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TSX-V: HME
OTCQX: HMENF



Hemisphere

ENERGY

2020

ANNUAL REPORT

Corporate Summary

Hemisphere Energy Corporation is a Canadian oil company focused on the sustainable growth of our high-netback, low decline heavy oil pools utilizing enhanced oil recovery methods and proven exploitation technologies. Hemisphere trades on the TSX Venture Exchange as a Tier 1 issuer under the symbol "HME" and on the OTCQX Best Market under the symbol "HMENF".

2021 Annual General and Special Meeting of Shareholders

June 15, 2021 at 9:00am Pacific Time
 Harper Grey LLP
 3200 – 650 West Georgia Street,
 Vancouver, British Columbia

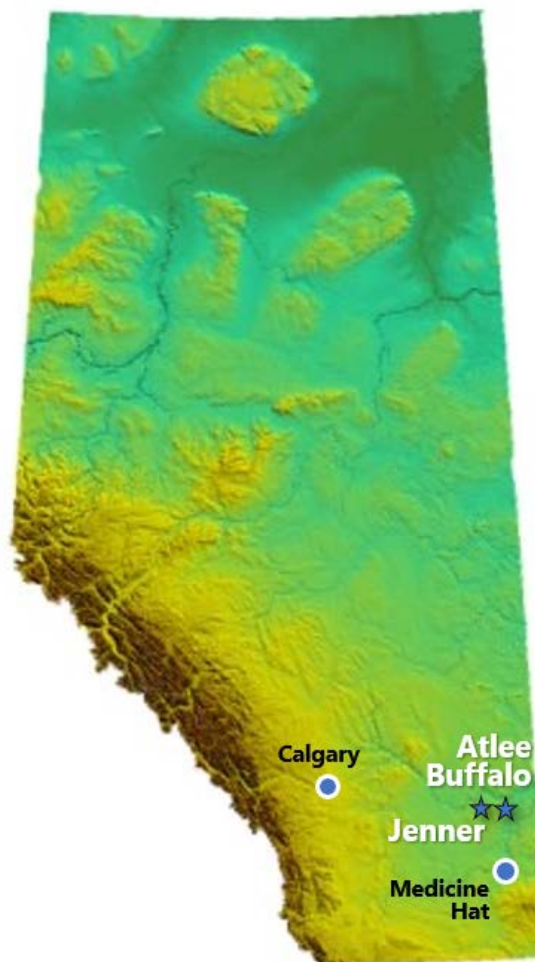


Table of Contents

2020 FINANCIAL AND OPERATING HIGHLIGHTS	Error! Bookmark not defined.
MESSAGE TO SHAREHOLDERS	3
MANAGEMENT'S DISCUSSION AND ANALYSIS	4
MANAGEMENT'S REPORT	26
INDEPENDENT AUDITORS' REPORT	27
STATEMENTS OF FINANCIAL POSITION	30
STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	31
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY	32
STATEMENTS OF CASH FLOWS	33
NOTES TO THE FINANCIAL STATEMENTS	34

2020 FINANCIAL AND OPERATING HIGHLIGHTS

	Year Ended December 31	
	2020	2019
FINANCIAL		
Petroleum and natural gas revenue	\$ 18,660,257	\$ 31,511,084
Operating field netback ⁽¹⁾	10,745,098	20,123,062
Operating netback ⁽²⁾	14,459,691	18,719,149
Cash flow provided by operating activities	9,389,702	10,451,802
Adjusted funds flow from operations ⁽³⁾	9,294,933	13,043,478
Per share, basic and diluted ⁽³⁾	0.11	0.14
Net income (loss)	(415,908)	1,577,810
Per share, basic and diluted	(0.00)	0.02
Capital expenditures	1,685,422	10,947,329
Net debt ⁽⁴⁾	24,429,191	31,982,764
Gross term loan ⁽⁵⁾	\$ 26,096,500	\$ 34,418,200
Average daily production		
Heavy oil (bbl/d)	1,692	1,607
Natural gas (Mcf/d)	88	342
NGL (bbl/d)	-	1
Combined (boe/d)	1,706	1,665
Oil and NGL weighting	99%	97%
Average sales prices		
Heavy oil (\$/bbl)	\$ 30.03	\$ 53.30
Natural gas (\$/Mcf)	2.14	1.87
NGL (\$/bbl)	68.84	42.05
Combined (\$/boe)	\$ 29.88	\$ 51.85
Operating netback (\$/boe)		
Petroleum and natural gas revenue	\$ 29.88	\$ 51.85
Royalties	(2.73)	(6.38)
Operating costs	(7.41)	(9.81)
Transportation costs	(2.53)	(2.55)
Operating field netback ⁽¹⁾	17.21	33.11
Realized commodity hedging gain (loss)	5.95	(2.31)
Operating netback ⁽²⁾	\$ 23.16	\$ 30.80

Notes:

- (1) Operating field netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis.
- (2) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.
- (3) Adjusted funds flow from operations, is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for any decommissioning expenditures, and may not be comparable to measures used by other companies.
- (4) Net debt is a non-IFRS measure calculated as current assets minus current liabilities, excluding fair value of financial instruments, lease and warrant liabilities, plus gross term loan.
- (5) Gross term loan is calculated as the total USD draws, less any payments, on the term loan translated to Canadian Dollars at the period end exchange rate.

	As at December 31	
	2020	2019
RESERVES		
Proved (Mboe) ⁽¹⁾	11,679.7	9,911.8
Proved plus Probable (Mboe) ⁽¹⁾	14,921.2	12,195.7
COMMON SHARES		
Common shares outstanding	86,782,302	88,902,302
Stock options outstanding	8,429,000	8,184,000
Warrants outstanding	13,750,000	13,750,000
Fully diluted shares outstanding	108,961,302	110,836,302
Weighted-average shares outstanding – basic	88,161,583	89,662,316
Weighted-average shares outstanding – diluted	88,161,583	90,362,590

Note:

- (1) Reserves as attributed by the Company's independent reserves evaluator, McDaniel & Associates Consultants Ltd., in its report dated March 5, 2021 and effective as of December 31, 2020, prepared in accordance with the COGE Handbook and National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities.

MESSAGE TO SHAREHOLDERS

Dear Fellow Hemisphere Shareholders,

I hope this letter finds everyone healthy and safe as we look forward to a very prosperous 2021.

While the past year brought the oil and gas industry numerous challenges, Hemisphere reacted quickly by cutting our capital spending program, reducing operating costs, focusing on maintaining production and cash flow, and paying down a significant portion of our debt.

Our team prioritized essential capital expenditures, and spent only \$1.7 million during the year. This capital was dedicated to expanding our waterflood injection pattern and preparing for polymer flood conversion in the Atlee Buffalo G pool. Reservoir simulation and analogue analysis both show great potential for a substantial increase in oil production and recovery from these conversions. In fact, Hemisphere's production through the latter half of April is already trending 25% higher than in the fourth quarter from the three waterflood injector conversions that were done at the end of 2020.

The operations team did an exceptional job lowering our field operating costs by 20% over the previous year to \$9.94/boe. This is an outstanding result for a heavy oil company, and helped us to keep all of our employees, contractors, and small business partners employed throughout such an extremely volatile market.

Maintaining production with minimal capital spending and no drilling activity was a key corporate goal. We managed to obtain 2% year over year growth in average annual production at just over 1,700 boe/d (99% heavy oil). Negligible overall production decline, and subsequent incline from waterflood conversions, is a testament to our stable, high quality oil reserves.

Despite a reduction in annual revenue by over 40% in 2020 due to the impact of COVID-19 on oil prices, we achieved adjusted funds flow from operations of \$9.3 million. This allowed us to lower our previously outstanding debt by almost 25%, thereby strengthening our leverage metrics as we move forward into growth mode.

Hemisphere is at an exciting point in its journey forward. In 2017, we took a term-loan to finance the development of our first-class oil resource. We were cash flow poor, but extremely asset rich. Things have changed, and we are now a simple, clean, and unique small-cap oil company with plenty of room for growth and cash flow to fund it. Over the coming two years, we intend to continue developing our Atlee Buffalo oil pools, pay down our debt, and return value to our shareholders through our share buyback program and potential future dividends. Thank you for your continued support, and we hope you'll hang on for the ride!!

Best Regards,
(Signed) "Don Simmons"
President & CEO

Please refer to the attached Management's Discussion and Analysis for Reader Advisories regarding, among other matters, forward-looking information, non-IFRS measures, analogous information, reserves advisories and original oil in place. This Message to Shareholders should be read in conjunction with the audited annual financial statements of Hemisphere Energy Corporation together with Management's Discussion and Analysis for the year ended December 31, 2020, which can be found on SEDAR at www.sedar.com and is subject to the same cautionary statements as set out therein.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as at April 28, 2021

The following Management's Discussion and Analysis ("MD&A") is a review of the operations and current financial position for the year ended December 31, 2020 for Hemisphere Energy Corporation ("Hemisphere" or the "Company") and should be read in conjunction with the audited Annual Financial Statements and related notes for the years ended December 31, 2020 and 2019. These documents and additional information relating to the Company, including the Company's Annual Information Form, are available on SEDAR at www.sedar.com or the Company's website at www.hemisphereenergy.ca.

The information in this MD&A is based on the audited annual financial statements which were prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

This MD&A contains non-IFRS measures and forward-looking statements. Readers are cautioned that this document should be read in conjunction with Hemisphere's disclosure under "Non-IFRS and additional IFRS Measures" and "Forward-Looking Statements" included at the end of this MD&A. All figures are in Canadian dollars unless otherwise noted.

Business Overview

Hemisphere produces oil and natural gas from its Atlee Buffalo and Jenner properties in southeast Alberta. The Company is headquartered in Vancouver, British Columbia and is traded on the TSX Venture Exchange under the symbol "HME" and on the OTCQX Best Market under the symbol "HMENF".

Atlee Buffalo, Alberta

The Company owns and operates all of its wells in the Atlee Buffalo area. The property is accessible year-round and is located north of Medicine Hat in southeastern Alberta. Hemisphere has a 100% working interest in 8,800 net acres.

Jenner, Alberta

Hemisphere owns and operates all of its wells and has a land position of 8,024 net acres in the Jenner area. The property is accessible year-round and is located 25 kilometers west of the Company's Atlee Buffalo property in southeastern Alberta.

Operating Results

The Company generated adjusted funds flow from operations¹ of \$9,294,933 (\$0.11/share) for the year ended December 31, 2020, as compared to \$13,043,478 (\$0.14/share) for the year ended December 31, 2019. For the fourth quarter of 2020, the Company generated adjusted funds flow from operations of \$2,380,051 (\$0.03/share) as compared to adjusted funds flow from operations of \$4,324,443 (\$0.05/share) for the fourth quarter of 2019. The decrease in adjusted funds flow from operations for

¹ Adjusted funds flow from operations, is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for any decommissioning expenditures, and may not be comparable to measures used by other companies.

three and twelve months ended December 31, 2020 are primarily due to the decline in realized commodity pricing of 20% and 42% over the comparable three and twelve months in 2019, as discussed below under 'Average Benchmark and Realized Prices'.

The Company reported a net loss of \$415,908 (\$0.00/share) for the year ended December 31, 2020 as compared to net income of \$1,577,810 (\$0.02/share) for the year ended December 31, 2019. The decrease in annual net income for 2020 of \$1,993,718 is primarily attributed to the decrease in operating field netback of \$9,377,964 and an increase in impairment of \$3,111,946, offset by increases in realized and unrealized hedging gains of \$5,118,506 and \$3,308,750, and a decrease in depletion and depreciation expenses of \$1,237,723. For the fourth quarter of 2020, the Company reported a net loss of \$1,501,079 (\$0.02/share) compared to a net loss of \$2,888,075 (\$0.03/share) for the fourth quarter of 2019. This improvement of \$1,386,994 in the fourth quarter of 2020 includes an increase in foreign exchange gain of \$1,293,291 over the comparable period in 2019.

Production

By product	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Heavy oil (bbl/d)	1,507	2,101	1,692	1,607
Natural gas (Mcf/d)	88	381	88	342
NGL (bbl/d)	-	2	-	1
Total (boe/d)	1,522	2,166	1,706	1,665
Oil and NGL weighting	99%	97%	99%	97%

In the fourth quarter of 2020, the Company's average daily production was 1,522 boe/d (99% heavy crude oil and 1% conventional natural gas). This represents a 30% decrease in production from the fourth quarter of 2019. This decrease is primarily due to the conversion of three wells in the Atlee G Pool from oil producing wells to water injectors, and wells being on flush production through the fourth quarter of 2019 due to a significant drilling program in the latter half of that year. The Company's average daily production for the year ended December 31, 2020 increased by 2% to 1,706 boe/d (99% heavy crude oil and 1% conventional natural gas) from the year ended December 31, 2019. This increase in production is attributed to the continued success of the base waterflood performance in the Upper Mannville F and G pools, despite the shut-in of high water cut Jenner wells during the second quarter.

Average Benchmark and Realized Prices

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Benchmark Prices				
WTI (US\$/bbl) ⁽¹⁾	\$ 42.66	\$ 56.96	\$ 39.40	\$ 57.02
Exchange rate (Cdn\$/US\$)	1.3029	1.3198	1.3400	1.3267
WTI (C\$/bbl)	55.58	75.18	52.79	75.65
WCS Diff (\$/bbl)	12.16	20.89	17.20	16.88
WCS (C\$/bbl) ⁽²⁾	43.42	54.29	35.59	58.77
AECO natural gas (\$/Mcf) ⁽³⁾	2.65	2.48	2.24	1.80
Average realized prices				
Heavy oil (\$/bbl)	38.47	48.57	30.03	53.30
Natural gas (\$/Mcf)	2.51	2.21	2.14	1.87
NGL (\$/bbl)	-	38.64	68.84	42.05
Combined (\$/boe)	\$ 38.24	\$ 47.53	\$ 29.88	\$ 51.85

Notes:

(1) Represents posting prices of West Texas Intermediate Oil.

(2) Represents posting prices of Western Canadian Select.

(3) Represents the Alberta 30 day spot AECO posting prices.

The Company's oil and natural gas sales and financial results are significantly influenced by changes in commodity prices. The West Texas Intermediate pricing ("WTI") at Cushing, Oklahoma is the benchmark reference price for North American crude oil prices. Canadian oil prices, including Hemisphere's heavy crude oil, are based on price postings, which is WTI-adjusted for transportation, quality and the currency conversion rates from United States dollar ("USD") to Canadian dollar.

The Company's combined average realized price decreased by 20% from \$47.53/boe during the three months ended December 31, 2019 to \$38.24/boe during the three months ended December 31, 2020. The Company's combined average realized price decreased by 42% from \$51.85/boe during the twelve months ended December 31, 2019 to \$29.88/boe during the twelve months ended December 31, 2020. This decrease is the result of decreases in realized WTI pricing of US\$14.30/bbl and US\$17.62/bbl respectively, combined with changes to the differential between WCS and WTI pricing of (\$8.73)/bbl and \$0.32/bbl respectively, for the three and twelve ended December 31, 2020 over the comparable periods in 2019.

As at the date of this MD&A, the Company held derivative commodity contracts as follows:

Product	Type	Volume	Price	Index	Term
Crude oil	3-Way	625 bbl/d	US\$40.00(put)/US\$48.00(put)/US\$60(call)	WTI-NYMEX	Apr. 1, 2021 – Jun. 30, 2021
Crude oil	Phys. Swap	400 bbl/d	US\$48.00	WCS	Apr. 1, 2021 – Jun. 30, 2021
Crude oil	Swap	200 bbl/d	US\$11.15	WCS Differential	May 1, 2021 – Jun. 30, 2021
Crude oil	Phys. Swap	200 bbl/d	US\$46.05	WCS	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Phys. Swap	200 bbl/d	US\$9.45	WCS Differential	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	100 bbl/d	US\$56.75	WTI-NYMEX	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	500 bbl/d	US\$60.07	WTI-NYMEX	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	200 bbl/d	US\$11.50	WCS Differential	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	100 bbl/d	US\$11.20	WCS Differential	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	100 bbl/d	US\$11.15	WCS Differential	Jul. 1, 2021 – Sep. 30, 2021
Crude oil	Swap	800 bbl/d	US\$58.45	WTI-NYMEX	Oct. 31, 2021 – Dec. 31, 2021
Crude oil	Swap	100 bbl/d	US\$12.50	WCS Differential	Oct. 31, 2021 – Dec. 31, 2021
Crude oil	Swap	100 bbl/d	US\$12.00	WCS Differential	Oct. 31, 2021 – Dec. 31, 2021
Crude oil	Swap	800 bbl/d	US\$57.03	WTI-NYMEX	Jan. 1, 2022 – Mar. 31, 2022
Crude oil	Put Spread	725 bbl/d	US\$30.00(put sell)/US\$40.00(put buy), net cost US\$1.65/bbl	WTI-NYMEX	Apr. 1, 2022 – Aug. 31, 2022

At December 31, 2020, the commodity contracts were fair valued as an asset of \$193,688 recorded on the statement of financial position, an unrealized loss for the three month period of \$1,194,784, and an unrealized gain for the twelve month period of \$1,323,231, respectively (December 31, 2019 – unrealized losses of \$1,162,462 and \$1,985,519, respectively).

Revenue

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Heavy oil	\$ 5,334,243	\$ 9,388,453	\$ 18,591,509	\$ 31,257,434
Natural gas	20,354	77,547	68,531	234,123
NGL	-	6,078	217	19,527
Total	\$ 5,354,596	\$ 9,472,078	\$ 18,660,257	\$ 31,511,084

Revenue for the three and twelve months ended December 31, 2020 decreased by 43% and 41%, respectively, from the comparable periods in 2019. These declines are mainly attributed to decreases of 20% and 42% in the Company's combined average realized prices over the comparable periods in 2019.

Operating Netback

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Operating netback				
Revenue	\$ 5,354,596	\$ 9,472,078	\$ 18,660,257	\$ 31,511,084
Royalties	(597,340)	(990,107)	(1,703,489)	(3,877,854)
Operating costs	(1,468,134)	(1,665,713)	(4,630,390)	(5,959,810)
Transportation costs	(357,657)	(531,928)	(1,581,280)	(1,550,357)
Operating field netback ⁽¹⁾	2,931,465	6,284,329	10,745,098	20,123,062
Realized commodity hedging gain (loss)	628,346	(165,651)	3,714,593	(1,403,913)
Operating netback ⁽²⁾	\$ 3,559,811	\$ 6,118,678	\$ 14,459,691	\$ 18,719,149
Operating netback (\$/boe)				
Revenue	\$ 38.24	\$ 47.53	\$ 29.88	\$ 51.85
Royalties	(4.27)	(4.97)	(2.73)	(6.38)
Operating costs	(10.49)	(8.36)	(7.41)	(9.81)
Transportation costs	(2.55)	(2.67)	(2.53)	(2.55)
Operating field netback ⁽¹⁾	20.94	31.53	17.21	33.11
Realized commodity hedging gain (loss)	4.49	(0.83)	5.95	(2.31)
Operating netback ⁽²⁾	\$ 25.43	\$ 30.70	\$ 23.16	\$ 30.80

Notes:

(1) Operating field netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent.

(2) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent.

Royalties for the fourth quarter of 2020 were \$4.27/boe, representing a 14% decrease from the fourth quarter of 2019. Royalties for the year ended December 31, 2020 were \$2.73/boe, representing a 57% decrease over the year ended December 31, 2019. These decreases were primarily the result of lower realized commodity prices.

Operating costs include all costs for gathering, processing, dehydration, compression, water processing and marketing of the heavy oil, natural gas and NGLs, as well as additional costs incurred periodically for maintenance and repairs. Operating costs for the three months ended December 31, 2020 decreased on an absolute basis by \$197,579 or 12% but increased on a per boe basis by \$2.13 or 25% over the comparable period in 2019. For the year ended December 31, 2020 operating costs decreased on an absolute basis by \$1,329,420 or 22% and on a per boe basis by \$2.40 or 24% over the comparable period in 2019. As a direct result of the historically low realized commodity prices throughout 2020 due to the ongoing global pandemic, the Company took steps to reduce operating costs. The Company shut in the majority of high water cut production in Jenner in Q2/2020, worked with vendors and oilfield service providers for temporary rate reductions, optimized maintenance work, optimized chemical use, and reduced operator overtime. The slight increase in operating costs per boe in the fourth quarter of 2020 is due those costs being distributed across decreased production resulting from the conversion of three producing wells in the Atlee Buffalo G Pool to water injectors. The Company continues to work to find efficiencies in its operations to keep operating costs low.

Transportation costs include all costs incurred to transport emulsion, oil, and gas sales to processing and distribution facilities. Transportation costs were \$2.55/boe during the fourth quarter of 2020, which is a

\$0.12/boe decrease over the comparable quarter in 2019. Transportation costs were \$2.53/boe for the year ended December 31, 2020, which represents a \$0.02/boe decrease over the same period in 2019.

Operating netback for the three and twelve months ended December 31, 2020 were \$25.43/boe and \$23.16/boe respectively, 17% and 25% lower than the comparable periods in 2019. This is mainly due to the 20% and 42% decrease in the Company's combined average realized price over the comparable periods, offset by the lower royalties and operating costs discussed above, and the respective \$4.49/boe and \$5.95/boe realized hedging gains in the comparable three and twelve month periods of 2020 (losses of \$0.83/boe for the three months and of \$2.31/boe for the year ended December 31, 2019).

Exploration and Evaluation

Exploration and evaluation expenses generally consists of certain geological and geophysical costs, expiry of undeveloped lands, and costs of uneconomic exploratory wells. Exploration and evaluation expenses for the three months ended December 31, 2020 and 2019 were \$221,312 and \$994,518, respectively. For the years ended December 31, 2020 and 2019, exploration and evaluation expenses were \$258,269 and \$1,047,447, respectively.

Depletion and Depreciation

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Depletion expense	\$ 891,225	\$ 1,539,348	\$ 4,378,402	\$ 5,617,663
Depreciation expense	26,006	28,355	111,409	109,871
Total	\$ 917,231	\$ 1,567,703	\$ 4,489,811	\$ 5,727,534
\$ per boe	\$ 6.55	\$ 7.87	\$ 7.19	\$ 9.42

The depletion rate is calculated using the unit-of-production method on Proved and Probable oil and natural gas reserves, taking into account the future development costs ("FDC") to develop and produce undeveloped and non-producing reserves.

Depletion and depreciation expenses for the three months ended December 31, 2020 decreased to \$6.55/boe from \$7.87/boe for the same period in 2019. For the year ended December 31, 2020, depletion and depreciation expenses decreased to \$7.19/boe from \$9.42/boe for the same period in 2019. The decrease in depletion expense for the three months and year ended December 31, 2020 over the comparable periods in 2019 is due to realized impairment, as discussed below, in combination with the amortization of production over a larger reserve base from the Company's December 31, 2020 independent engineer's evaluation report as prepared by McDaniel and Associates Consultants Ltd.

Impairment

At December 31, 2020, the Company performed an assessment of potential impairment indicators on each of its Cash Generating Units (CGUs), and management determined that an impairment test on its petroleum and natural gas assets was required due to a significant reduction in one CGU's reserve value. It was determined that the carrying amount of Jenner CGU exceeded its recoverable amount of \$1,211,160 for the year ended December 31, 2020. Accordingly, the Company recognized an impairment charge of \$2,161,477 as at December 31, 2020. This impairment charge was in addition to a previous impairment charge of \$3,859,110 for Jenner, which was recognized as at March 31, 2020. No impairment was recognized for Atlee Buffalo CGU as its recoverable value exceeded the carrying amount.

The recoverable amounts were determined with fair value less costs to sell using a discounted cash flow method and categorized in Level 3 of the fair value hierarchy. Key assumptions in the determination of cash flows from reserves include crude oil and natural gas prices, royalties, operating costs, future development costs and discount rates specific to the underlying composition of assets residing in each CGU.

Capital Expenditures

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Land and lease	\$ 23,776	\$ 18,617	\$ 34,064	\$ 129,263
Geological and geophysical	183,585	123,557	865,909	447,477
Drilling and completions	145,397	326,473	483,845	7,812,851
Facilities and infrastructure	265,290	500,064	301,604	2,557,737
Total capital expenditures ⁽¹⁾	\$ 618,048	\$ 968,711	\$ 1,685,422	\$ 10,947,329

Note:

(1) Total capital expenditures include property, plant, and equipment, exploration and evaluation expenditures, and capitalized G&A, and exclude decommissioning costs and non-cash items.

The development capital spent during the year ended December 31, 2020 focused on projects that have long-term operating costs savings and will increase oil recovery, including the conversion of three producing wells to injectors, and the evaluation and planning of future polymer floods.

General and Administrative Expense ("G&A")

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Gross G&A	\$ 569,905	\$ 1,054,091	\$ 2,582,012	\$ 2,699,855
Capitalized G&A	(104,312)	(125,795)	(629,454)	(580,389)
Total	\$ 465,593	\$ 928,296	\$ 1,952,558	\$ 2,119,466
\$ per boe	\$ 3.33	\$ 4.66	\$ 3.13	\$ 3.49

General and administrative ("G&A") expenses decreased by 50% and 8% on an absolute basis for the three months and year ended December 31, 2020, and on a per boe basis by 29% and 10% respectively over the comparable period in 2019. The G&A costs decreased in the fourth quarter mainly due to reduced bonuses. The Company also recorded a reduction in wages of \$93,169 through claims received from the Canada Revenue Agency under the Canada Emergency Wage Subsidy program to support businesses through the COVID-19 pandemic and subsequent economic downturn.

The Company capitalizes some general and administrative expenses which can be attributed to any costs incurred during the period relating to its development and exploration activities. For the three months and year ended December 31, 2020, capitalized general and administrative expenses decreased by \$21,483 and increased by \$49,065, over the respective comparable periods in 2019.

Share-based Payments

Share-based payments are non-cash expenses which reflect the estimated value of stock options issued to directors, employees and consultants of the Company.

In June of 2020 the Company granted 1,500,000 stock options to officers, directors, employees and consultants at an exercise price of \$0.12 over five years, all of which vested immediately. The Company

uses a Black-Scholes option pricing model to calculate the fair value of stock option grants where the corresponding expense is recognized over the option vesting period. The total valuation of the options from grants in the year ended December 31, 2020, was \$150,866, of which \$115,664 was expensed as stock-based compensation and \$35,202 was capitalized.

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Share-based payments (recovery)	\$ -	\$ (108,027)	\$ 115,664	\$ 9,052
Capitalized costs	-	-	35,202	62,866
Total share-based payments (recovery)	\$ -	\$ (108,027)	\$ 150,866	\$ 71,918

Finance Expense

	Three Months Ended December 30		Year Ended December 30	
	2020	2019	2020	2019
Loan interest	\$ 661,045	\$ 843,425	\$ 3,002,024	\$ 3,464,170
Lease interest	9,363	10,555	39,331	45,073
Loss/(gain) in fair value of warrant liability	449,107	344,533	(228,256)	656,620
Accretion of debt issuance costs	168,099	207,201	491,144	407,173
Amortization of deferred charges	(71,389)	(35,093)	136,777	144,407
Accretion of decommissioning liabilities	32,256	37,233	129,023	148,932
Total	\$ 1,248,481	\$ 1,407,854	\$ 3,570,042	\$ 4,866,375
\$ per boe	\$ 8.92	\$ 7.06	\$ 5.72	\$ 8.01

Loan interest for the three months and year ended December 31, 2020 decreased by \$182,380 and \$462,146 over the respective periods in 2019 which is the result of a decrease in the 3-month LIBOR rate for the periods upon which the term loan quarterly interest is calculated, combined with a reduction in the principle of the term loan via US\$6 million repayments during the year. The Company also recorded \$9,363 and \$39,330 of lease interest on right-of-use assets liability under IFRS 16 for the three months and year ended December 31, 2020. The finance expense per boe has decreased by 29% compared to 2019 due primarily to reduced loan interest costs and the reduction in the warrant liability valuation.

Accretion expense represents the adjusted present value of the Company's decommissioning obligations which include the abandonment and reclamation costs associated with wells and facilities. During the three months and year ended December 31, 2020, accretion expense decreased by 13% over the comparable periods in 2019.

Remeasurement Loss/(Gain) on Warrant Liability

For the three months and year ended December 31, 2020, the Company recognized a remeasurement loss of \$449,107, and a gain of \$228,256, respectively (\$344,533 loss and \$656,620 loss for comparable periods in the prior year²). The Company issued 13,750,000 warrants to a third-party lender on September 15, 2017 in conjunction with its term loan. Each warrant entitles the holder to purchase one common share of Hemisphere at an exercise price of \$0.28 per share prior to September 15, 2022. The exercise price of the warrants represented a 40% premium to the 30-day volume weighted average price ("VWAP") of Hemisphere's common shares at market close on September 14, 2017. The warrants are subject to a forced exercise clause which applies upon a 30-day VWAP equaling or exceeding \$1.40 per share. The warrants are non-transferable.

² Prior period comparisons have been revised as outlined in note 4 in the December 31, 2020 audited financial statements.

The warrants are classified as a financial liability as a result of a cashless exercise provision. In no event will the Company be required to settle the warrants through a cash payment. The fair value of the warrants are revalued every quarter using the Black and Scholes pricing model. Valuations for the current and previous quarter were calculated with the following inputs:

	December 31, 2020	December 31, 2019
Share Price	\$ 0.20	\$ 0.21
Risk-free interest rate	0.39%	1.68%
Expected life (years)	1.70	2.70
Expected volatility	112%	109%

Tax Pools

The Company has approximately \$60.2 million (2019 - \$67.6 million) of tax pools available to be applied against future income for tax purposes. Based on available pools and current commodity prices, the Company does not expect to pay current income tax in 2020 and any taxes payable beyond 2020 will primarily be a function of commodity prices, capital expenditures and production volumes.

	Deduction Rate	December 31, 2020	December 31, 2019
Canadian exploration expense (CEE)	100%	\$ 3,336,823	\$ 3,336,823
Canadian development expense (CDE)	30%	19,655,797	19,140,307
Canadian oil and gas property expense (COGPE)	10%	4,438,962	4,932,180
Non-capital losses carry forwards (NCL)	100%	31,174,540	37,947,967
Undepreciated capital cost (UCC)	20-55%	811,977	1,086,076
Share issuance costs and other	Various	748,801	1,140,239
Total		\$ 60,166,900	\$ 67,583,592

Selected Annual Information

The following are highlights of the Company's financial data for the three most recently completed fiscal years:

	Year Ended December 31		
	2020	2019	2018
Average daily production (boe/d)	1,706	1,665	1,111
Petroleum and natural gas revenue	\$ 18,660,257	\$ 31,511,084	\$ 17,756,439
Operating netback ⁽¹⁾	14,459,691	18,719,149	6,415,532
Cash provided by operating activities	9,389,702	10,451,802	2,230,071
Net income (loss) ⁽⁵⁾	(415,908)	1,577,810	(4,375,886)
Per share, basic and diluted	(0.00)	0.02	(0.05)
Adjusted funds flow from operations ⁽²⁾	9,294,933	13,043,478	2,012,847
Per share, basic and diluted	0.11	0.14	0.02
Average realized price (\$/boe)	29.88	51.85	43.78
Operating netback (\$/boe) ⁽¹⁾	23.16	30.80	15.82
Capital expenditures, including property acquisitions	1,685,422	10,947,329	16,057,316
Net debt ⁽³⁾	24,429,191	31,982,764	35,446,384
Gross term loan ⁽⁴⁾	26,096,500	34,418,200	35,458,800
Total assets	\$ 52,479,049	\$ 61,520,356	\$ 59,197,488

Notes:

(1) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.

(2) Adjusted funds flow from operations is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for any decommissioning expenditures, and may not be comparable to measures used by other companies.

(3) Net debt is a non-IFRS measure calculated as current assets minus current liabilities, excluding fair value of financial instruments, lease and warrant liabilities, plus gross term loan.

(4) Gross term loan is calculated as the total USD draws on the term loan translated to Canadian Dollars at the period end exchange rate.

(5) The net income (loss) has changed from prior presentation due to the recast of warrants from equity to debt, see Note 4. of the Audited Annual Financial Statements

Summary of Quarterly Results

	2020				2019			
	Dec. 31 Q4 ⁽¹⁾	Sep. 30 Q3 ⁽²⁾	Jun. 30 Q2 ⁽³⁾	Mar. 31 Q1 ⁽⁴⁾	Dec. 31 Q4 ⁽⁵⁾	Sep. 30 Q3 ⁽⁶⁾	Jun. 30 Q2 ⁽⁷⁾	Mar. 31 Q1 ⁽⁸⁾
Average daily production (boe/d)	1,522	1,686	1,645	1,973	2,166	1,738	1,367	1,379
Heavy oil and natural gas revenue	5,354,596	5,889,668	2,452,793	4,963,201	9,472,078	8,207,658	7,396,095	6,435,252
Operating field netback ⁽⁹⁾	2,931,465	3,862,969	1,259,856	2,690,808	6,284,329	5,206,705	4,357,767	4,274,261
Cash provided by operating activities	2,127,640	3,087,950	816,755	3,357,353	3,519,506	3,792,868	2,524,737	612,621
Adjusted funds flow from operations ⁽¹⁰⁾	2,380,051	3,406,612	1,353,680	2,154,594	4,324,443	3,547,634	2,548,388	2,620,947
Per share, basic and diluted	0.03	0.04	0.02	0.02	0.05	0.04	0.03	0.03
Net income (loss) ⁽¹²⁾	(1,501,079)	1,410,470	(3,420,988)	3,095,690	(2,888,075)	2,744,160	3,142,104	(1,420,379)
Per share, basic and diluted	(0.02)	0.02	(0.04)	0.02	(0.03)	0.03	0.03	(0.01)
Combined average realized price (\$/boe)	38.24	37.96	16.38	27.64	47.53	51.34	59.44	51.85
Operating netback (\$/boe) ⁽¹¹⁾	25.43	30.41	17.74	19.63	30.70	30.64	31.10	30.89

Notes:

- (1) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to a decrease in realized commodity prices and average production rates.
- (2) The increases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to an increase in realized commodity prices.
- (3) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to a decrease in realized commodity prices and average production rates.
- (4) The decreases in revenue, netbacks and adjusted funds flow from (used in) operations are due primarily to a decrease in realized commodity prices.
- (5) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in production rates and realized commodity prices.
- (6) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in production rates.
- (7) The increases in revenue and netbacks are due to increases in realized commodity prices.
- (8) The increases in revenue, netbacks and adjusted funds flow from operations are due to increases in realized commodity prices.
- (9) Operating field netback per boe is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis.
- (10) Adjusted funds flow from operations is a non-IFRS measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for any decommissioning expenditures, and may not be comparable to measures used by other companies.
- (11) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.
- (12) The net income (loss) has changed from prior presentation due to the recast of warrants from equity to debt, see Note 4. of the Audited Annual Financial Statements

Outstanding Share Data

	April 28, 2021	December 31, 2020	December 31, 2019
Fully diluted share capital			
Common shares issued and outstanding	88,074,802	86,782,302	88,902,302
Stock options	6,759,000	8,429,000	8,184,000
Warrants	13,750,000	13,750,000	13,750,000
Total fully diluted shares outstanding	108,583,802	108,961,302	110,836,302

On June 27, 2019 the Company announced notice of a normal course issuer bid (NCIB) to purchase and cancel, from time to time, up to 8,016,731 common shares of the Company until July 1, 2020. The Company subsequently purchased and canceled 1,301,000 shares under this NCIB for \$179,273 as at June 30, 2020, for an average cost of \$0.14 per share. This included 320,000 shares purchased and cancelled in the first half of fiscal 2020 for \$55,597 at an average cost of \$0.17 per share.

Further, on June 29, 2020 the Company announced the renewal of the normal course issuer bid (NCIB) to purchase and cancel, from time to time, up to 7,869,931 common shares of the Company until July 1, 2021. During the six months ended December 31, 2020, the Company purchased and canceled 1,800,000 shares under the NCIB for \$209,880 at an average cost of \$0.12 per share.

Subsequent to the year ended December 31, 2020:

- a) The Company has purchased and cancelled an additional 377,500 shares under the NCIB for \$96,629 at an average cost of \$0.26 per share, as at April 28, 2021.
- b) The Company issued 1,670,000 shares for stock options exercised in February 2021.

The Company has the following stock options that are outstanding and exercisable as at April 28, 2021:

Exercise Price	Grant Date	Expiry Date	Balance Outstanding April 28, 2021	Balance Exercisable April 28, 2021
\$0.25	September 21, 2017	September 21, 2022	4,809,000	4,809,000
\$0.28	October 2, 2017	October 2, 2022	150,000	150,000
\$0.25	January 1, 2018	January 1, 2023	250,000	250,000
\$0.12	March 1, 2019	March 1, 2024	50,000	50,000
\$0.12	June 17, 2020	June 17, 2025	1,500,000	1,500,000
			6,759,000	6,759,000
Weighted-average exercise price			\$0.22	\$0.22

Exercise Price	Grant Date	Expiry Date	Changes in the Year				Balance Outstanding Dec. 31, 2020	Balance Exercisable Dec. 31, 2020
			Balance Outstanding Dec. 31, 2019	Granted	Exercised	Forfeited/ Expired		
\$0.24	29-Jan-15	29-Jan-20	1,000,000	-	-	(1,000,000)	-	-
\$0.39	1-Mar-15	1-Mar-20	100,000	-	-	(100,000)	-	-
\$0.08	11-Feb-16	11-Feb-21	1,595,000	-	-	-	1,595,000	1,595,000
\$0.08	12-Feb-16	12-Feb-21	125,000	-	-	(50,000)	75,000	75,000
\$0.25	21-Sep-17	21-Sep-22	4,914,000	-	-	(105,000)	4,809,000	4,809,000
\$0.28	2-Oct-17	2-Oct-22	150,000	-	-	-	150,000	150,000
\$0.25	01-Jan-18	01-Jan-23	250,000	-	-	-	250,000	250,000
\$0.12	01-Mar-19	01-Mar-24	50,000	-	-	-	50,000	50,000
\$0.12	17-Jun-20	17-Jun-25	-	1,500,000	-	-	1,500,000	1,500,000
			8,184,000	1,500,000	-	(1,255,000)	8,429,000	8,429,000
Weighted-average exercise price			\$0.21	\$0.12	-	\$0.25	\$0.19	\$0.19

Liquidity and Capital Management

The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when they become due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company.

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

Management plans over the next two years to significantly lower debt while growing production and funds flow, which should allow the Company to accelerate internal projects, make strategic acquisitions, and increase return of capital to shareholders. In 2021, Hemisphere has set a capital program of approximately \$6 million on polymer flood implementation, facilities upgrades, and a drilling program.

Management's forecasts may change materially based upon actual prices received, changes in future strip pricing, production volumes, operating costs, activity levels, cash flows, and the timing thereof and other

factors which may or may not be within the control of the Company. The economic climate may lead to adverse changes in cash flow, working capital levels or debt balances, which may also have a direct impact on the Company's liquidity and ability to generate profits in the future.

a) Financing

The Company's net cash used in financing activities during the three and twelve months ended December 31, 2020 were \$2,693,811 and \$8,259,072, respectively. These funds are primarily a repayment of US\$6,000,000 (CAD\$7,914,175) towards the Company's term loan during the year 2020, plus shares purchased under the NCIB, and lease liability payments in the period.

b) Term Loan

On September 15, 2017, the Company entered into a first lien senior secured credit agreement (the "Credit Agreement") with a third-party lender (the "Lender") providing for a multi-draw, non-revolving term loan facility of a maximum aggregate principal amount of up to US\$35.0 million. Security granted by the Company under the Credit Agreement included a demand debenture for US\$75.0 million which provides for a first ranking security interest and floating and fixed charges over all of the real and personal property present and after acquired of the Company.

An initial commitment amount of US\$15.0 million (the "Term Loan") was granted at inception and on January 23, 2018 and June 1, 2018 the Company amended its credit agreement with its Lender to increase the commitment amount by US\$5.0 million and US\$10.0 million respectively. This brings the Company's aggregate amount committed by the Lender under the Term Loan to US\$30.0 million.

As at December 31, 2020 the Company had a term loan balance of US\$20.5 million (CAD\$26,096,500 at period close exchange rate) resulting from total draws of US\$26.5 million less total repayments of US\$6.0 million.

The Company's ability to access additional commitments in excess of US\$30.0 million is subject to approval of the Lender based on review and approval of the Company's future development plans.

The interest rate for the Term Loan is the three-month United States dollar London Interbank Offered Rate ("LIBOR") with a LIBOR floor of 1%, plus 7.50% payable quarterly, for a five-year term with a maturity date of September 15, 2022. The Company issued 13,750,000 warrants, in conjunction with the term loan, entitling the Lender to purchase one common share of Hemisphere at an exercise price of \$0.28/share prior to September 15, 2022.

The Term Loan is subject to certain quarterly financial and performance covenants to the maturity date of the loan on September 15, 2022:

1. Interest coverage ratio shall not be less than 3.00 to 1.00.
2. Total leverage ratio shall not be more than 3.25 to 1.00.

3. Minimum average production shall not be less than 1,500 boe/d.
4. Proved developed producing coverage ratio, based on reserve reports internally prepared by Hemisphere, shall not be less than 1.00 to 1.00.
5. Total proved reserves coverage, based on reserve reports internally prepared by Hemisphere, shall not be less than 1.50 to 1.00.
6. The Company also has an annual financial covenant for its cash general and administrative costs for a base sum of \$2.725 million per annum for the year ending December 31, 2020.

Covenants³ table for the quarter ended December 31, 2020:

Ratio			Required	Actual December 31, 2020
1.	Interest Coverage Ratio	Greater than	3.00	4.55
2.	Total Leverage Ratio	Less than	3.25	2.15
3.	Minimum Average Production Boe/d	Greater than	1,500	1,522
4.	Proved Developed Producing Coverage Ratio	Greater than	1.00	2.22
5.	Total Proved Reserves Coverage Ratio	Greater than	1.50	3.93
6.	Annual gross General and Administrative Costs \$MM	Less than	\$2.725	\$2.582

At December 31, 2020 the Company is in compliance with the financial and performance covenants as noted in the table above. In the event of a covenant violation, this would represent a default under the Term Loan and, if not remedied or waived by the lender, would result in the right of the lender to demand repayment of all amounts owed.

Management forecasts the Company will continue to meet all financial and operational covenants. Management's forecasts may change materially based upon actual prices received during the year, changes in future strip pricing, production volumes, operating costs, activity levels, cash flows, and the timing thereof and other factors which may or may not be within the control of the Company.

c) Capital Management

The Company manages its capital with the following objectives:

- Ensure sufficient flexibility to achieve the Company's ongoing business objectives including the replacement of production, funding of future growth opportunities, and pursuit of accretive acquisitions; and
- Maximize shareholder return through enhancing the Company's share value.

As part of its capital management process the Company prepares budgets and forecasts, which are used by management and the Board of Directors to direct and monitor the strategy and ongoing operations and liquidity of the Company. Budgets and forecasts are subject to significant judgment and estimates relating to activity levels, future cash flows and the timing thereof and other factors which may or may not be within the control of the Company.

³ Details on the calculations of the covenants can be found in the Credit Agreement and the amendment thereto filed on SEDAR at www.sedar.com on September 22, 2017 and February 1, 2018 respectively, under the Company's profile.

The Company monitors its capital structure and makes adjustments according to market conditions in an effort to meet its objectives given the current outlook of the business and industry in general. The capital structure of the Company is composed of shareholders' equity and the Term Loan. The Company may manage its capital structure by issuing new shares, repurchasing outstanding shares, incurring additional indebtedness under the Term Loan, issuing new debt instruments, other financial or equity-based instruments, adjusting capital spending, or disposing of assets. The capital structure is reviewed on an ongoing basis.

Commitments

The Company has a commitment to make monthly service payments pursuant to the office rental agreement at its current location until May 31, 2023.

As at December 31, 2020, the gross balance of the Term Loan was \$26,096,500 (US\$20,500,000), exclusive of the debt issuance costs. The Term Loan matures on September 15, 2022.

	2021	2022	2023	Total
Office agreement	\$ 78,420	78,420	32,675	189,515
Term loan	-	26,096,500	-	26,096,500
Term loan interest	2,218,203	1,663,652	-	3,881,855
	\$ 2,296,623	27,838,572	32,675	30,167,870

Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet transactions.

Related Party Transactions

Compensation to key executive personnel, consisting of the Company's officers, directors and Chairman, was paid as follows:

	Years Ended December 31	
	2020	2019
Salaries and wages	\$ 1,400,000	\$ 1,580,000
Share-based payments	80,462	71,918

Proposed Transactions

As of the effective date, there are no outstanding proposed transactions.

Critical Accounting Estimates

The Company's significant accounting estimates, judgments and policies are set out in Notes 2 and 3 of the audited annual financial statements for the year ended December 31, 2020 and have been consistently followed in the preparation of the audited annual financial statements.

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

Company's financial statements is included in the Company's audited annual financial statements for the year ended December 31, 2020.

An additional significant area of estimation uncertainty in applying accounting policies that has a significant effect on the amount recognized in the financial statements is foreign exchange. Estimates of foreign exchange conversion to value US dollar dominated amounts into Canadian currency include the Term Loan, cash balances and hedging contracts.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Changes in Accounting Policies

New Accounting Standard

In October 2018, the IASB issued amendments to the definition of IFRS 3 "Business Combinations". The amendments are intended to provide additional guidance to determine if a transaction should be recorded as a business combination or an asset acquisition. The amendments clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess if an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. This standard was effective January 1, 2020 and was applied prospectively. No business combinations were completed by the Company as of the date of these financial statements.

Government Grants

Since commencement of the Canada Emergency Wage Subsidy ("CEWS") program on March 15, 2020, the Company has applied for a subsidy for its eligible employees. Government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions associated with the grant are met. Claims under government grant programs related to income are deducted in reporting the related expense and are recorded in the period in which the eligible expenses were incurred.

Financial Instruments

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, changes in assumptions can significantly affect estimated fair values. At December 31, 2020, the Company's financial instruments include cash and cash equivalents, accounts receivable, warrant liability, reclamation deposits, term loan, and accounts payable and accrued liabilities.

The fair values of cash and cash equivalents, accounts receivable, reclamation deposits and accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of these financial instruments. The fair value of the term loan is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

a) Fair value hierarchy

Fair value measurements of financial instruments are required to be classified using a fair value hierarchy that reflects the significance of inputs in making the measurements. The levels of the fair value hierarchy are defined as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs for the asset or liability that are not based on observable market data.

b) Non-derivative financial instruments

Financial assets

At initial recognition, financial assets are classified into four main categories: loans and receivables; held-to-maturity investments; available for sale financial assets; or financial assets at fair value through profit or loss. All financial assets are recognized initially at fair value, normally being the transaction price, plus any directly attributable transaction costs. Transaction costs for instruments at fair value through profit or loss are recognized immediately in earnings.

The subsequent measurement of financial assets depends on their classification.

Loans, receivables and held-to-maturity investments are subsequently measured at amortized cost using the effective interest method, less any impairment losses. Gains and losses are recognized in earnings when the asset is derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets are subsequently measured at fair value, with changes in fair value recognized directly in other comprehensive income until the asset is derecognized or determined to be impaired, at which time the cumulative change in fair value previously reported in other comprehensive income is recognized in earnings.

Financial assets at fair value through profit or loss are subsequently measured at fair value, with changes in those fair values recognized in earnings.

Financial assets are derecognized when the contractual rights to the cash flows expire, or when substantially all the risks and rewards of ownership of the financial asset are transferred to a third party.

Financial assets and liabilities are shown separately in the statement of financial position unless the Company has a legal right to offset the amounts and intends to either settle on a net basis or to realize the asset and settle the liability simultaneously, in which case they are presented on a net basis.

Impairment of financial assets

A financial asset that is not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that a loss event has occurred after initial recognition and has had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

The Company considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant financial assets are tested for impairment on an individual basis. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. The remaining financial assets are assessed collectively for impairment in groups that share similar credit risk characteristics.

In assessing collective impairment the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

All impairment losses are recognized in earnings.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in earnings.

Financial liabilities

At initial recognition, financial liabilities are classified as either financial liabilities at fair value through profit or loss, or other financial liabilities. All financial liabilities are recognized initially at fair value, normally being the transaction price less any directly attributable transaction costs. Transaction costs for instruments at fair value through profit or loss are recognized immediately in earnings.

The subsequent measurement of financial liabilities depends on their classification.

Financial liabilities at fair value through profit or loss are subsequently measured at fair value, with changes in those fair values recognized in earnings.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Financial liabilities are derecognized when the contractual obligation expires, is discharged, or cancelled. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognized in earnings.

c) Financial derivative instruments

The Company may use financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices and foreign exchange. These instruments are not used for trading or speculative purposes.

The Company has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Company considers all derivative contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recognized at fair value. Transaction costs are recognized in earnings when incurred.

Physical delivery contracts are entered into for the purpose of delivery of oil in accordance with the Company's expected sale requirements, and therefore are not recorded in the statement of financial position. These contracts are recorded in revenue on their settlement dates.

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

Risks

The Company's activities expose it to a variety of risks that arise as a result of its exploration, development, production and financing activities. These risks and uncertainties include, among other things, volatility in market prices for crude oil and natural gas, general economic conditions in Canada, the US and globally and other factors described under "Risk Factors" in Hemisphere's most recently filed Annual Information Form which is available on the Company's website at www.hemisphereenergy.ca or on SEDAR at www.sedar.com. Readers are cautioned that this list of risk factors should not be construed as exhaustive.

The following provides information about the Company's exposure to some risks associated with the oil and gas industry, as well as the Company's objectives, policies and processes for measuring and managing risk.

Business Risk

Oil and gas exploration and development involves a high degree of risk whereby many properties are ultimately not developed to a producing stage. There can be no assurance that the Company's future exploration and development activities will result in discoveries of commercial bodies of oil and gas. Whether an oil and gas property will be commercially viable depends on a number of factors including the particular attributes of the reserve and its proximity to infrastructure, as well as commodity prices and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, and environmental protection. The exact effect of these factors cannot be accurately predicted, and the combination of these factors may result in an oil and gas property not being profitable.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its payment obligations. This risk arises principally from the Company's receivables from joint operators and oil and natural gas marketers, and reclamation deposits. The credit risk associated with reclamation deposits is minimized substantially by ensuring this financial asset is placed with major financial institutions with strong investment-grade ratings by a primary ratings agency. The credit risk associated with accounts receivable is mitigated as the Company monitors monthly balances to limit the risk associated with collections. The Company does not anticipate any default. There are no balances over 90 days past due or impaired.

The maximum exposure to credit risk is as follows:

	December 31, 2020	December 31, 2019
Accounts receivable		
Marketing receivables	\$ 1,767,578	\$ 2,773,405
Trade receivables	159,776	11,438
Receivables from joint ventures	5,309	6,809
Reclamation deposits	115,535	115,535
	\$ 2,048,198	\$ 2,907,187

The Company sells the majority of its oil production to two major oil marketers and, therefore, is subject to concentration risk which is mitigated by management's policies and practices related to credit risk, as discussed above. Historically, the Company has never experienced any collection issues with its oil marketer.

Liquidity risk

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

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

In light of the current volatility in oil and gas prices and uncertainty regarding the timing for recovery in such prices as well as pipeline and transportation capacity constraints, management's ability to prepare financial forecasts is challenging. The economic climate may lead to adverse changes in cash flow, working capital levels or debt balances, which may also have a direct impact on the Company's liquidity and ability to generate profits in the future.

At December 31, 2020, the Company had net debt (current assets less current liabilities excluding fair value of financial instruments, lease and warrant liabilities, and including the gross term loan) of \$24,429,191 (December 31, 2019 - \$31,982,764). The Company funds its operations through operating cash flows and the term loan. At December 31, 2020, the Company has an additional US\$3.5 million of

borrowing base committed with its lender, which it can draw from for future capital programs, subject to the lender's approval.

Market risk

Market risk is the risk that changes in market prices, such as, foreign exchange rates, commodity prices, and interest rates will affect the value of the financial instruments. Market risk is comprised of interest rate risk, foreign currency risk, commodity price risk, and other price risk.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Borrowings under the Company's Term Loan are subject to variable interest rates. A one percent change in interest rates would have a \$261,000 annual effect on net income.

Foreign currency risk

The Company's functional and reporting currency is Canadian dollars. The Company does not sell or transact in any foreign currency; except i) the Company's commodity prices are largely denominated in USD, and as a result the prices that the Company receives are affected by fluctuations in the exchange rates between the USD and the Canadian dollar. The exchange rate effect cannot be quantified, but generally an increase in the value of the Canadian dollar compared to the USD will reduce the prices received by the Company for its crude oil and natural gas sales, and ii) the Company's Term Loan is denominated in USD and, as a result, the amount that the Company will be obligated to repay at the term of the loan will be affected by fluctuations in the exchange rate between the USD and the Canadian dollar at that time. A one percent change in the foreign exchange rate would have a \$277,000 effect on the annual net income.

Commodity price risk

Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the USD. Significant changes in commodity prices may materially impact the Company's adjusted funds flow from operations, and ability to raise capital. The Company has derivative commodity contracts in place as further disclosed within this MD&A.

Other price risk

Other price risk is the risk that the fair or future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk, foreign currency risk or commodity price risk. The Company is not exposed to significant other price risk.

COVID-19 Risk

In March 2020, the World Health Organization declared a global pandemic following the emergence and rapid spread of a novel strain of the coronavirus ("COVID-19"). The outbreak and subsequent measures

enforced to limit the spread of the pandemic contributed to volatility in financial markets. The pandemic has adversely impacted global commercial activity, including significantly reducing worldwide demand for crude oil and natural gas. The full extent of the impact of COVID-19 on the Company's operations and future financial performance, including the recoverable amounts of its exploration and evaluation assets and property, plant and equipment, is currently unknown. It will depend on future developments that are uncertain and unpredictable, including the duration and spread of COVID-19, the global roll-out of a vaccine and the virus' continued impact on financial markets. The outbreak and current market conditions have increased the complexity of estimates and assumptions used to prepare the audited annual financial statements, particularly related to recoverable amounts. There is a high degree of uncertainty regarding the estimates and assumptions used in determining the recoverable amounts including future crude oil and natural gas commodity prices, foreign exchange rates, discount rates and the Company's future crude oil and natural gas production. As the understanding of the longer-term impacts of COVID-19 develops, the estimates and assumptions used in determining the recoverable amounts could change and there could be a material financial impact in future periods.

Non-IFRS Measures

This document contains the terms "adjusted funds flow from operations," "operating netback", "operating field netback" and "net debt" which are not recognized measures under IFRS and may not be comparable to similar measures presented by other companies.

- a) The Company considers adjusted funds flow from operations to be a key measure that indicates the Company's ability to generate the funds necessary to support future growth through capital investment and to repay any debt. Adjusted funds flow from operations is a measure that represents cash generated by operating activities, before changes in non-cash working capital and adjusted for decommissioning expenditures, and may not be comparable to measures used by other companies. Adjusted funds flow from operations per share is calculated using the same weighted-average number of shares outstanding as in the case of the earnings per share calculation for the period.

A reconciliation of adjusted funds flow from operations to cash provided by operating activities is presented as follows:

	Three Months Ended December 31		Year Ended December 31	
	2020	2019	2020	2019
Cash provided by operating activities	\$ 2,127,640	\$ 3,519,508	\$ 9,389,702	\$ 10,451,802
Change in non-cash working capital	247,111	728,870	(213,339)	2,515,611
Adjust: Decommissioning obligation expenditures	5,300	76,065	118,570	76,065
Adjusted funds flow from operations	\$ 2,380,051	\$ 4,324,443	\$ 9,294,933	\$ 13,043,478
Per share, basic and diluted	\$ 0.03	\$ 0.05	\$ 0.11	\$ 0.14

- b) Operating field netback is a benchmark used in the oil and natural gas industry and a key indicator of profitability relative to current commodity prices. Operating field netback is calculated as oil and gas sales, less royalties, operating expenses and transportation costs on an absolute and per barrel of oil equivalent basis. These terms should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income or loss as determined in accordance with IFRS as an indicator of the Company's performance.

- c) Operating netback is a non-IFRS measure calculated as the operating field netback plus the Company's realized commodity hedging gain (loss) on an absolute and per barrel of oil equivalent basis.
- d) Net debt is closely monitored by the Company to ensure that its capital structure is maintained by a strong balance sheet to fund the future growth of the Company. Net debt is used in this document in the context of liquidity and is calculated as the total of the Company's current assets less current liabilities, excluding the fair value of financial instruments, lease and warrant liabilities, and including the gross term loan. There is no IFRS measure that is reasonably comparable to net debt.

The following table outlines the Company calculation of net debt:

	As at December 31	
	2020	2019
Current assets ⁽¹⁾	\$ 3,001,611	\$ 4,301,975
Current liabilities ⁽¹⁾	(1,334,300)	(1,866,538)
Gross term loan ⁽²⁾	(26,096,500)	(34,418,200)
Net debt	\$ (24,429,191)	\$ (31,982,764)

Notes:

(1) Excluding fair value of financial instruments and lease and warrant liabilities.

(2) Gross term loan is calculated as the total USD draws on the term loan translated to Canadian Dollars at the period end exchange rate.

Boe Conversion

Within this document, petroleum and natural gas volumes and reserves are converted to a common unit of measure, referred to as a barrel of oil equivalent ("boe"), using a ratio of 6,000 cubic feet of natural gas to one barrel of oil. Use of the term boe may be misleading, particularly if used in isolation. The conversion ratio is based on an energy equivalent method and does not necessarily represent a value equivalency at the wellhead.

Forward-Looking Statements

In the interest of providing Hemisphere's shareholders and potential investors with information regarding the Company, including management's assessment of the future plans and operations of Hemisphere, certain statements contained in this MD&A (particularly the Message to Shareholders) constitute forward-looking statements or information (collectively "forward-looking statements") within the meaning of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "could", "plan", "intend", "should", "believe", "outlook", "potential", "target" and similar words suggesting future events or future performance. In particular, but without limiting the foregoing, this document (particularly the Message to Shareholders) contains forward-looking statements pertaining to the following: volumes and estimated net present value of the future net revenue of Hemisphere's oil and natural gas reserves; future oil and natural gas prices; future operational activities; and plans for continued growth in the Company's production, reserves and cash flow; the compliance of the Company under its credit agreements, and the expectation for the increasing of the Company's reserves with continued successful waterflood operations. In addition, statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and can be profitably produced in the future.

With respect to forward-looking statements contained in this MD&A, the Company has made assumptions regarding, among other things: future capital expenditure levels; future oil and natural gas prices and differentials between light, medium and heavy oil prices; results from operations including future oil and natural gas production levels; future exchange rates and interest rates; Hemisphere's ability to obtain equipment in a timely manner to carry out

development activities; Hemisphere's ability to market its oil and natural gas successfully to current and new customers; the impact of increasing competition; Hemisphere's ability to obtain financing on acceptable terms; and Hemisphere's ability to add production and reserves through our development and exploitation activities.

Although Hemisphere believes that the expectations reflected in the forward-looking statements contained in this MD&A, and the assumptions on which such forward-looking statements are made, are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned not to place undue reliance on forward-looking statements included in this MD&A, as there can be no assurance that the plans, intentions or expectations upon which the forward-looking statements are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause Hemisphere's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things, the following: volatility in market prices for oil and natural gas; general economic conditions in Canada, the U.S. and globally; and the other factors described under "Risk Factors" in Hemisphere's most recently filed Annual Information Form available on the Company's website at www.hemisphereenergy.ca or on SEDAR at www.sedar.com. Readers are cautioned that this list of risk factors should not be construed as exhaustive.

The forward-looking statements contained in this MD&A speak only as of the date of this document. Except as expressly required by applicable securities laws, Hemisphere does not undertake any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

Analogous Information

The information concerning analogue pools in this MD&A (particularly in the Message to Shareholders, included with the Annual Report) may be considered to be "analogous information" within the meaning of applicable securities laws. Such information was obtained by Hemisphere management throughout the year ended December 31, 2020 from various public sources including information available to Hemisphere through the Alberta Energy Regulator. Management believes that the performance of such pools is analogous to the pools in which the Company has an interest at its Atlee Buffalo property area and is relevant as it may help to demonstrate the reaction of such pools to waterflood stimulations. Hemisphere is unable to confirm whether the analogous information was prepared by a qualified reserves evaluator or auditor or in accordance with National Instruments 51-101 – Standards of Disclosure for Oil and Gas Activities and the COGE Handbook and therefore, the reader is cautioned that the data relied upon by Hemisphere may be in error and/or may not be analogous to the oil pools in which Hemisphere holds an interest.

Reserves Advisories

It should not be assumed that the net present value of the estimated net revenues of the reserve presented in herein represent the fair market value of the reserves. There is no assurance that the forecast prices and costs assumptions upon which such estimates are made will be attained and variances could be material. The reserve estimates of Hemisphere's crude oil, natural gas liquids and natural gas reserves and any estimated recovery factors provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual crude oil, natural gas and natural gas liquids reserves may be greater than or less than the estimates provided herein.