenues on the 25th of each month.

c) Market risk

Market risk is the risk that changes in market prices such as foreign exchange rates, TOU share price, commodity prices and interest rates will affect the Company's net loss or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Company utilizes both financial derivatives and fixed price physical delivery sales contracts to manage market risks related to commodity prices, foreign currency rates and TOU share investment prices. All such transactions are conducted in accordance with the Company's Risk Management Policy, which has been approved by the Board of Directors.

i) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flow will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted not only by the relationship between the Canadian and United States dollar, but also by world economic events that dictate the levels of supply and demand. The Company manages commodity price risk using various financial derivatives and fixed price physical delivery sales contracts.

As at December 31, 2018, the Company has variable priced physical natural gas sales contracts based on future market prices. These contracts are not classified as non-financial derivatives since the settlement price corresponds directly with fluctuations in natural gas prices.

Natural gas contracts

At December 31, 2018, the Company had entered into the following physical basis differential contracts between AECO and NYMEX:

Term	Sold/bought	Volumes (*MMBtu/d*)	AECO-NYMEX differential (*US$/MMBtu*)	Fair Value (*$ thousands*)
January 2019 – March 2019	Sold	7,500	(1.55)	479
January 2019 – March 2019	Bought	40,000	(2.30)	1,191
January 2019 – December 2019	Sold	2,500	(1.55)	487
April 2019 – October 2019	Sold	5,000	(1.62)	457
April 2019 – October 2019	Bought	10,000	(1.64)	(863)
April 2019 – December 2019	Sold	10,000	(1.54)	1,367
January 2020 – December 2020	Sold	12,500	(1.41)	1,496
January 2021 – December 2021	Sold	5,000	(1.15)	679

At December 31, 2018, the Company had entered into the following financial basis differential contracts between AECO and NYMEX:

Term	Sold/bought	Volumes (*MMBtu/d*)	AECO-NYMEX differential (*US$/MMBtu*)	Fair Value (*$ thousands*)
April 2019 – December 2019	Sold	7,500	(1.50)	1,041
January 2020 – December 2020	Sold	15,000	(1.41)	1,730

At December 31, 2018, the Company had entered into the following financial fixed price natural gas sales arrangements at AECO:

Term	Sold/bought	Volumes (*GJ/d*)	Average price (*$/GJ*)	Fair Value (*$ thousands*)
January 2019 – March 2019	Sold	17,500	2.36	1,440
January 2019 – March 2019	Bought	10,000	1.30	125

Natural gas contracts - sensitivity analysis

As at December 31, 2018, if future natural gas prices changed by $0.25 per GJ with all other variables held constant, the fair value of derivatives and net loss for the period would change by $4.1 million. Fair value sensitivity was based on published forward AECO and NYMEX prices.

Oil contracts

At December 31, 2018, the Company had entered into the following financial costless collar oil sales arrangements which settle in US$:

Term	Volumes at WTI (*bbls/d*)	Floor price (*US$/bbl*)	Ceiling price (*US$/bbl*)	Fair Value (*$ thousands*)
January 2019 – December 2019	500	60.00	72.40	3,353

At December 31, 2018, the Company had entered into the following financial oil basis differential contracts between WTI and WCS trading:

Term	Volumes at WTI (*bbls/d*)	WTI-WCS differential (*US$/bbl*)	Fair Value (*$ thousands*)
January 2019 – December 2019	750	(25.22)	(2,064)

Oil contracts - sensitivity analysis

As at December 31, 2018, if future oil prices changed by $5.00 per boe with all other variables held constant, the fair value of derivatives and net loss for the period would change by $2.3 million. Fair value sensitivity was based on published forward WTI and WCS prices.

Foreign exchange contracts

At December 31, 2018, the Company had entered into the following US$ forward sales arrangements to manage the Company's exposure to US$ denominated natural gas sales:

Term	Notional (*US$/month*)	Strike rate (*US$/Cdn$*)	Fair Value (*$ thousands*)
January 2019 – March 2019	2,500,000	1.30	(454)
April 2019 – October 2019	2,000,000	1.31	(694)
November 2019 – March 2020	2,000,000	1.29	(634)
April 2020 – October 2020	1,500,000	1.30	(517)

Foreign exchange contracts - sensitivity analysis

As at December 31, 2018, if future exchange rates changed by $0.10 US$/Cdn$ with all other variables held constant, the fair value of foreign exchange derivatives and net loss for the period would change by $4.2 million. Fair value sensitivity was based on published forward US$/Cdn$ rates.

The following table is a summary of the fair value of the Company's derivative contracts by type:

	December 31, 2018	December 31, 2017
Physical natural gas contracts	**$ 5,293**	$ 1,209
Financial natural gas contracts	**4,336**	1,506
Financial oil contracts	**1,289**	157
Financial foreign exchange contracts	**(2,299)**	–
Fixed portion of retained shallow gas marketing arrangements	**–**	(929)
Non-fixed portion of retained shallow gas marketing arrangements	**–**	(6,737)
Fair value of derivatives	**$ 8,619**	$ (4,794)
Fair value of derivatives – current assets	**7,012**	1,585
Fair value of derivatives – non-current assets	**3,906**	1,506
Fair value of derivatives – current liabilities	**(1,405)**	(7,885)
Fair value of derivatives – non-current liabilities	**(894)**	–
Fair value of derivatives	**$ 8,619**	$ (4,794)

The following table details the Company's changes in fair value of derivatives:

	December 31, 2018	December 31, 2017
Unrealized gain (loss) on financial natural gas contracts	**2,830**	(3,099)
Unrealized gain (loss) on physical natural gas contracts	**4,084**	(667)
Unrealized gain (loss) on financial oil contracts	**1,132**	1,294
Unrealized gain (loss) on forward foreign exchange contracts	**(2,299)**	5,022
Unrealized change in fair value of derivatives	**5,747**	2,550
Realized gain (loss) on financial natural gas contracts	**4,141**	9,221
Realized gain (loss) on financial oil contracts	**(820)**	(1,738)
Realized gain (loss) on forward foreign exchange contracts	**(250)**	(4,178)
Change in fair value of derivatives	**8,818**	5,855

Fair value of financial assets and liabilities

The Company's fair value measurements are classified as one of the following levels of the fair value hierarchy:

Level 1 – inputs represent unadjusted quoted prices in active markets for identical assets and liabilities. An active market is characterized by a high volume of transactions that provides pricing information on an ongoing basis.

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These valuations are based on inputs that can be observed or corroborated in the marketplace, such as market interest rates or forward prices for commodities.

Level 3 – inputs for the asset or liability are not based on observable market data.

The Company aims to maximize the use of observable inputs when preparing calculations of fair value. Classification of each measurement into the fair value hierarchy is based on the lowest level of input that is significant to the fair value calculation.

The fair value of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity. Revolving bank debt and the TOU share margin demand loan bear interest at a floating market rate, and accordingly, the fair market value approximates the carrying amount.

The fair value of the gas over bitumen royalty financing is estimated by discounting future cash payments based on the forecasted Alberta gas reference price multiplied by the contracted deemed volume. This fair value measurement is classified as level 3 as significant unobservable inputs, including the discount rate and forecasted Alberta gas reference prices, are used in determination of the carrying amount. The discount rate of 12.2% was determined on inception of the agreement based on the characteristics of the instrument. The forecasted Alberta gas reference prices for the remaining term are based on AECO forward market pricing with adjustments for historical differences between the Alberta reference price and market prices.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels:

				Fair value		
As at December 31, 2018	**Gross**	**Netting[1]**	**Carrying Amount**	**Level 1**	**Level 2**	**Level 3**
Financial assets						
Fair value through profit and loss						
TOU share investment	28,132	–	28,132	28,132	–	–
Fair value of derivatives	14,092	(3,174)	10,918	–	10,918	–
Financial liabilities						
Financial liabilities at amortized cost						
TOU share margin demand loan	(14,109)	–	(14,109)	(14,144)	–	–
Revolving bank debt	(42,561)	–	(42,561)	(42,689)	–	–
Senior notes	(31,880)	–	(31,880)	–	(30,126)	–
Term loan	(43,729)	–	(43,729)	–	–	(45,000)
Fair value through profit and loss						
Fair value of derivatives	(5,473)	3,174	(2,299)	–	(2,299)	–
Gas over bitumen royalty financing	(1,152)	–	(1,152)	–	–	(1,152)

(1) Derivative assets and liabilities presented in the statement of financial position are shown net of offsetting assets or liabilities where the arrangement provides for the legal right and intention for net settlement exists.

				Fair value		
As at December 31, 2017	**Gross**	**Netting**	**Carrying Amount**	**Level 1**	**Level 2**	**Level 3**
Financial assets						
Fair value through profit and loss						
TOU share investment	37,985	–	37,985	37,985	–	–
Fair value of derivatives	3,462	(371)	3,091	–	3,091	–
Financial liabilities						
Financial liabilities at amortized cost						
TOU share margin demand loan	(18,406)	–	(18,406)	(18,490)	–	–
Revolving bank debt	(31,581)	–	(31,581)	(31,826)	–	–
Senior notes	(31,680)	–	(31,680)	–	(32,490)	–
Term loan	(43,233)	–	(43,233)	–	–	(45,000)
Fair value through profit and loss						
Fair value of derivatives	(8,256)	371	(7,885)	–	(7,885)	–
Gas over bitumen royalty financing	(2,739)	–	(2,739)	–	–	(2,739)

22. DEFERRED INCOME TAXES

The provision for income taxes in the consolidated financial statements differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Company's income (loss) before income tax. This difference results from the following items:

	December 31, 2018	December 31, 2017
Net loss before income tax	**$ (20,380)**	$ (35,971)
Combined federal and provincial tax rate	**27.0%**	27.0%
Computed income tax expense (recovery)	**(5,503)**	(9,712)
Increase (decrease) in income taxes resulting from:		
Non-deductible expenses	**695**	1,163
Non-taxable capital (gain) loss	**1,293**	3,061
Other	**729**	(521)
Change in unrecognized tax asset	**2,786**	6,009
Deferred income taxes	**$ –**	$ –

The following table summarizes the deferred income tax liabilities of the Company and its subsidiaries, which are offset against certain deferred income tax assets:

For the years ended	December 31, 2018	December 31, 2017
Liability:		
Senior notes	$ 164	$ 218
Term loan	353	477
TOU share investment	2,948	–
Other	–	846
Total deferred income tax liabilities	3,465	1,541
Asset:		
Decommissioning obligations	$ (3,465)	$ (1,541)

The unused tax losses and deductible temporary differences included in the Company's unrecognized deferred income tax assets are as follows:

For the years ended	December 31, 2018	December 31, 2017
Non-capital losses	$ 179,021	$ 169,027
Capital losses	142,552	138,817
Property, plant and equipment	33,189	26,750
Decommissioning obligations	27,300	31,373
Gas over bitumen royalty financing	1,151	2,739
TOU share investment	19,055	9,506
Fair value of derivatives	2,300	7,885
Other	3,974	5,483
	$ 408,542	$ 391,580

At December 31, 2018, the unused non-capital losses expire between 2024 and 2038, and unused capital losses have no expiry date. The deductible temporary differences do not expire under current tax legislation. The oil and natural gas properties and facilities owned by the Company and its subsidiaries have an approximate tax basis of $319 million (December 31, 2017 – $336 million) available for future use as deductions from taxable income.

Deferred income tax assets have not been recognized in respect of these unused tax losses and temporary differences because it is not probable that future taxable profit will be available against which the Company can utilize the benefits.

23. KEY MANAGEMENT PERSONNEL

The Company has defined key management personnel as executive officers, as well as the Board of Directors, as they have the collective authority and responsibility for planning, directing and controlling the activities of the Company. The following table outlines the total compensation expense for key management personnel:

For the years ended	December 31, 2018	December 31, 2017
Short-term compensation	$ 2,593	$ 2,015
Share-based payments	1,717	2,008
	$ 4,310	$ 4,023

24. SUPPLEMENTAL DISCLOSURE

The Company's consolidated statements of loss and comprehensive loss are prepared primarily by nature of expense, except for employee compensation costs which are included in both production and operating and general and administrative expenses.

The following table details the amount of total employee compensation costs included in production and operating and general and administrative expenses in the consolidated statements of loss and comprehensive loss.

For the years ended	December 31, 2018	December 31, 2017
Production and operating	$ 2,006	$ 1,945
General and administrative	8,685	9,414
Share-based payments	2,573	4,310
	$ 13,264	$ 15,669