

MANAGEMENT'S REPORT

To the Shareholders of Birchcliff Energy Ltd.

The annual financial statements of Birchcliff Energy Ltd. for the year ended December 31, 2018 were prepared by management within the acceptable limits of materiality and are in accordance with International Financial Reporting Standards. Management is responsible for ensuring that the financial and operating information presented in the annual report is consistent with that shown in the financial statements.

The financial statements have been prepared by management in accordance with the accounting policies as described in the notes to the financial statements. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. When necessary, such estimates are based on informed judgments made by management.

Management has designed and maintains an appropriate system of internal controls to provide reasonable assurance that all assets are safeguarded and financial records properly maintained to facilitate the preparation of financial statements for reporting purposes.

KPMG LLP, an independent firm of Chartered Professional Accountants appointed by shareholders, have conducted an examination of the corporate and accounting records in order to express their opinion on the financial statements.

The Audit Committee, consisting of non-management directors, has met with representatives of KPMG LLP and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Respectfully,

(signed) "*Bruno P. Geremia*"

Bruno P. Geremia

Vice-President and Chief Financial Officer

(signed) "*A. Jeffery Tonken*"

A. Jeffery Tonken

President and Chief Executive Officer

Calgary, Canada

March 13, 2019

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Birchcliff Energy Ltd.

Opinion

We have audited the financial statements of Birchcliff Energy Ltd. (the "Company"), which comprise:

- the statements of financial position as at December 31, 2018 and December 31, 2017
- the statements of income (loss) and comprehensive income (loss) for the years then ended
- the statements of changes in shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the 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 financial position of the Company as at December 31, 2018 and December 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. 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 Report".

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 Report" 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.

The information, other than the financial statements and the auditors' report thereon, included in a document to be entitled "Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

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 Timothy Arthur Richards.

(signed) "KPMG LLP"

Chartered Professional Accountants

Calgary, Canada

March 13, 2019

BIRCHCLIFF ENERGY LTD.

STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of Canadian dollars)

As at December 31,	2018	2017
ASSETS		
Current assets:		
Cash	53	48
Accounts receivable (Note 18)	51,941	69,302
Prepaid expenses and deposits	3,386	2,622
Financial instruments (Note 18)	36,798	-
	92,178	71,972
Non-current assets:		
Deposit on acquisition (Note 22)	3,900	-
Petroleum and natural gas properties and equipment (Note 5)	2,633,460	2,545,131
Investment in securities (Note 6)	10,005	10,005
Financial instruments (Note 18)	23,377	-
	2,670,742	2,555,136
Total assets	2,762,920	2,627,108
LIABILITIES		
Current liabilities:		
Accounts payable and accrued liabilities	76,567	83,039
Financial instruments (Note 18)	-	4,046
	76,567	87,085
Non-current liabilities:		
Revolving term credit facilities (Note 7)	605,267	587,126
Decommissioning obligations (Note 8)	129,264	124,825
Deferred income taxes (Note 9)	119,553	82,694
Capital securities (Note 10)	49,535	49,225
Other liabilities (Note 14)	7,844	-
	911,463	843,870
Total liabilities	988,030	930,955
SHAREHOLDERS' EQUITY		
Share capital (Note 10)		
Common shares	1,478,260	1,477,750
Preferred shares (perpetual)	41,434	41,434
Contributed surplus	76,747	69,959
Retained earnings	178,449	107,010
	1,774,890	1,696,153
Total shareholders' equity and liabilities	2,762,920	2,627,108

Subsequent event (Note 22)

Commitments (Note 19)

The accompanying notes are an integral part of these financial statements.

Approved by the Board

(signed) "Dennis A. Dawson"
Dennis A. Dawson
 Lead Independent Director

(signed) "A. Jeffery Tonken"
A. Jeffery Tonken
 Director

BIRCHCLIFF ENERGY LTD.

STATEMENTS OF NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

(Expressed in thousands of Canadian dollars, except per share information)

Years Ended December 31,	2018	2017
REVENUE		
Petroleum and natural gas sales (Note 11)	621,421	556,942
Royalties	(38,306)	(28,727)
Net revenue from oil and natural gas sales	583,115	528,215
Other income (Note 6)	800	268
Realized gain (loss) on financial instruments (Note 18)	(15,771)	25,785
Unrealized gain (loss) on financial instruments (Note 18)	64,222	5,387
	632,366	559,655
EXPENSES		
Operating (Note 12)	99,104	110,486
Transportation and other	103,547	71,224
Administrative, net (Note 13)	32,299	30,563
Depletion and depreciation (Note 5)	208,868	185,666
Finance (Note 15)	32,711	32,939
Dividends on capital securities (Note 10)	3,500	3,500
Loss on sale of assets (Note 5)	10,192	186,143
	490,221	620,521
Net income (loss) before taxes	142,145	(60,866)
Income tax expense (recovery) (Note 9)	39,933	(13,886)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	102,212	(46,980)
Net income (loss) per common share (Note 10)		
Basic	\$0.37	(\$0.19)
Diluted	\$0.37	(\$0.19)

The accompanying notes are an integral part of these financial statements.

BIRCHCLIFF ENERGY LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Expressed in thousands of Canadian dollars)

	Share Capital			Retained Earnings	Total
	Common Shares	Preferred Shares	Contributed Surplus		
As at December 31, 2016	1,464,567	41,434	63,847	184,559	1,754,407
Dividends on common shares (Note 10)	-	-	-	(26,522)	(26,522)
Dividends on perpetual preferred shares (Note 10)	-	-	-	(4,047)	(4,047)
Exercise of stock options	13,183	-	(3,833)	-	9,350
Stock-based compensation	-	-	9,945	-	9,945
Net loss and comprehensive loss	-	-	-	(46,980)	(46,980)
As at December 31, 2017	1,477,750	41,434	69,959	107,010	1,696,153
Dividends on common shares (Note 10)	-	-	-	(26,586)	(26,586)
Dividends on perpetual preferred shares (Note 10)	-	-	-	(4,187)	(4,187)
Exercise of stock options (Note 10)	510	-	(126)	-	384
Stock-based compensation (Note 13)	-	-	6,914	-	6,914
Net income and comprehensive income	-	-	-	102,212	102,212
As at December 31, 2018	1,478,260	41,434	76,747	178,449	1,774,890

The accompanying notes are an integral part of these financial statements.

BIRCHCLIFF ENERGY LTD. STATEMENTS OF CASH FLOWS

(Expressed in thousands of Canadian dollars)

Years ended December 31,	2018	2017
Cash provided by (used in):		
OPERATING		
Net income (loss) and comprehensive income (loss)	102,212	(46,980)
Adjustments for items not affecting operating cash:		
Unrealized (gain) on financial instruments	(64,222)	(5,387)
Depletion and depreciation	208,868	185,666
Other compensation (Note 13)	7,697	4,059
Finance	32,711	32,939
Loss on sale of assets	10,192	186,143
Income tax expense (recovery)	39,933	(13,886)
Interest paid	(27,969)	(28,374)
Dividends on capital securities	3,500	3,500
Decommissioning expenditures	(1,079)	(794)
Changes in non-cash working capital (Note 20)	12,591	(29,226)
	324,434	287,660
FINANCING		
Exercise of stock options	384	9,350
Financing fees paid on credit facilities	(950)	(2,375)
Dividends on common shares	(26,586)	(26,522)
Dividends on perpetual preferred shares	(4,187)	(4,047)
Dividends on capital securities	(3,500)	(3,500)
Net change in revolving term credit facilities	17,868	15,783
	(16,971)	(11,311)
INVESTING		
Petroleum and natural gas properties	(301,763)	(416,786)
Acquisition of petroleum and natural gas properties and equipment	(1,524)	(999)
Sale of petroleum and natural gas properties and equipment (Note 5)	5,269	131,657
Deposit on acquisition	(3,900)	-
Changes in non-cash working capital (Note 20)	(5,540)	9,780
	(307,458)	(276,348)
Net change in cash	5	1
Cash, beginning of year	48	47
CASH, END OF YEAR	53	48

The accompanying notes are an integral part of these financial statements.

BIRCHCLIFF ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(Expressed In thousands Of Canadian Dollars, Unless Otherwise Stated)

1. NATURE OF OPERATIONS

Birchcliff Energy Ltd. (“**Birchcliff**” or the “**Corporation**”) is domiciled and incorporated in Alberta, Canada. Birchcliff is engaged in the exploration for and the development, production and acquisition of petroleum and natural gas reserves in Western Canada. The Corporation’s financial year end is December 31. The address of the Corporation’s registered office is Suite 1000, 600 – 3rd Avenue S.W., Calgary, Alberta, Canada T2P 0G5. Birchcliff’s common shares, Series A Preferred Shares and Series C Preferred Shares are listed for trading on the Toronto Stock Exchange under the symbols “**BIR**”, “**BIR.PR.A**” and “**BIR.PR.C**”, respectively.

These financial statements were approved and authorized for issuance by the Board of Directors on March 13, 2019.

2. BASIS OF PREPARATION

These financial statements present Birchcliff’s financial results of operations and financial position under International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board (“**IASB**”) as at and for the years ended December 31, 2018 and December 31, 2017. The financial statements have been prepared in accordance with IFRS accounting policies and methods of computation as set forth in Note 3.

Operating, transportation and marketing expenses in profit or loss are presented as a combination of function and nature in conformity with industry practices. Depletion and depreciation, finance expenses, dividends on capital securities and gain or loss on sale of assets are presented in a separate line by their nature, while net administrative expenses are presented on a functional basis. Significant expenses such as salaries and benefits and other compensation are presented by their nature in the notes to the financial statements.

Birchcliff’s financial statements are prepared on a historical cost basis, except for certain financial and non-financial assets and liabilities which have been measured at fair value. The Corporation’s financial statements include the accounts of Birchcliff only and are expressed in Canadian dollars, unless otherwise stated. Birchcliff does not have any subsidiaries.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue Recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids (“**NGLs**”) is measured based on the consideration specified in contracts with marketers and other third parties. Birchcliff recognizes revenue when it transfers control of the product to the contract counterparty. In making this evaluation, management considers if Birchcliff has the ability to direct the use of, and obtain substantially all of the remaining benefits from the delivery of the product.

Birchcliff evaluates its arrangements with marketers and other third parties to determine if the Corporation acts as the principal or as an agent. In making this evaluation, the Corporation considers if it obtains control of the product delivered or services provided, which is indicated by the Corporation having the primary responsibility for the delivery of the product or rendering of the service, having the ability to establish prices or having inventory risk. If the Corporation acts in the capacity of an agent rather than as a principal in a transaction, then the revenue is recognized on a net-basis, only reflecting the fee, if any, realized by the Corporation from the transaction.

(b) Cash and Cash Equivalents

Cash may consist of cash on hand, deposits and term investments held with a financial institution, with an original maturity of three months or less. Restricted cash is not considered part of cash and cash equivalents.

(c) **Jointly Owned Assets**

Certain activities of the Corporation are conducted jointly with others where the participants have a direct ownership interest in the related assets. Accordingly, the accounts of Birchcliff reflect only its working interest share of revenues, expenses and capital expenditures related to these jointly owned assets. The relationship with jointly owned asset partners have been referred to as joint venture in the remainder of the financial statements as this is common terminology in the Canadian oil and natural gas industry.

(d) **Exploration and Evaluation Assets**

Costs incurred prior to obtaining the right to explore a mineral resource are recognized as an expense in the period incurred.

Intangible exploration and evaluation expenditures are initially capitalized and may include mineral license acquisitions, geological and geophysical evaluations, technical studies, exploration drilling and testing and other directly attributable administrative costs. Tangible assets acquired which are consumed in developing an intangible exploration asset are recorded as part of the cost of the exploration asset. These costs are accumulated in cost centres by exploration area pending the determination of technical feasibility and commercial viability.

The technical feasibility and commercial viability of extracting a mineral resource in an exploration area is considered to be determinable when economic quantities of proved reserves are determined to exist. A review of each exploration project by area is carried out at each reporting date to ascertain whether such reserves have been discovered. Upon determination of commercial proved reserves, associated exploration costs are transferred from exploration and evaluation to developing and producing petroleum and natural gas properties and equipment as reported on the statements of financial position. Exploration and evaluation assets are reviewed for impairment prior to any such transfer. Assets classified as exploration and evaluation are not subject to depletion and depreciation until they are reclassified to petroleum and natural gas properties and equipment.

(e) **Petroleum and Natural Gas Properties and Equipment**

(i) *Recognition and measurement*

Petroleum and natural gas properties and equipment are measured at cost less accumulated depletion and depreciation and accumulated impairment losses, if any.

Petroleum and natural gas properties and equipment consists of the purchase price and costs directly attributable to bringing the asset to the location and condition necessary for its intended use. Petroleum and natural gas assets include developing and producing interests such as mineral lease acquisitions, geological and geophysical costs, facility and production equipment and associated turnarounds, other directly attributable administrative costs and the initial estimate of the costs of dismantling and removing an asset and restoring the site on which it was located.

(ii) *Subsequent costs*

Costs incurred subsequent to the determination of technical feasibility and commercial viability are recognized as developing and producing petroleum and natural gas interests when they increase the future economic benefits embodied in the specific asset to which they relate. Such capitalized petroleum and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on an area basis. The cost of day-to-day servicing of an item of petroleum and natural gas properties and equipment is expensed in profit or loss as incurred.

Petroleum and natural gas properties and equipment are de-recognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising from the disposal of an asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss.

(iii) Asset exchanges

For exchanges or parts of exchanges that involve only exploration and evaluation assets, the exchange is accounted for at carrying value. Exchanges of development and production assets are measured at fair value, unless the exchange transaction lacks commercial substance or the fair value of the assets given up or the assets received cannot be reliably estimated. The cost of the acquired asset is measured at the fair value of the asset given up, unless the fair value of the asset received is more reliable. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gain or loss on the de-recognition of the asset given up is recognized in profit and loss.

(iv) Depletion and depreciation

The net carrying value of developing and producing petroleum and natural gas assets, net of estimated residual value, is depleted on an area basis using the unit of production method. This depletion calculation includes actual production in the period and total estimated proved plus probable reserves attributable to the assets being depreciated, taking into account total capitalized costs plus estimated future development costs necessary to bring those reserves into production. Relative volumes of reserves and production (before royalties) are converted at the energy equivalent conversion ratio of six thousand cubic feet of natural gas to one barrel of oil. These estimates are reviewed by the Corporation's independent reserves evaluator at least annually.

Capitalized plant turnaround costs are depreciated on a straight-line basis over the estimated time until the next turnaround is completed. Corporate assets, which include office furniture and equipment, software, computer equipment and leasehold improvements, are depreciated on a straight-line basis over the estimated useful lives of the assets, which are estimated to be four years.

When significant parts of property and equipment, including petroleum and natural gas interests, have different useful lives, they are accounted for as separate items (major components). Depreciation methods, useful lives and residual values for petroleum and natural gas properties and equipment are reviewed at each reporting date.

(f) Provisions

Provisions are recognized when the Corporation has a present obligation (legal or constructive), as a result of a past event, if it is probable that the Corporation will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is significant).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Provisions are not recognized for future operating losses.

(g) Decommissioning Obligations

The Corporation's activities give rise to dismantling, restoration and site disturbance remediation activities. Costs related to abandonment activities are estimated by management in consultation with the Corporation's independent reserves evaluators based on risk-adjusted current costs which take into consideration current technology in accordance with existing legislation and industry practices.

Decommissioning obligations are measured at the present value of the best estimate of expenditures required to settle the present obligations at the reporting date. When the best estimate of the liability is initially

measured, the estimated cost, discounted using a pre-tax risk-free discount rate, is capitalized by increasing the carrying amount of the related petroleum and natural gas properties and equipment. The increase in the provision due to the passage of time, which is referred to as accretion, is recognized as a finance expense. Actual costs incurred upon settlement of the liability are charged against the obligation to the extent that the obligation was previously established. The carrying amount capitalized in petroleum and natural gas properties and equipment is depleted in accordance with the Corporation's depletion and depreciation policy. The Corporation reviews the obligation at each reporting date and revisions to the estimated timing of cash flows, discount rates and estimated costs result in an increase or decrease to the obligations and the related petroleum and natural gas properties and equipment. Any difference between the actual costs incurred upon settlement of the obligation and the recorded liability is recognized as a gain or loss in profit or loss.

(h) Share-Based Payments

Equity-settled share-based awards granted by the Corporation include stock options and performance warrants granted to officers, directors and employees. The fair value determined at the grant date of an award is expensed on a graded basis over the vesting period of each respective tranche of an award with a corresponding increase to contributed surplus. In calculating the expense of share-based awards, the Corporation revises its estimate of the number of equity instruments expected to vest by applying an estimated forfeiture rate for each vesting tranche and subsequently revising this estimate throughout the vesting period, as necessary, with a final adjustment to reflect the actual number of awards that vest. Upon the exercise of share-based awards, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. In the event that vested share-based awards expire without being exercised, previously recognized compensation costs associated with such awards are not reversed. The expense related to share-based awards is included within administrative expenses in profit or loss.

The fair value of equity-settled share-based awards is measured using the Black-Scholes option-pricing model taking into account the terms and conditions upon which the awards were granted. Measurement inputs as at the grant date include: share price, exercise price, expected volatility (based on weighted average historical traded daily volatility), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends and the risk-free interest rate (based on government bonds) applicable to the term of the award.

A portion of share-based compensation expense directly attributable to the exploration and development of the Corporation's assets are capitalized.

(i) Finance Income and Expenses

Finance expenses include interest expense on borrowings, accretion of the discount on decommissioning and post-employment benefit obligation, amortization of deferred charges and impairment losses (if any) recognized on financial assets. Interest and dividend income is recognized as it is earned and is presented as "other income" in profit and loss.

(j) Borrowing Costs

Borrowing costs incurred for the acquisition, construction or production of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use or sale. Assets are considered to be qualifying assets when this period of time is substantial. The capitalization rate, used to determine the amount of borrowing costs to be capitalized, is the weighted average interest rate applicable to the Corporation's outstanding borrowings during the period. All other borrowing costs are charged to profit or loss using the effective interest method.

(k) **Financial Instruments**

(i) *Non-derivative financial instruments*

Non-derivative financial instruments are comprised of cash, accounts receivable, deposits, investment in securities, accounts payable and accrued liabilities, outstanding credit facilities and capital securities. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured based on their classification. The Corporation has made the following classifications:

- Cash, accounts receivable, and deposits are classified as loans and receivables and are measured at amortized cost using the effective interest method. Typically, the fair value of these balances approximates their carrying value due to their short term to maturity.
- Investment in securities have been categorized as fair value through profit and loss which requires the securities to be fair valued at the end of each reporting period with any gains or losses recognized in other comprehensive income. In the event of disposal or impairment the cumulative fair value changes recognized in other comprehensive income are reclassified to profit or loss. Distributions declared are recorded to profit or loss and presented as an operating activity on the statement of cash flow.
- Accounts payable and accrued liabilities and outstanding credit facilities are classified as other financial liabilities and are measured at amortized cost using the effective interest method. Due to the short-term nature of accounts payable and accrued liabilities, their carrying values approximate their fair values. The Corporation's outstanding credit facilities bear interest at a floating rate and accordingly the fair market value approximates the carrying value before the carrying value is reduced for any remaining unamortized costs. The interest costs and financing fees associated with the Corporation's credit facilities have been deferred and netted against the amounts drawn, and are being amortized to profit or loss using the effective interest method over the applicable term.
- The proceeds from the issuance of Series C Preferred Shares, which are presented as "capital securities" on the statement of financial position, are classified as "other financial liabilities" under IFRS. The incremental costs directly attributable to the issuance of Series C Preferred Shares are initially recognized as a reduction to capital securities and subsequently amortized to profit and loss, using the effective interest rate method, as a finance expense. Dividend distributions on capital securities are recorded as an expense directly to profit and loss and presented as a financing activity on the statements of cash flows.

(ii) *Derivative financial instruments*

Derivatives may be used by the Corporation to manage economic exposure to market risk relating to commodity prices, interest rates and foreign exchange. Birchcliff's policy is not to utilize derivative financial instruments for speculative purposes. The Corporation does not designate its financial derivative contracts as hedges, and as such does not apply hedge accounting. As a result, financial derivatives are classified at fair value through profit or loss and are recorded on the statements of financial position at fair value.

The fair value of commodity price risk management contracts is determined by discounting the difference between the contracted prices/rates and published forward price/rate curves as at the statement of financial position date. The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

The Corporation accounts for any forward physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items, in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts

are not considered to be derivative financial instruments and have not been recorded at fair value on the statements of financial position. Settlements on physical sales contracts are recognized in petroleum and natural gas sales in profit and loss.

(iii) Share capital

Common shares and perpetual preferred shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a reduction in share capital, net of any tax effects.

(l) Impairment

(i) Impairment of financial assets

Impairment of financial assets is determined by measuring the assets' expected credit loss ("ECL"). Birchcliff's financial assets are not considered to have a significant financing component and a lifetime ECL is measured at the date of initial recognition of the financial asset. ECL allowances have not been recognized for cash and cash equivalents due to the virtual certainty associated with their collection. The ECL pertaining to accounts receivable, financial instruments and investment in securities is assessed at initial recognition and this provision is re-assessed at each reporting date. ECLs are a probability-weighted estimate of all possible default events related to the financial asset (over the lifetime or within 12 months after the reporting period, as applicable) and are measured as the difference between the present value of the cash flows due to Birchcliff and the cash flows the Corporation expects to receive, including cash flows expected from collateral and other credit enhancements that are a part of contractual terms. In making an assessment as to whether financial assets are credit-impaired, the Corporation considers historically realized bad debts, evidence of a debtor's present financial condition and whether a debtor has breached certain contracts, the probability that a debtor will enter bankruptcy or other financial reorganization, changes in economic conditions that correlate to increased levels of default, the number of days a debtor is past due in making a contractual payment, and the term to maturity of the specified receivable. The carrying amounts of financial assets are reduced by the amount of the ECL through an allowance account and losses are recognized within general and administrative expense in profit and loss.

Based on contractual terms and conditions, the Corporation considers its financial assets to be in default when the counterparty fails to make contractual payments as required. Once the Corporation has pursued collection activities and it has been determined that the incremental cost of pursuing collection outweighs the benefits, Birchcliff derecognizes the gross carrying amount of the financial asset and the associated allowance from the statement of financial position.

(ii) Impairment of non-financial assets

The Corporation's petroleum and natural gas properties and equipment are grouped into Cash Generating Units ("CGUs") for the purpose of assessing impairment. A CGU represents the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

CGUs are reviewed at each reporting date for indicators of potential impairment. Such indicators may include, but are not limited to, changes in the Corporation's business plan, deterioration in commodity prices or a significant downward revision of estimated recoverable reserves. If indicators of asset impairment exist, an impairment test is performed by comparing a CGU's carrying value to its recoverable amount. A CGU's recoverable amount is the greater of its fair value less cost to sell and its current value in use. The calculation of the recoverable amount is sensitive to the assumptions regarding production volumes, discount rates and commodity prices. Any excess of carrying value over recoverable amount is recognized as impairment loss in profit or loss.

In assessing the value in use, the estimated future cash flows from proved and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. The petroleum and natural gas future prices used in the impairment test are based on period-end commodity price forecasts estimated by the Corporation's independent reserves evaluator and are adjusted for petroleum and natural gas differentials and transportation and marketing costs specific to the Corporation.

Where circumstances change such that an impairment no longer exists or is less than the amount previously recognized, the carrying amount of the CGU is increased to the revised estimate of its recoverable amount as long as the revised estimate does not exceed the carrying amount that would have been determined, net of depletion and depreciation, had no impairment loss been recognized for the CGU in prior periods. A reversal of an impairment loss is recognized immediately through profit or loss.

Exploration and evaluation assets are assessed for impairment if: (i) sufficient data exists to determine technical feasibility and commercial viability of an exploration area, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to CGUs.

(m) Income Taxes

Birchcliff is a corporation as defined under the *Income Tax Act* (Canada) and is subject to Canadian Federal and provincial taxes. Birchcliff is subject to provincial taxes in Alberta as the Corporation operates in this jurisdiction. The Corporation's income tax expenses include current and/or deferred tax. Income tax expense is recognized through profit or loss except to the extent that it relates to items recognized directly in equity, in which case the related income taxes are also recognized in equity.

Current tax is the expected tax payable on taxable income and Part VI.I dividend tax payable on taxable preferred shares for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable income will be available against which those deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is expected to be settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which Birchcliff expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

(n) Flow-Through Shares

The Corporation may issue flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. The difference between the value ascribed to flow-through shares issued and the value that would have been received for common shares at the date of announcements of the flow-through shares is initially recognized as a liability on the statements of financial position. When the expenditures are incurred, the liability is drawn down, a deferred tax liability is recorded equal to the

estimated amount of deferred income tax payable by the Corporation as a result of the renunciation and the difference is recognized as a deferred tax expense.

(o) Per Common Share

The Corporation calculates per common share amounts using net income available to Birchcliff's shareholders, reduced for perpetual preferred share dividends and divided by the weighted average number of common shares outstanding. Basic per share information is computed using the weighted average number of basic common shares outstanding during the period. Diluted per share information is calculated using the treasury stock method, which assumes that any proceeds from the exercise of "in-the-money" stock options, performance warrants or warrants (the "**Securities**"), plus the unamortized stock-based compensation expense amounts, would be used to purchase common shares at the average market price during the period. No adjustment to diluted earnings per share is made if the result of these calculations is anti-dilutive. The average market value of the Corporation's shares for the purpose of calculating the dilutive effect is based on average quoted market prices for the time that the Securities were outstanding during the period.

(p) Business Combinations

The purchase method of accounting is used to account for acquisitions of businesses 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 and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If the consideration given up is less than the fair value of the net assets received, the difference is recognized immediately in the income statement. If the consideration is greater than the fair value of the net assets received, the difference is recognized as goodwill on the statement of financial position. Acquisition costs incurred are expensed.

(q) Post-Employment Benefit Obligation

Birchcliff's post-employment benefits are defined benefit obligations under IFRS. The cost of the post-employment benefit obligation is determined using the projected unit credit method. The obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that have terms to maturity approximating the terms of the related liability. Post-employment benefit obligation is presented on the statements of financial position as other liabilities. Past service cost is the change in the present value of the obligation and can arise from the introduction, amendment or curtailment of a plan. Current service cost is the increase in the present value of the obligation resulting from the service provided by an employee in the current period. Current and past service costs are recognized as post-employment benefit expenses of the Corporation when incurred and presented in profit and loss as an administrative expense. The unwinding of the present value of the post-employment benefit obligation is recorded as accretion (interest) expense and is presented in profit and loss as a finance expense.

Remeasurements of the post-employment benefit obligation will result in gains and losses and will be included in other comprehensive income. Remeasurements result from increases or decreases in the present value of the obligation as a result of changes in assumptions including unexpectedly high or low rates of employee turnover, early retirement, change in expected future salaries and benefits and revision to the discount rate. Settlements will be recorded as a reduction to the obligation in the period incurred. Any difference between the actual costs incurred upon settlement of the obligation and the recorded liability is recognized as a gain or loss in profit or loss.

(r) Critical Accounting Judgments and Key Sources of Estimation Uncertainty

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and income and expenses. Accordingly, actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Critical judgments in applying accounting policies:

The following are the critical judgments that management has made in the process of applying the Corporation's accounting policies and that have the most significant effect on the amounts recognized in these financial statements:

(i) Identification of cash-generating units

Birchcliff's assets are required to be aggregated into CGUs for the purpose of calculating impairment based on their ability to generate largely independent cash inflows. CGUs have been determined based on similar geological structure, shared infrastructure, geographical proximity, operating structure, commodity type and similar exposures to market risks. By their nature, these assumptions are subject to management's judgment and may impact the carrying value of the Corporation's assets in future periods.

(ii) Identification of impairment indicators

IFRS requires Birchcliff to assess, at each reporting date, whether there are any indicators that its petroleum and natural gas assets may be impaired. Birchcliff is required to consider information from both external sources (such as negative downturn in commodity prices, significant adverse changes in the technological, market, economic or legal environment in which the entity operates) and internal sources (such as downward revisions in reserves, significant adverse effect on the financial and operational performance of a CGU, evidence of obsolescence or physical damage to the asset). By their nature, these assumptions are subject to management's judgment.

(iii) Tax uncertainties

IFRS requires Birchcliff, at each reporting date, to make certain judgments on uncertain tax positions by relevant tax authorities. Judgments include determining whether the Corporation will "more likely than not" be successful in defending its tax positions by considering information from relevant tax interpretations and tax laws in Canada. As such, this recognition threshold is subject to management's judgment and may impact the carrying value of the Corporation's deferred tax assets and liabilities at the end of the reporting period.

Key sources of estimation uncertainty:

The following are the key assumptions concerning the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities within the next financial year:

(i) Reserves

Reported recoverable quantities of proved and probable reserves requires estimation regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying values of the Corporation's petroleum and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning obligations, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from Birchcliff's petroleum and natural gas interests are independently evaluated by reserve engineers at least annually.

The Corporation's petroleum and natural gas reserves represent the estimated quantities of petroleum, natural gas and NGLs which geological, geophysical and engineering data demonstrate with

a specified degree of certainty to be economically recoverable in future years from known reservoirs and which are considered commercially producible. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon (i) a reasonable assessment of the future economics of such production; (ii) a reasonable expectation that there is a market for all or substantially all the expected petroleum and natural gas production; and (iii) evidence that the necessary production, transmission and transportation facilities are available or can be made available. Reserves may only be considered proved and probable if producibility is supported by either production or conclusive formation tests. Birchcliff's oil and gas reserves are determined in accordance with the standards contained in National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* and the *Canadian Oil and Gas Evaluation Handbook*.

(iv) Share-based payments

All equity-settled, share-based awards issued by the Corporation are fair valued using the Black-Scholes option-pricing model. In assessing the fair value of equity-based compensation, 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.

(v) Decommissioning obligations

The Corporation estimates future remediation costs of production facilities, wells and pipelines at different stages of development and construction of assets or facilities. In most instances, removal of assets occurs many years into the future. This requires an estimate regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability-specific discount rates to determine the present value of these cash flows.

(vi) Post-employment benefit obligation

The Corporation estimates the post-employment benefit obligation at the end of each reporting period. In most instances, the obligation occurs many years into the future. The Corporation uses estimates related to the initial measurement of the obligation for eligible employees including expected age of employee retirement, employee turnover, probability of early retirement, discount rate and inflation rate on salary and benefits. From time to time, these estimates may change causing the obligation recorded by the Corporation to change.

(vii) Impairment of non-financial assets

For the purposes of determining the extent of any impairment or its reversal, estimates must be made regarding future cash flows taking into account key assumptions including future petroleum and natural gas prices, expected forecasted production volumes and anticipated recoverable quantities of proved and probable reserves. These assumptions are subject to change as new information becomes available. Changes in economic conditions can also affect the rate used to discount future cash flow estimates. Changes in the aforementioned assumptions could affect the carrying amount of the Corporation's assets, and impairment charges and reversal will affect profit or loss.

(viii) Income taxes

Birchcliff files corporate income tax, goods and service tax and other tax returns with various provincial and federal taxation authorities in Canada. There can be differing interpretations of applicable tax laws and regulations. The resolution of these tax positions through negotiations or litigation with tax authorities can take several years to complete. The Corporation does not anticipate that there will be any material impact upon the results of its operations, financial position or liquidity.

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods.

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 a judgment as to whether or not 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. Estimates of future taxable income are based on forecasted cash flows from operations. To the extent that any interpretation of tax law is challenged by the tax authorities or future cash flows and taxable income differ significantly from estimates, the ability of Birchcliff to realize the deferred tax assets recorded at the statement of financial position date could be impacted.

4. CHANGES IN ACCOUNTING POLICIES

Accounting Pronouncements Adopted

On January 1, 2018, Birchcliff adopted IFRS 15: *Revenue from Contracts with Customers* (“**IFRS 15**”) using the cumulative effect method. Under this method, the comparative periods have not been restated and the cumulative effect on net earnings and the change in opening retained earnings as a result of the application of IFRS 15 to revenue contracts in progress at January 1, 2018 is nil. The Corporation reviewed its revenue streams and major contracts with customers using the IFRS 15 five step model and there were no changes to net earnings or timing of petroleum and natural gas sales recognized. It should be noted, however, that certain profit and loss line item reclassifications were made.

On January 1, 2018, Birchcliff adopted IFRS 9: *Financial Instruments* (“**IFRS 9**”) to replace IAS 39: *Financial Instruments: Recognition and Measurement* (“**IAS 39**”). IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income and fair value through profit or loss. The previous IAS 39 categories of held to maturity, loans and receivables and available for sale are eliminated. IFRS 9 bases the classification of financial assets on the contractual cash flow characteristics and the Corporation’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 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. The adoption of IFRS 9 has resulted in changes to the Corporation’s investment in securities which, upon adoption of IFRS 9, are measured at fair value through profit or loss. Under the previous IAS 39 standard, Birchcliff’s investment in securities were categorized as available for sale which required the securities to be fair valued with any gains or losses recognized in other comprehensive income. There were no changes to the treatment of distributions declared on the investment in securities which are recorded to profit or loss. The adoption of IFRS 9 had no impact on the amounts recorded in the financial statements as at January 1, 2018 or on the comparative periods.

Future Accounting Pronouncements

In January 2016, the IASB issued IFRS 16: *Leases* (“**IFRS 16**”) which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer (“**lessee**”) and the supplier (“**lessor**”) and replaces the previous lease standards, IAS 17: *Leases* and IFRIC 4: *Determining whether an Arrangement contains a Lease*. IFRS 16 requires the recognition of a right-of-use asset and lease liability on the statement of financial position for most leases, where Birchcliff is acting as a lessee. For lessees applying IFRS 16, the dual classification model of leases as either operating leases or finance leases no longer exists, effectively treating all leases as finance leases. IFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019. The standard is required to be adopted either retrospectively or using a modified retrospective approach. The Corporation will adopt IFRS 16 using the modified retrospective approach, which does not require restatement of prior period financial information and applies the standard prospectively.

IFRS 16 is expected to increase Birchcliff’s total assets and liabilities at January 1, 2019. Future net income will be impacted as the finance charges and depreciation charges associated with lease contracts are not expected to correspond in any one period to the amount of related cash flows. Cash flows associated with lease repayments will be allocated between operating and financing activities based on their interest repayment and principal repayment portions. The actual impact of applying IFRS 16 on the financial statements in the period of initial application will depend on multiple factors and conditions, including but not limited to, the Corporation’s borrowing rate at January

1, 2019, the composition of the Corporation's lease portfolio at that date, the Corporation's latest assessment of whether it will exercise any lease renewal options, and the extent to which the Corporation chooses to use practical expedients and recognition exemptions. On initial adoption, Birchcliff will have the following optional practical expedients available under IFRS 16:

- Certain short-term leases and leases of low value assets that have been identified for recognition at January 1, 2019 can be excluded from recognition on the statements of financial position. Payments for these leases will be disclosed in the notes to the financial statements.
- Certain classes of lease arrangements that transfer a separate good or service under the same contract that have been identified for recognition at January 1, 2019 can be recognized as a single lease component rather than separating between their lease and non-lease components.
- For leases having similar characteristics, a portfolio approach can be used by applying a single discount rate.

The Corporation continues to review all existing contracts in detail. The full extent of the impact has not yet been determined. At minimum, Birchcliff expects to record a right-of-use asset and corresponding lease liability on the statement of financial position for the Corporation's head office lease. The Corporation will disclose the financial impact of IFRS 16 in its unaudited financial statements for the first quarter 2019 and continue to develop and implement changes to its internal controls, information systems and business and accounting processes throughout 2019.

5. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT

The continuity for petroleum and natural gas ("P&NG") properties and equipment are as follows:

<i>(\$000s)</i>	Exploration & Evaluation Assets⁽⁵⁾	Developed & Producing Assets	Corporate Assets	Total
<i>Cost:</i>				
As at December 31, 2016	53	3,376,236	13,950	3,390,239
Additions	28	455,894	1,774	457,696
Acquisitions	-	999	-	999
Dispositions ⁽¹⁾	-	(542,027)	-	(542,027)
As at December 31, 2017	81	3,291,102	15,724	3,306,907
Additions	31	311,887	2,013	313,931
Acquisitions	-	2,173	-	2,173
Dispositions ⁽²⁾	-	(55,636)	-	(55,636)
As at December 31, 2018 ⁽³⁾	112	3,549,526	17,737	3,567,375
<i>Accumulated depletion and depreciation:</i>				
As at December 31, 2016	-	(735,221)	(9,181)	(744,402)
Depletion and depreciation expense	-	(183,831)	(1,835)	(185,666)
Dispositions ⁽¹⁾	-	168,292	-	168,292
As at December 31, 2017	-	(750,760)	(11,016)	(761,776)
Depletion and depreciation expense	-	(206,892)	(1,976)	(208,868)
Dispositions ⁽²⁾	-	36,729	-	36,729
As at December 31, 2018	-	(920,923)	(12,992)	(933,915)
<i>Net book value:</i>				
As at December 31, 2017 ⁽⁴⁾	81	2,540,342	4,708	2,545,131
As at December 31, 2018⁽⁴⁾	112	2,628,603	4,745	2,633,460

(1) Consists largely of two asset dispositions, the Worsley Charlie Lake Light Oil Pool Disposition (the "Worsley Disposition") and the Progress Area Disposition (the "Progress Disposition"). The Worsley Disposition had a net book value of \$321.1 million for total consideration of \$100 million, before closing adjustments and other costs, consisting of: (i) cash consideration of \$90 million; and (ii) securities of affiliates of the purchaser with a total value of \$10 million (Note 6). The Worsley Disposition closed on August 31, 2017. The Progress Disposition had a net book value of \$18.7 million for cash consideration of \$31.7 million, before closing adjustments and other costs. The Progress Disposition closed on October 2, 2017.

(2) Consists mainly of two asset dispositions with a combined net book value of \$18.9 million for total consideration of \$5.3 million.

(3) The Corporation's P&NG properties and equipment were pledged as security for its credit facilities. Although the Corporation believes that it has title to its P&NG properties, it cannot control or completely protect itself against the risk of title disputes and challenges. There were no borrowing costs capitalized to P&NG properties and equipment.

- (4) Birchcliff performed an impairment assessment of its P&NG assets on a CGU basis and determined there were impairment indicators present at the end of each reporting period. The Corporation performed an asset impairment test to ensure that the carrying value of its P&NG properties and equipment was recoverable. Birchcliff's P&NG properties and equipment were not impaired at December 31, 2018 and December 31, 2017.
- (5) E&E assets consist of the Corporation's exploration activities which are pending the determination of economic quantities of commercially producible proved reserves. Additions represent the Corporation's net share of costs incurred on E&E activities during the period. A review of each exploration project by area is carried out at each reporting date to ascertain whether economical quantities of proved reserves have been discovered and whether such costs should be transferred to depletable petroleum and natural gas components. There were no exploration costs reclassified from the E&E category to petroleum and natural gas properties and equipment category during 2018 and 2017.

6. INVESTMENT IN SECURITIES

The Corporation received on August 31, 2017 (the "**Issuance Date**") securities consisting of 4,500,000 common A units (the "**Common A LP Units**") in a limited partnership (the "**Limited Partnership**") affiliated with the purchaser and 10,000,000 preferred units (the "**Preferred Trust Units**") in a trust (the "**Trust**") affiliated with the purchaser (collectively, the "**Securities**") at a combined value of \$10 million. The Securities acquired are not publicly listed and do not constitute significant investments of the entities.

The Securities have limited voting rights and, in the case of the Common A LP Units, no redemption rights and limited participation rights in the event of the liquidation, dissolution or wind-up of the Limited Partnership. Holders of the Securities are entitled to, if and when declared, non-cumulative, quarterly dividend distributions for each three month period ending March 31, June 30, September 30 and December 31. The Preferred Trust Units are redeemable on demand by Birchcliff. For each Preferred Trust Unit redeemed by Birchcliff within the first five years of the Issuance Date, the redemption price will be equal to the lesser of (i) 90% of the fair market value of each redeemed Preferred Trust Unit at the date the redemption and (ii) \$0.90 per redeemed Preferred Trust Unit. For each Preferred Trust Unit redeemed on a date that is later than five years from the Issuance Date, being after August 31, 2022 (the "**Fifth Anniversary Date**"), the redemption price will be equal to the lesser of (i) the fair market value of each redeemed Preferred Trust Unit at the date the redemption and (ii) \$1.00 per redeemed Preferred Trust Unit.

Payment of the redemption price by the Trust is limited to a maximum cash amount of \$10,000 per month (or a greater amount, if the trustees of the Trust so decide) and any portion of the redemption price in excess of such cash amount (the "**Balance**") will be repaid through the Trust's issuance of a redemption note or an *in specie* distribution of the Trust's property. If the Preferred Trust Units are redeemed by Birchcliff before the Fifth Anniversary Date, the Balance is paid by the Trust through the issuance of redemption notes due and payable prior to the sixth anniversary of the Issuance Date, being August 31, 2023. If the Preferred Trust Units are redeemed by Birchcliff after the Fifth Anniversary Date, the Balance is paid by the Trust through the issuance of redemption notes due and payable within less than a year of the date the redemption notes are issued.

The Securities had a fair value of \$10 million at December 31, 2018 and December 31, 2017. During 2018, Birchcliff recorded \$0.8 million (2017 - \$0.3 million) in dividend distributions in respect of the Securities that are included in other income.

7. REVOLVING TERM CREDIT FACILITIES

The components of the Corporation's revolving credit facilities include:

As at, (\$000s)	December 31, 2018	December 31, 2017
Syndicated credit facility	586,000	578,000
Working capital facility	22,821	16,823
Drawn revolving term credit facilities	608,821	594,823
Unamortized prepaid interest on bankers' acceptances	(1,021)	(4,891)
Unamortized deferred financing fees	(2,533)	(2,806)
Revolving term credit facilities	605,267	587,126

At December 31, 2018, the Corporation's credit facilities consisted of extendible revolving credit facilities in the aggregate principal amount of \$950 million with maturity dates of May 11, 2021 (the "**Credit Facilities**"). At December 31, 2018, the Credit Facilities were comprised of: (i) an extendible revolving syndicated term credit facility (the "**Syndicated Credit Facility**") of \$850 million; and (ii) an extendible revolving working capital facility (the "**Working Capital Facility**") of \$100 million.

Birchcliff has outstanding \$17.2 million in letters of credit at December 31, 2018 (see Note 17). The letters of credit reduces the amount available under the Working Capital Facility from \$100 million to approximately \$82.8 million.

The Credit Facilities allow for prime rate loans, LIBOR loans, U.S. base rate loans, bankers' acceptances and, in the case of the Working Capital Facility only, letters of credit. The interest rates applicable to the drawn loans are based on a pricing margin grid and will change as a result of the ratio of outstanding indebtedness to EBITDA as calculated in accordance with the agreement governing the Credit Facilities. EBITDA is defined as earnings before interest and non-cash items including (if any) income taxes, other compensation, gains and losses on sale of assets, unrealized gains and losses on financial instruments and depletion, depreciation and amortization.

The Credit Facilities are subject to a semi-annual review of the borrowing base limit by Birchcliff's syndicate of lenders, which limit is directly impacted by the value of Birchcliff's oil and natural gas reserves. In addition, pursuant to the terms of the credit agreement governing the Credit Facilities, the borrowing base of the Credit Facilities may be adjusted in certain other circumstances. Upon any change in or redetermination of the borrowing base limit which results in a borrowing base shortfall, Birchcliff must eliminate the borrowing base shortfall amount. Birchcliff may each year, at its option, request an extension to the maturity date of the Syndicated Credit Facility and the Working Capital Facility, or either of them, for an additional period of up to three years from May 11 of the year in which the extension request is made. In connection with the most recently completed semi-annual review of the Corporation's borrowing base limit under its credit facilities, the Corporation and the lenders agreed to the borrowing base remaining unchanged at \$950 million.

The Credit Facilities are secured by a fixed and floating charge debenture and pledge charging substantially all of the Corporation's assets. No fixed charges have been granted pursuant to such debenture. The Credit Facilities do not contain any financial maintenance covenants.

8. DECOMMISSIONING OBLIGATIONS

The Corporation's decommissioning obligations result from its net ownership interests in petroleum and natural gas assets, including well sites, gathering systems and processing facilities. The Corporation estimates the total undiscounted (inflated) amount of cash flow required to settle its decommissioning obligations is approximately \$272.1 million at December 31, 2018 (December 31, 2017 – \$269.7 million) and is expected to be incurred up until 2069.

A reconciliation of the decommissioning obligations is set forth below:

<i>As at, (\$000s)</i>	December 31, 2018	December 31, 2017
Balance, beginning	124,825	133,470
Obligations incurred	3,930	8,468
Obligations acquired	649	626
Obligations divested	(3,446)	(45,902)
Changes in estimated future cash flows ⁽²⁾	1,177	25,902
Accretion expense	3,208	3,055
Actual expenditures	(1,079)	(794)
Balance, ending⁽¹⁾	129,264	124,825

(1) Birchcliff applied a risk-free rate of 2.36% and an inflation rate of 2.0% to calculate the discounted fair value of its decommissioning liabilities as at December 31, 2018 and December 31, 2017.

(2) Changes in estimated future cash flows largely due to the revision in abandonment and reclamation cost and date estimates for Birchcliff's oil and natural gas wells and facilities.

9. INCOME TAXES

Included in income tax expense is a deferred income tax expense of \$36.9 million in 2018 and deferred income tax recovery of \$16.9 million in 2017. Part VI.I dividend tax totalling \$3.1 million in 2018 (2017 – \$3.0 million) resulting from preferred share dividends paid during the period. For the purposes of determining the current and deferred income tax, the Corporation applied a combined Canadian federal and provincial income tax rate of 27% in 2018 (2017 – 27%).

The components of income tax expense (recovery) are set forth below:

Years ended December 31, (\$000s)	2018	2017
Net income (loss) before taxes	142,145	(60,866)
Computed expected income tax expense (recovery)	38,379	(16,434)
Decrease (increase) in taxes resulting from:		
Non-deductible stock-based compensation	2,315	1,275
Non-deductible dividends on capital securities	945	945
Non-deductible expenses	155	161
Non-capital losses and investment tax credits	(1,861)	167
Balance, ending	39,933	(13,886)

The components of net deferred income tax liabilities are set forth below:

As at, (\$000s)	December 31, 2018	December 31, 2017
<i>Deferred income tax liabilities:</i>		
P&NG properties and equipment and E&E assets	322,526	286,604
Deferred financing fees	684	758
Capital securities	125	209
Risk management contracts	16,247	-
<i>Deferred income tax assets:</i>		
Decommissioning obligations	(34,901)	(33,703)
Risk management contracts	-	(1,092)
Share issue costs	(3,599)	(5,133)
Non-capital losses and investment tax credits	(181,529)	(164,949)
Deferred income tax liabilities	119,553	82,694

A continuity of the net deferred income tax liabilities is set forth below:

(\$000s)	Balance Jan. 1, 2018	Recognized in Profit or Loss	Balance Dec. 31, 2018
P&NG and E&E assets	286,604	35,922	322,526
Deferred financing fees	758	(74)	684
Capital securities	209	(84)	125
Decommissioning obligations	(33,703)	(1,198)	(34,901)
Risk management contracts	(1,092)	17,339	16,247
Share issue costs	(5,133)	1,534	(3,599)
Non-capital losses and investment tax credits	(164,949)	(16,580)	(181,529)
	82,694	36,859	119,553

(\$000s)	Balance Jan. 1, 2017	Recognized in Profit or Loss	Balance Dec. 31, 2017
P&NG and E&E assets	309,741	(23,137)	286,604
Deferred financing fees	441	317	758
Capital securities	293	(84)	209
Decommissioning obligations	(36,037)	2,334	(33,703)
Risk management contracts	(2,547)	1,455	(1,092)
Share issue costs	(6,041)	908	(5,133)
Non-capital losses and investment tax credits	(166,251)	1,302	(164,949)
	99,599	(16,905)	82,694

As at December 31, 2018, the Corporation had approximately \$2.1 billion (2017 – \$2.1 billion) in tax pools available for deduction against future taxable income. Included in this tax basis are estimated non-capital loss carry forwards of approximately \$641 million that expire between 2028 and 2038. Discretionary tax deductions, including Canadian Development Expenses, Canadian Oil and Gas Property Expense and Capital Cost Allowance, were maximized in the respective tax years in order to reduce Birchcliff's accounting profits into a loss position for tax purposes.

10. CAPITAL STOCK

Share Capital

(a) Authorized:

Unlimited number of voting common shares, with no par value.

Unlimited number of preferred shares, with no par value.

The preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

(b) Number of common shares and perpetual preferred shares issued:

The following table sets forth the number of common shares and perpetual preferred shares issued:

As at, (000s)	December 31, 2018	December 31, 2017
<i>Common shares:</i>		
Outstanding at beginning of period	265,797	264,042
Exercise of stock options	114	1,755
Outstanding at end of period⁽¹⁾	265,911	265,797
<i>Series A preferred shares (perpetual)⁽²⁾:</i>		
Outstanding at beginning of period	2,000	2,000
Outstanding at end of period	2,000	2,000

(1) On November 20, 2018, Birchcliff announced that the TSX had accepted the Corporation's notice of intention to make a normal course issuer bid (the "NCIB"). Pursuant to the NCIB, Birchcliff may purchase up to 18,767,520 of its outstanding common shares. The total number of common shares that Birchcliff is permitted to purchase is subject to a daily purchase limit of 320,520 common shares; provided, however, that the Corporation may make one block purchase per calendar week which exceeds the daily purchase restriction. The NCIB commenced on November 23, 2018 and will terminate on November 22, 2019, or such earlier time as the NCIB is completed or is terminated at the option of Birchcliff. Purchases under the NCIB will be effected through the facilities of the TSX and/or Canadian alternative trading systems at the prevailing market price at the time of such transaction. All common shares purchased under the NCIB will be cancelled. During 2018 and 2017, Birchcliff has not purchased any common shares pursuant to the NCIB.

(2) In August 2012, Birchcliff completed a bought deal equity financing for gross proceeds of \$50 million. The Corporation issued 2,000,000 preferred units at a price of \$25.00 per preferred unit for gross proceeds of \$50 million. Each preferred unit was comprised of one cumulative redeemable five year rate reset Series A Preferred Share of Birchcliff, to yield initially 8% per annum.

The Series A Preferred Shares paid cumulative dividends of \$2.00 per Series A Preferred Share per annum for the initial five year period ending September 30, 2017. On September 30, 2017, the Series A Preferred Shares dividend was reset to \$2.09 per Series A Preferred Share per annum, payable quarterly if, as and when declared by Birchcliff's Board of Directors. Thereafter, the dividend rate will be reset every five years at a rate equal to the then current five year Government of Canada bond yield plus 6.83%. The Series A Preferred Shares were redeemable at \$25.00 per preferred share at the option of the Corporation on September 30, 2017. The Corporation did not exercise the option to redeem any Series A Preferred Shares on September 30, 2017. The next opportunity for the Corporation to redeem the Series A Preferred Shares at \$25.00 per preferred share is September 30, 2022 and on September 30 in every fifth year thereafter. Holders of the Series A Preferred Shares had the right, at their option, to convert their Series A Preferred Shares into cumulative redeemable floating rate Series B Preferred Shares, subject to certain conditions, on September 30, 2017. None of Birchcliff's outstanding Series A Preferred Shares were converted into Series B Preferred Shares on September 30, 2017 as only 165,960 Series A Preferred Shares were tendered for conversion, which was less than the 250,000 shares required to give effect to conversions into Series B Preferred Shares. The next opportunity for holders of the Series A Preferred Shares to convert their Series A Preferred Shares into Series B Preferred Shares, subject to certain conditions, is September 30, 2022 and on September 30 in every fifth year thereafter. The holders of the Series B Preferred Shares will be entitled to receive quarterly floating rate cumulative preferential cash dividends, if declared by Birchcliff's Board of Directors, at a rate equal to the sum of the then current 90 day Government of Canada Treasury Bill rate plus 6.83%. In the event of liquidation, dissolution or winding-up of Birchcliff, the holders of the Series A Preferred Shares and Series B Preferred Shares will be entitled to receive \$25.00 per share as well as all accrued unpaid dividends before any amounts will be paid or any assets will be distributed to the holders of any other shares ranking junior to the Series A Preferred Shares and the Series B Preferred Shares. The holders of the Series A Preferred Shares and the Series B Preferred Shares will not be entitled to share in any further distribution of the assets of the Corporation.

Capital Securities

On June 14, 2013, Birchcliff completed a \$50 million preferred share issue. The Corporation issued 2,000,000 cumulative redeemable Series C Preferred Shares, at a price of \$25.00 per share. The Series C Preferred Shares bear a 7% dividend and their holders are entitled to receive, as and when declared by the Board of Directors of Birchcliff, fixed cumulative preferential cash dividends at an annual rate of \$1.75 per share, payable quarterly.

The Series C Preferred Shares are not redeemable by the Corporation prior to June 30, 2018. On and after June 30, 2018, the Corporation may, at its option, redeem for cash, all or any number of the outstanding Series C Preferred Shares at \$25.75 per share if redeemed before June 30, 2019, at \$25.50 per share if redeemed on or after June 30,

2019 but before June 30, 2020 and at \$25.00 per share if redeemed on or after June 30, 2020, in each case together with all accrued and unpaid dividends to but excluding the date fixed for redemption.

The Series C Preferred Shares are not redeemable by the holders of the preferred shares prior to June 30, 2020. On and after June 30, 2020, a holder of Series C Preferred Shares may, at its option, redeem for cash, all or any number of Series C Preferred Shares held by such holder on the last day of March, June, September and December of each year at \$25.00 per share, together with all accrued and unpaid dividends to but excluding the date fixed for redemption. Upon receipt of the Notice of Redemption, the Corporation may, at its option elect to convert such Series C Preferred Shares into common shares of the Corporation.

On or after June 30, 2018, the Corporation may, at its option, convert all or any number of the outstanding Series C Preferred Shares into common shares. The Corporation has outstanding 2,000,000 Series C Preferred Shares at December 31, 2018 (December 31, 2017 – 2,000,000).

As at December 31, 2018, Birchcliff has not redeemed for cash any of its outstanding Series C Preferred Shares or converted any number of the outstanding Series C Preferred Shares into common shares.

Dividends

The following table sets forth the dividend distributions by the Corporation for each class of shares:

Years ended December 31,	2018	2017
<i>Common shares:</i>		
Dividend distribution (\$000s)	26,586	26,522
Per common share (\$)	0.1000	0.1000
<i>Preferred shares - Series A:</i>		
Series A dividend distribution (\$000s)	4,187	4,047
Per Series A preferred share (\$)	2.0935	2.0234
<i>Preferred shares - Series C:</i>		
Series C dividend distribution (\$000s)	3,500	3,500
Per Series C preferred share (\$)	1.7500	1.7500

Per Common Share

The following table sets forth the computation of net income (loss) per common share:

Years ended December 31, (\$000s, except for per share information)	2018	2017
Net income (loss)	102,212	(46,980)
Dividends on Series A preferred shares	(4,187)	(4,047)
Net income (loss) to common shareholders	98,025	(51,027)
<i>Weighted average common shares:</i>		
Weighted average basic common shares outstanding	265,852	265,182
Effects of dilutive securities	1,471	-
Weighted average diluted common shares outstanding ⁽¹⁾	267,323	265,182
<i>Net income (loss) per common share:</i>		
Basic	\$0.37	(\$0.19)
Diluted	\$0.37	(\$0.19)

(1) The weighted average diluted common shares outstanding as of December 31, 2018 excludes 9,512,201 common shares issuable pursuant to outstanding stock options that were anti-dilutive. As the Corporation reported a loss in 2017, the basic and diluted weighted average shares outstanding are the same for the periods and all stock options and warrants were anti-dilutive.

11. PETROLEUM AND NATURAL GAS SALES

The following table sets forth Birchcliff's petroleum and natural gas sales:

Years ended December 31, (\$000s)	2018	2017
Light oil sales	122,118	134,597
Natural gas sales	332,979	318,790
NGLs sales	166,194	103,245
Total P&NG sales ⁽¹⁾⁽²⁾	621,291	556,632
Royalty income	130	310
Total P&NG sales	621,421	556,942

(1) Excludes the effects of financial derivatives but includes the effects of any physical delivery sales contracts outstanding during the period.

(2) Included in accounts receivable at December 31, 2018 was \$49.1 million in P&NG sales to be received from its marketers in respect of December 2018 production, which was subsequently received in January 2019.

12. OPERATING EXPENSES

The Corporation's operating expenses include all costs with respect to day-to-day well and facility operations. The components of operating expenses are set forth below:

Years ended December 31, (\$000s)	2018	2017
Field operating costs	102,099	112,287
Recoveries	(2,995)	(1,917)
Field operating costs, net	99,104	110,370
Expensed workovers and other	-	116
Operating expenses	99,104	110,486

13. ADMINISTRATIVE EXPENSES

The components of administrative expenses are set forth below:

Years ended December 31, (\$000s)	2018	2017
<i>Cash:</i>		
Salaries and benefits ⁽¹⁾	28,618	31,437
Other ⁽²⁾	13,329	13,498
General and administrative, gross	41,947	44,935
Operating overhead recoveries	(150)	(202)
Capitalized overhead ⁽³⁾	(17,195)	(18,229)
General and administrative, net	24,602	26,504
<i>Non-cash:</i>		
Other compensation ⁽⁴⁾	14,758	9,945
Capitalized compensation ⁽³⁾	(7,061)	(5,886)
Other compensation, net	7,697	4,059
Administrative expenses, net	32,299	30,563

(1) Includes salaries, benefits and bonuses paid to officers and employees of the Corporation and retainer fees, meeting fees and benefits paid to directors of the Corporation.

(2) Includes costs such as rent, legal, tax, insurance, minor computer hardware and software and other business expenses incurred by the Corporation.

(3) Includes a portion of gross general and administrative expenses and other compensation directly attributable to the exploration and development activities of the Corporation, which have been capitalized.

(4) Includes stock-based compensation expense of \$6.9 million and post-employment benefit expense of \$7.8 million in 2018 (2017 - \$9.9 million and \$nil, respectively) (Notes 14 & 16).

Gross compensation for the Corporation's executive officers and directors are comprised of the following:

Years ended December 31, (\$000s)	2018	2017
Salaries and benefits ⁽¹⁾	6,312	8,623
Stock-based compensation ⁽²⁾	1,770	2,256
Post-employment benefit expense ⁽³⁾	7,844	-
Executive Officers and Directors compensation	15,926	10,879

- (1) Includes salaries, benefits and bonuses paid to officers of the Corporation and directors' fees and benefits paid to the directors of the Corporation.
- (2) Represents the amortization of stock-based compensation expense in the year associated with options granted to the executive officers participating in the Option Plan (as defined herein).
- (3) Represents past service costs associated with post-employment benefits granted in the year to the Corporation's executive officers (Note 14).

14. OTHER LIABILITIES

The Corporation has established a post-employment benefit plan for eligible employees, which provides for post-employment benefits based upon the age at retirement and their period of service with Birchcliff (the "Plan"). The Plan is not funded and as such no plan assets exist. The post-employment benefit obligation arising from the Plan is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that have terms to maturity approximating the terms of the related liability. The expenses associated with the Plan are comprised of current and past service costs and the interest (accretion) on the unwinding of the present value of the post-employment benefit obligation.

The Corporation estimates the total undiscounted (inflated) amount of cash flow required to settle its post-employment obligations is approximately \$14.8 million at December 31, 2018 (December 31, 2017 – \$nil). A reconciliation of the discounted post-employment benefit obligation is set forth below:

As at, (\$000s)	December 31, 2018	December 31, 2017
Balance, beginning	-	-
Post-employment benefit expense ⁽¹⁾	7,844	-
Balance, ending⁽²⁾	7,844	-

- (1) Represents the past service costs associated with post-employment benefits.
- (2) Birchcliff applied a discount rate of 2.8% and an inflation rate of 3.0% to calculate the present value of the post-employment benefit obligation at December 31 2018.

Birchcliff recorded a post-employment benefit obligation of \$7.8 million at December 31, 2018 (December 31, 2017 – \$nil). A 1% increase in the discount rate would result in a \$0.3 million decrease in the post-employment benefit obligation at December 31, 2018 (December 31, 2017 - \$nil)

15. FINANCE EXPENSES

The components of finance expenses are set forth below:

Years ended December 31, (\$000s)	2018	2017
<i>Cash:</i>		
Interest on credit facilities	27,969	28,374
<i>Non-cash:</i>		
Accretion ⁽¹⁾	3,208	3,055
Amortization of deferred financing fees	1,534	1,510
Finance expenses	32,711	32,939

- (1) Includes accretion on decommissioning obligations and post-employment benefits.

16. SHARE-BASED PAYMENTS

Stock Options

At December 31, 2018, the Corporation's stock option plan (the "Option Plan") permitted the grant of options in respect of a maximum of 26,591,136 (December 31, 2017 – 26,579,670) common shares. At December 31, 2018, there remained available for issuance options in respect of 10,743,566 (December 31, 2017 – 12,421,563) common shares. For stock options exercised during 2018, the weighted average common share trading price on the Toronto Stock Exchange was \$4.03 (2017 – \$6.22) per common share.

A summary of the outstanding stock options is set forth below:

	Number	Price (\$) ⁽¹⁾
Outstanding, December 31, 2016	12,899,775	6.45
Granted ⁽²⁾	4,867,400	7.67
Exercised	(1,754,796)	(5.33)
Forfeited	(1,606,437)	(7.49)
Expired	(247,835)	(7.55)
Outstanding, December 31, 2017	14,158,107	6.88
Granted ⁽²⁾	4,734,900	3.23
Exercised	(114,664)	(3.35)
Forfeited	(483,405)	(5.59)
Expired	(2,447,368)	(7.57)
Outstanding, December 31, 2018	15,847,570	5.74

(1) Calculated on a weighted average basis.

(2) Each stock option granted entitles the holder to purchase one common share at the exercise price.

The weighted average fair value per option granted during 2018 was \$1.03 (2017 – \$2.96). In determining the stock-based compensation expense for options issued during 2018, the Corporation applied a weighted average estimated forfeiture rate of 11% (2017 – 11%).

The weighted average assumptions used in calculating the Black-Scholes fair values are set forth below:

Years ended December 31,	2018	2017
Risk-free interest rate	2.0%	1.0%
Expected life (years)	4.0	4.0
Expected volatility	49.7%	49.3%
Dividend yield	3.2%	0.1%

A summary of the stock options outstanding and exercisable under the Option Plan at December 31, 2018 is set forth below:

Exercise Price (\$)		Awards Outstanding			Awards Exercisable		
Low	High	Quantity	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price (\$)	Quantity	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price (\$)
3.00	6.00	7,056,369	3.5	3.34	1,595,513	2.1	3.49
6.01	9.00	8,668,201	1.9	7.64	5,932,938	1.3	7.57
9.01	12.00	123,000	1.0	10.07	103,666	0.7	10.25
		15,847,570	2.6	5.74	7,632,117	1.4	6.75

Performance Warrants

On January 14, 2005, Birchcliff issued 4,049,665 performance warrants as part of the Corporation's initial restructuring to become a public entity. There are 2,939,732 performance warrants outstanding and exercisable at December 31, 2018 (December 31, 2017 – 2,939,732). Each performance warrant is exercisable at a price of \$3.00 to purchase one common share of Birchcliff and expires on January 31, 2020.

17. CAPITAL MANAGEMENT

The Corporation's general policy is to maintain a sufficient capital base in order to manage its business in the most effective manner with the goal of increasing the value of its assets and thus its underlying share value. The Corporation's objectives when managing capital are to maintain financial flexibility in order to preserve its ability to meet financial obligations (including potential obligations arising from additional acquisitions), to maintain a capital structure that allows Birchcliff to finance its business strategy using primarily internally-generated cash flow and its available debt capacity and to optimize the use of its capital to provide an appropriate investment return to its shareholders. There were no changes in the Corporation's approach to capital management during 2018 and 2017.

The following table sets forth the Corporation's total available credit:

As at, (\$000s)	December 31, 2018	December 31, 2017
<i>Maximum borrowing base limit⁽¹⁾:</i>		
Revolving term credit facilities	950,000	950,000
<i>Principal amount utilized:</i>		
Drawn revolving term credit facilities	(608,821)	(594,823)
Outstanding letters of credit ⁽²⁾	(17,205)	(12,184)
	(626,026)	(607,007)
Unused credit	323,974	342,993

(1) The Credit Facilities are subject to a semi-annual review of the borrowing base limit, which is directly impacted by the value of Birchcliff's petroleum and natural gas reserves.

(2) Letters of credit are issued to various service providers. The letters of credit reduced the amount available under the Working Capital Facility.

The capital structure of the Corporation is as follows:

As at, (\$000s)	December 31, 2018	December 31, 2017	% Change
Shareholders' equity ⁽¹⁾	1,774,890	1,696,153	
Capital securities	49,535	49,225	
Shareholders' equity & capital securities	1,824,425	1,745,378	5%
Shareholders' equity & capital securities as a % of total capital ⁽²⁾	74%	74%	
Working capital deficit ⁽³⁾	21,187	11,067	
Drawn revolving term credit facilities	605,267	594,823	
Drawn debt	626,454	605,890	3%
Drawn debt as a % of total capital	26%	26%	
Total capital	2,450,879	2,351,268	4%

(1) Shareholders' equity is defined as share capital plus contributed surplus plus retained earnings, less any deficit.

(2) Of the 74%, approximately 95% relates to common capital stock and 5% relates to preferred capital stock.

(3) Working capital is defined as current assets less current liabilities (excluding fair value of financial instruments).

18. FINANCIAL RISK MANAGEMENT

Birchcliff is exposed to credit risk, liquidity risk and market risk as part of its normal course of business. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's financial risk management framework and periodically reviews the results of all risk management activities and all outstanding positions.

Credit Risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial asset fails to meet its contractual obligation, and arises principally from Birchcliff's receivables from its oil and natural gas marketers and its financial instruments. Cash is comprised of bank balances. Historically, the Corporation has not carried short-term investments. Should this change in the future, counterparties will be selected based on credit ratings, management will monitor all investments to ensure a stable return and complex investment vehicles with higher risk will be avoided. The Corporation's exposure to cash credit risk at the statement of financial position date is low.

The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers. The following table illustrates the Corporation's maximum exposure for accounts receivable:

As at, (\$000s)	December 31, 2018	December 31, 2017
Marketers ⁽¹⁾	49,070	59,821
Joint venture	2,342	3,544
Other	529	5,937
Accounts receivable	51,941	69,302

(1) At December 31, 2018, approximately 33% was due from one marketer (2017 – 23%, one marketer). During 2018, the Corporation received 23%, 11% and 10% of its revenue, respectively, from three marketers (2017 – 20%, 16% and 10% of its revenue, respectively, from three marketers).

Typically, Birchcliff's maximum credit exposure from its marketers is revenue from its commodity sales. Receivables from marketers are normally collected on the 25th day of the month following production. Birchcliff mitigates the

credit risk associated with these receivables by establishing marketing relationships with credit worthy purchasers, obtaining guarantees from their ultimate parent companies and obtaining letters of credit, if and as appropriate. The Corporation historically has not experienced any material collection issues with its marketers.

Birchcliff's accounts receivables are aged as follows:

As at, (\$000s)	December 31, 2018	December 31, 2017
Current (less than 30 days)	48,052	66,901
30 to 60 days	2,006	1,637
61 to 90 days	1,099	666
91 to 120 days	160	26
Over 120 days	624	72
Accounts receivable	51,941	69,302

At December 31, 2018, approximately \$0.6 million or 1.2% (2017 – \$0.07 million or 0.1%) of Birchcliff's total accounts receivable are aged over 120 days and considered past due. The majority of these accounts are due from various joint venture partners. Birchcliff attempts to mitigate the credit risk from joint venture receivables by obtaining pre-approval of significant capital expenditures. However, the receivables are 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 and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increases the potential for non-collection. The Corporation does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Corporation does have the ability to withhold production from joint venture partners in the event of non-payment.

The carrying amount of Birchcliff's accounts receivable, financial instruments and investment in securities represents its maximum credit exposure. Birchcliff determined that the ultimate collection of these financial assets were not in doubt and therefore no allowance or charge to profit or loss was recorded in 2018 and 2017.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its obligations associated with financial liabilities that are settled by cash as they become due. Birchcliff's approach to managing liquidity is to ensure, as much as possible, that it will have sufficient liquidity to meet its short-term and long-term financial obligations when due, under both normal and unusual conditions without incurring unacceptable losses or risking harm to the Corporation's reputation. Birchcliff actively manages its liquidity using cash and debt management programs. Strategies include monitoring forecast and actual cash flows from operating, financing, and investing activities and managing available credit and working capital under its Credit Facilities.

All of the Corporation's contractual financial liabilities can be settled in cash. Typically, the Corporation ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of financial obligations. To achieve this objective, the Corporation prepares annual capital expenditure budgets, which are approved by the Board of Directors and are regularly reviewed and updated as considered necessary. Petroleum and natural gas production is monitored daily and is used to provide monthly cash flow estimates. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to manage capital expenditure. The Corporation also attempts to match its payment cycle with collection of petroleum and natural gas revenue on the 25th of each month. Should commodity prices deteriorate materially, Birchcliff may adjust its capital spending accordingly to ensure that it is able to service its short-term financial obligations.

To facilitate the capital expenditure program, the Corporation has an aggregate \$950 million reserve-based bank credit facilities at the end of 2018 (2017 – \$950 million) which are reviewed semi-annually by its lenders. The principal amount drawn under the Corporation's total credit facilities at December 31, 2018 was \$626.0 million (2017 – \$607.0 million) and \$324 million in unused credit was available at the end of 2018 (2017 – \$343.0 million) to fund future obligations.

The following table lists the Corporation's financial liabilities at December 31, 2018 in the period they are due:

(\$000s)	2019	2021
Accounts payable and accrued liabilities	76,567	-
Drawn revolving credit facilities	-	608,821
Financial liabilities	76,567	608,821

Market Risk

Market risk is the risk that changes in market conditions, such as commodity prices, exchange rates and interest rates, will affect the Corporation's net income or the value of its financial instruments, if any. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns. These risks are consistent with prior years. All risk management transactions are conducted within risk management tolerances that are reviewed by the Board of Directors.

Commodity Price Risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can materially impact cash flows and the Corporation's borrowing base limit. Lower commodity prices can also reduce the Corporation's ability to raise capital. Commodity prices for petroleum and natural gas are not only influenced by Canadian ("CDN") and United States ("US") demand, but also by world events that dictate the levels of supply and demand.

Financial Derivative Contracts

As of December 31, 2018, Birchcliff had certain financial derivative contracts outstanding in order to manage commodity price risk. These instruments are not used for trading or speculative purposes. Birchcliff has not designated its financial derivative contracts as effective accounting hedges, even though the Corporation considers all commodity contracts to be effective economic hedges. As a result, all such financial derivative contracts are recorded on the statement of financial position at fair value, with the changes in fair value being recognized as an unrealized gain or loss in profit or loss.

As at December 31, 2018, Birchcliff had the following financial derivative contracts in place in order to manage commodity price risk:

Product	Type of Contract	Notional Quantity	Term ⁽¹⁾	Contract Price	Fair Value (\$000s)
Natural gas	AECO 7A basis swap ⁽²⁾	30,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2023	NYMEX HH less US\$1.298/MMBtu	16,474
Natural gas	AECO 7A basis swap ⁽²⁾	10,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2023	NYMEX HH less US\$1.32/MMBtu	5,079
Natural gas	AECO 7Abasis swap ⁽²⁾	30,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2023	NYMEX HH less US\$1.33/MMBtu	13,273
Natural gas	AECO 7A basis swap ⁽²⁾	15,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2024	NYMEX HH less US\$1.185/MMBtu	11,288
Natural gas	AECO 7A basis swap ⁽²⁾	5,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2024	NYMEX HH less US\$1.20/MMBtu	3,826
Natural gas	AECO 7A basis swap ⁽²⁾	5,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2024	NYMEX HH less US\$1.20/MMBtu	3,604
Natural gas	AECO 7A basis swap ⁽³⁾	10,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	NYMEX HH less US\$3.10/MMBtu	1,246
Natural gas	AECO 7A basis swap ⁽³⁾	10,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	NYMEX HH less US\$3.15/MMBtu	1,276
Natural gas	AECO 7A basis swap ⁽³⁾	30,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	NYMEX HH less US\$3.16/MMBtu	4,109
Fair Value Asset					60,175

(1) Transactions with common terms and the same counterparty have been aggregated and presented at the weighted average price.

(2) Birchcliff sold AECO basis swap.

(3) Birchcliff bought AECO basis swap.

The fair value asset of the Corporation's financial derivative contracts at December 31, 2018 was \$60.2 million (2017 – liability of \$4.0 million).

The following table provides a summary of the realized and unrealized gains (losses) on financial derivative contracts:

Years ended December 31, (\$000s)	2018	2017
Realized gain (loss) on derivatives ⁽¹⁾	(15,771)	25,785
Unrealized gain on derivatives	64,222	5,387

(1) During the fourth quarter of 2018, Birchcliff monetized all of its outstanding USD WTI fixed price contracts and recorded a realized gain of \$4.0 million.

At December 31, 2018, if the future AECO/NYMEX basis was US\$0.10/MMBtu higher, with all other variables held constant, after tax net income in 2018 would have increased by \$15.5 million.

The following financial derivative contracts were entered into subsequent to December 31, 2018:

Product	Type of Contract	Notional Quantity	Term ⁽¹⁾	Contract Price
Natural gas	AECO 7A basis swap ⁽²⁾	10,000 MMBtu/d	Jan. 1, 2025 – Dec. 31, 2025	NYMEX HH less US\$1.020/MMBtu
Natural gas	AECO 7A basis swap ⁽²⁾	20,000 MMBtu/d	Jan. 1, 2024 – Dec. 31, 2025	NYMEX HH less US\$1.119/MMBtu
Natural gas	AECO 7A basis swap ⁽²⁾	25,000 MMBtu/d	Jan. 1, 2024 – Dec. 31, 2025	NYMEX HH less US\$1.135/MMBtu
Natural gas	AECO 7A basis swap ⁽²⁾	5,000 MMBtu/d	Jan. 1, 2021 – Dec. 31, 2025	NYMEX HH less US\$1.178/MMBtu
Natural gas	AECO 7A basis swap ⁽²⁾	10,000 MMBtu/d	Jan. 1, 2021 – Dec. 31, 2025	NYMEX HH less US\$1.175/MMBtu
Natural gas	AECO 7A basis swap ⁽²⁾	5,000 MMBtu/d	Jan. 1, 2021 – Dec. 31, 2025	NYMEX HH less US\$1.190/MMBtu

(1) Transactions with common terms and the same counterparty have been aggregated and presented at the weighted average price.

(2) Birchcliff sold AECO basis swap.

Physical Delivery Sales Contracts

Birchcliff also enters into physical delivery sales contracts to manage commodity price risk. These contracts are considered normal executory sales contracts and are not recorded at fair value through profit or loss. At December 31, 2018, the Corporation had the following physical delivery sales contract in place:

Product	Type of Contract	Quantity	Term ⁽¹⁾	Contract Price
Natural gas	AECO 7A basis swap ⁽²⁾	5,000 MMBtu/d	Jan. 1, 2019 – Dec. 31, 2023	NYMEX HH less US\$1.205/MMBtu
Natural gas	Dawn fixed price ⁽³⁾	5,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	US\$5.100/MMBtu
Natural gas	Dawn fixed price ⁽³⁾	10,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	US\$5.000/MMBtu
Natural gas	Dawn fixed price ⁽³⁾	10,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	US\$5.005/MMBtu
Natural gas	Dawn fixed price ⁽³⁾	10,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	US\$5.020/MMBtu
Natural gas	Dawn fixed price ⁽³⁾	15,000 MMBtu/d	Jan. 1, 2019 – Mar. 31, 2019	US\$5.103/MMBtu

(1) Transactions with common terms and the same counterparty have been aggregated and presented at the weighted average price.

(2) Birchcliff sold AECO basis swap.

(3) Birchcliff entered into a 4-month fixed price physical natural gas Dawn sales arrangement commencing December 1, 2018.

There were no long-term physical delivery sales contracts entered into subsequent to December 31, 2018.

Foreign Currency Risk

Foreign currency risk is the risk that future cash flows will fluctuate as a result of changes in foreign currency exchange rates. The exchange rate effect cannot be quantified but generally an increase in the value of the CDN dollar as compared to the US dollar will reduce the CDN dollar prices received by Birchcliff for its petroleum and natural gas sales. The Corporation had no forward exchange rate contracts in place as at or during the years ended December 31, 2018 and 2017.

Interest Rate Risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Corporation's credit facilities are exposed to interest rate cash flow risk on a floating interest rate due to fluctuations in market interest rates. The remainder of Birchcliff's financial assets and liabilities are not exposed directly to interest rate risk.

A 1% change in the CDN prime interest rate in 2018 would have changed after-tax net income by approximately \$4.4 million (2017 – \$4.3 million), assuming that all other variables remain constant. A sensitivity of 1% is considered reasonable given the current level of the bank prime rate and market expectations for future movements.

The Corporation reviews its market interest rate risk exposure and may enter into interest rate swaps when market conditions are favourable in order to reduce volatility in its financial results. Subsequent to December 31, 2018, Birchcliff entered into a financial one-month bankers' acceptance CDOR (Canadian Dollar Offered Rate) fixed interest rate swap on \$350 million at 2.215% for the period from March 1, 2019 to March 1, 2024.

Fair Value of Financial Instruments

Birchcliff's financial instruments include cash, accounts receivable, deposits, investment in securities, accounts payable and accrued liabilities, financial derivative contracts, outstanding credit facilities and capital securities. All of Birchcliff's financial instruments are transacted in active markets. Financial instruments carried at fair value are assessed using the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

The carrying value and fair value of the Corporation's financial assets and liabilities at December 31, 2018 are set forth below:

	Carrying Value	Fair Value
<i>Loans and receivables:</i>		
Cash	53	53
Accounts receivable	51,941	51,941
Deposits	2,756	2,756
Investment in securities ⁽¹⁾	10,005	10,005
Fair value of financial derivatives ⁽²⁾	60,175	60,175
<i>Other liabilities:</i>		
Accounts payable and accrued liabilities	76,567	76,567
Capital Securities	49,535	48,400
Drawn revolving term credit facilities	608,821	608,821

(1) Investment in securities are fair valued based on level 1.

(2) Financial derivative contracts are fair valued based on level 2.

19. COMMITMENTS

The Corporation enters into contracts and commitments in the normal course of operations. The following table lists Birchcliff's commitments at December 31, 2018:

<i>(\$000s)</i>	2019	2020	2021 - 2023	Thereafter
Operating leases ⁽¹⁾	4,408	4,408	13,707	19,667
Firm transportation and fractionation ⁽²⁾	107,678	116,574	364,742	348,079
Natural gas processing ⁽³⁾	17,155	17,702	51,465	154,536
Commitments	129,241	138,684	429,914	522,282

- (1) On December 2, 2015, the Corporation entered into an operating lease commitment relating to a new office premises beginning February 1, 2018 and expiring on January 31, 2028. The commitment amount under the new 10 year office lease is estimated to be \$42.2 million, which includes costs allocated to base rent, parking and building operating expenses. The office lease commitment amounts disclosed in the above table have not been reduced for any rents receivable by the Corporation.
- (2) Includes firm transportation service arrangements with various terms on TCPL's Alberta NGTL System and on TCPL's Canadian Mainline to the AECO and Dawn trading hubs and fractionation commitments associated with NGLs production processed at third-party facilities.
- (3) Includes natural gas processing commitments at third-party facilities.

20. SUPPLEMENTARY CASH FLOW INFORMATION

Years ended December 31, (\$000s)	2018	2017
Provided by (used in):		
Accounts receivable	17,361	(6,730)
Prepaid expenses and deposits	(764)	(621)
Accounts payable and accrued liabilities	(6,472)	(9,076)
Dividend tax	(3,074)	(3,019)
	7,051	(19,446)
Provided by (used in):		
Operating	12,591	(29,226)
Investing	(5,540)	9,780
	7,051	(19,446)

21. CONTINGENT LIABILITY

Birchcliff's 2006 income tax filings were reassessed by the Canada Revenue Agency (the "CRA") in 2011 (the "Reassessment"). The Reassessment was based on the CRA's position that the tax pools available to Veracel Inc. ("Veracel"), prior to its amalgamation with Birchcliff, ceased to be available to Veracel after Birchcliff and Veracel amalgamated on May 31, 2005. The Veracel tax pools in dispute totalled \$39.3 million. Birchcliff appealed the Reassessment to the Tax Court of Canada (the "Trial Court") and the trial of that appeal occurred in November 2013. On October 1, 2015, the Trial Court issued its decision (the "Trial Decision") and dismissed Birchcliff's appeal on the basis of the general anti-avoidance rule contained in the *Income Tax Act* (Canada). The Trial Decision was rendered by a judge based on the written record and not by the judge who conducted the trial. As a result of the Trial Decision, Birchcliff recorded a non-cash deferred income tax expense in the amount of \$10.2 million in the fourth quarter of 2015.

Birchcliff appealed the Trial Decision to the Federal Court of Appeal (the "FCA"), which appeal was heard in January 2017. In April 2017, the FCA issued its decision and allowed the appeal and set aside the Trial Decision, based on the lack of jurisdiction by the judge who rendered the Trial Decision. In setting aside the Trial Decision, the FCA referred the matter back to the judge of the Trial Court who initially conducted the trial in 2013 to render a judgment. The judge of the Trial Court rendered a decision in November 2017 and dismissed the Corporation's appeal. The Corporation appealed that decision to the FCA, which appeal was heard on December 10, 2018 with judgment reserved.

22. SUBSEQUENT EVENT

On November 14, 2018, Birchcliff announced that it had entered into a definitive purchase and sale agreement to acquire Montney lands located between the Corporation's existing properties, as well as various other non-Montney lands and other assets, for total cash consideration of \$39 million (the "**Acquisition**"). The Corporation paid a deposit of \$3.9 million in connection with the Acquisition, the full amount of which was drawn under the Credit Facilities at December 31, 2018. The remaining cash required to close the Acquisition was financed by the Corporation's Credit Facilities on closing which occurred on January 3, 2019.