# CRUZSUR ENERGY CORP

# (formerly PentaNova Energy Corp.)

# INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

# JUNE 30, 2019

## CRUZSUR ENERGY CORP.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| *(Unaudited, expressed in U.S. Dollars)* | **June 30, 2019** | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Cash and cash equivalents | **1,725,202** | 1,616,970 |
| Accounts receivable and prepaids (Note 5) | **1,928,353** | 2,251,162 |
| Inventory | **317,644** | 330,057 |
| Assets held for sale (Note 13) | **608,428** | 314,287 |
| Restricted cash (Note 6) | **2,841,340** | 2,782,368 |
| | **7,420,967** | 7,294,844 |
| Non-current Assets | | |
| Exploration and evaluation assets (Note 7) | **7,162,802** | 19,928,304 |
| Property, plant and equipment (Note 8) | **1,927,413** | 2,755,774 |
| **Total Assets** | **16,511,182** | 29,978,922 |
| **Liabilities** | | |
| Current Liabilities | | |
| Accounts payable and accrued liabilities (Note 5) | **3,872,118** | 11,851,187 |
| Deferred Revenue | **-** | 75,141 |
| Cash calls assumed on acquisition (Note 4a) | **-** | 8,369,461 |
| | **3,872,118** | 20,295,789 |
| Non-current Liabilities | | |
| Liability component of convertible debentures (Note 9) | **1,693,852** | - |
| Decommissioning obligation | **3,391,684** | 5,194,788 |
| **Total Liabilities** | **8,957,654** | 25,490,577 |
| **Shareholders' Equity** | | |
| Share capital (Note 11) | **63,799,393** | 63,799,393 |
| Contributed surplus (Note 11) | **6,409,233** | 6,509,311 |
| Warrants (Note 11) | **10,201,910** | 10,201,910 |
| Equity component of convertible debentures (Note 9) | **748,188** | - |
| Deficit | **(73,311,083)** | (75,769,236) |
| Accumulated other comprehensive loss | **(294,113)** | (253,033) |
| **Total Shareholders' Equity** | **7,553,528** | 4,488,345 |
| **Total Liabilities and Shareholders' Equity** | **16,511,182** | 29,978,922 |

*Commitments (Note 15)*

*Subsequent Events (Note 18)*

*See accompanying notes to the interim condensed consolidated financial statements.*

## CRUZSUR ENERGY CORP.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

For the three and six months ended June 30

| | For the three months ended | | For the six months ended | |
|---|---|---|---|---|
| *(Unaudited, expressed in U.S. Dollars)* | **2019** | 2018 | **2019** | 2018 |
| **Revenue:** | | | | |
| Oil and natural gas revenue (Note 10) | **248,303** | 2,255,336 | **420,192** | 4,525,579 |
| Net revenue on carried working interest (Note 10) | **207,678** | 189,049 | **423,286** | 540,655 |
| Royalty expense | **(25,398)** | (483,301) | **(45,552)** | (929,779) |
| | **430,583** | 1,961,084 | **797,926** | 4,136,455 |
| **Expenses:** | | | | |
| Operating expenses | **222,906** | 1,351,745 | **374,764** | 2,752,553 |
| Inventory revaluation | **148,456** | 189,274 | **439,054** | 376,003 |
| General and administrative | **1,939,271** | 1,407,294 | **2,620,234** | 3,128,965 |
| Business development | **-** | 79,679 | **7,935** | 169,482 |
| Share-based compensation (Note 11) | **(167,517)** | 202,671 | **(100,078)** | 362,955 |
| Gain on settlement (Note 4e) | **(5,000,000)** | - | **(5,000,000)** | - |
| Depletion and depreciation (Note 8) | **132,118** | 580,405 | **273,765** | 1,222,835 |
| Impairment loss (Note 7) | **-** | 25,000,000 | **-** | 25,000,000 |
| Finance (Note 12) | **32,192** | (9,644) | **19,598** | 38,198 |
| Foreign exchange loss (gain) | **18,890** | 1,576,779 | **(19,935)** | 1,477,150 |
| Loss (gain) on revaluation of asset held for sale (Note 13) | **(183,424)** | 46,926 | **(275,564)** | 143,821 |
| | **(2,857,108)** | 30,425,129 | **(1,660,227)** | 34,671,962 |
| Income (loss) before income taxes | **3,287,691** | (28,464,045) | **2,458,153** | (30,535,507) |
| Deferred income tax recovery | **-** | 3,735,786 | **-** | 3,831,850 |
| **Net income (loss)** | **3,287,691** | (24,728,259) | **2,458,153** | (26,703,657) |
| **Other comprehensive loss** | | | | |
| Foreign currency translation adjustment | **(16,910)** | 17,738 | **(41,080)** | (29,770) |
| **Comprehensive income (loss)** | **3,270,781** | (24,710,521) | **2,417,073** | (26,733,427) |
| Loss per share – basic and diluted (Note 11) | **0.14** | (1.02) | **0.10** | (1.10) |
| Weighted average number of common Shares outstanding | **24,220,160** | 24,220,160 | **24,220,160** | 24,220,160 |

*See accompanying notes to the interim condensed consolidated financial statements.*

## CRUZSUR ENERGY CORP.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three and six months ended June 30

| *(Unaudited, expressed in U.S. Dollars)* | **For the three months ended** 2019 | 2018 | **For the six months ended** 2019 | 2018 |
|---|---|---|---|---|
| **Operating Activities** | | | | |
| Net income (loss) | **3,287,691** | (24,728,259) | **2,458,153** | (26,703,657) |
| Items not affecting cash: | | | | |
| Impairment loss | **-** | 25,000,000 | **-** | 25,000,000 |
| Depletion and depreciation (Note 8) | **132,118** | 580,405 | **273,765** | 1,222,835 |
| Share-based compensation (Note 11) | **(167,517)** | 202,671 | **(100,078)** | 362,955 |
| Unrealized foreign exchange loss (gain) | **18,738** | 164,419 | **(83,581)** | 302,622 |
| Gain on Settlement (Note 4e) | **(5,000,000)** | - | **(5,000,000)** | - |
| Loss (gain) on revaluation of assets held for sale (Note 13) | **(183,424)** | 46,926 | **(275,564)** | 143,821 |
| Accretion (Note 12) | **37,627** | 29,905 | **62,231** | 58,250 |
| Deferred income tax recovery | **-** | (3,735,786) | **-** | (3,831,850) |
| Change in non-cash working capital (Note 17) | **337,394** | (738,719) | **916,872** | (144,257) |
| **Cash used in operating activities** | **(1,537,373)** | (3,178,438) | **(1,748,202)** | (3,589,281) |
| **Investing Activities** | | | | |
| Exploration and evaluation asset recovery (additions) | **(150,000)** | (1,359,487) | **(63,699)** | (10,470,586) |
| Property, plant and equipment additions | **(481,390)** | (66,539) | **(481,390)** | (97,219) |
| Cash payments on Maria Conchita Acquisition | **-** | (112,104) | **-** | (2,237,104) |
| Short-term investments | **-** | 417,320 | **-** | 417,320 |
| Change in restricted cash | **(36,328)** | 676,747 | **(22,599)** | 7,986,240 |
| Change in non-cash working capital (Note 17) | **14,848** | (972,164) | **6,511** | 4,820,903 |
| **Cash used in investing activities** | **(652,870)** | (1,416,227) | **(561,177)** | 419,554 |
| **Financing Activities** | | | | |
| Proceeds on convertible debentures, net of transaction costs (Note 9) | **2,378,688** | - | **2,378,688** | - |
| **Cash provided by financing activities** | **2,378,688** | - | **2,378,688** | - |
| **Net increase in cash** | **188,445** | (4,594,665) | **69,309** | (3,169,727) |
| Foreign exchange gain (loss) on cash | **28,272** | (344,839) | **38,923** | (344,520) |
| **Increase in cash** | **216,717** | (4,939,504) | **108,232** | (3,514,247) |
| Cash, beginning of period | **1,508,485** | 10,387,628 | **1,616,970** | 8,962,371 |
| **Cash, end of period** | **1,725,202** | 5,448,124 | **1,725,202** | 5,448,124 |

*Cash is defined as cash and cash equivalents.*

*See accompanying notes to the interim condensed consolidated financial statements.*

## CRUZSUR ENERGY CORP.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| *(Unaudited, expressed in U.S. Dollars)* | **Number of Common Shares** | **Share Capital** | **Contributed Surplus** | **Warrants** | **ECCD[1]** | **Deficit** | **AOCL[2]** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2017 | 24,220,160 | 63,799,393 | 5,900,862 | 10,201,910 | - | (14,533,961) | (311,609) | 65,056,595 |
| Net loss | - | - | - | - | - | (26,703,657) | - | (26,703,657) |
| Foreign currency translation adjustment | - | - | - | - | - | - | (29,770) | (29,770) |
| Share-based compensation | - | - | 423,558 | - | - | - | - | 423,558 |
| **Balance at June 30, 2018** | **24,220,160** | **63,799,393** | **6,324,420** | **10,201,910** | **-** | **(41,237,618)** | **(341,379)** | **38,746,726** |

| | **Number of Common Shares** | **Share Capital** | **Contributed Surplus** | **Warrants** | **ECCD[1]** | **Deficit** | **AOCL[2]** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2018 | 24,220,160 | 63,799,393 | 6,509,311 | 10,201,910 | - | (75,769,236) | (253,033) | 4,488,345 |
| Net income | - | - | - | - | - | 2,458,153 | - | 2,458,153 |
| Issuance of convertible debentures | - | - | - | - | 748,188 | - | - | 748,188 |
| Foreign currency translation adjustment | - | - | - | - | - | - | (41,080) | (41,080) |
| Share-based compensation | - | - | (100,078) | - | - | - | - | (100,078) |
| **Balance at June 30, 2019** | **24,220,160** | **63,799,393** | **6,409,233** | **10,201,910** | **748,188** | **(73,311,083)** | **(294,113)** | **7,553,528** |

*(1) Equity component of convertible debentures*

*(2) Accumulated other comprehensive loss*

*See accompanying notes to the interim condensed consolidated financial statements.*

## 1. REPORTING ENTITY

CruzSur Energy Corp. ("CruzSur") is an oil and gas company incorporated in Canada which formerly operated under the name PentaNova Energy Corp ("PentaNova"). The Company is engaged in exploration and development activities in Colombia and Argentina. The Company's registered address is 25th Floor, 700 West Georgia Street, Vancouver, British Columbia, Canada V7Y 1B3. CruzSur's common shares are listed on the TSX Venture Exchange ("TSX-V") under the symbol "CZR".

**Share consolidation**

On September 4, 2018, the Company completed a share consolidation in which one post-consolidation common share replaced ten pre-consolidation common shares. As a result, the outstanding common shares of the Company were reduced to 24,220,160 common shares. All information relating to the weighted average number of common shares outstanding, issued and outstanding common shares, warrants, stock options and per share amounts have been adjusted retroactively to reflect the impact of the ten for one share consolidation in these interim condensed consolidated financial statements.

## 2. GOING CONCERN

These interim condensed consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to discharge its obligations and realize its assets in the normal course of operations for the foreseeable future.

During the six months ended June 30, 2019, the Company had income from operations of $2.5 million and used $1.7 million of cash flow in its operating activities. As at June 30, 2019 the Company had working capital of $3.5 million making it unfeasible to fund administrative budget and capital commitment amounts that exist for the upcoming year and beyond. As the Company will continue to utilize its financial resources to fund existing administrative budgets and capital commitments for the foreseeable future, there is material uncertainty as to the future operating ability of the Company as it will be contingent upon the Company's ability to successfully identify and procure necessary capital. Furthermore, the Company has contractually committed exploration and development amounts as outlined in Note 15. These commitments could leave the Company potentially cash deficient depending on the outcome of the Company's ongoing operations. As a result, these conditions give rise to a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

Management believes that the going concern assumption is appropriate for these interim condensed consolidated financial statements and that the Company will be able to meet its budgeted capital and administrative costs as well as its other potential capital commitments during the upcoming year and beyond. There is no guarantee that the Company will be successful in its endeavors and no certainty as to the timing of the Company's impending exploration commitments. Should the going concern assumption not be appropriate and the Company is not able to realize its assets and settle its liabilities, these consolidated financial statements would require adjustments to the amounts and classifications of assets and liabilities, and these adjustments could be significant.

## 3. BASIS OF PRESENTATION

### Statement of compliance

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

These interim condensed consolidated financial statements follow the same accounting policies and method of computation as the Company's annual audited consolidated financial statements for the year ended December 31, 2018, with the exception of certain disclosures that are normally required to be included in annual consolidated financial statements which have been condensed or omitted. These interim condensed consolidated financial statements should be read in conjunction with the Company's annual audited consolidated financial statements for the year ended December 31, 2018.

These interim condensed consolidated financial statements have been prepared on a historical basis except financial instruments, which include marketable securities, are measured at fair value through profit or loss. Unless otherwise stated, these interim condensed consolidated financial statements are presented in United States (US) dollars, and were authorized for issue by the Board of Directors on August 29, 2019.

### Significant accounting policies

The Company's significant accounting policies can be read in Note 4 of the Company's annual audited consolidated financial statements as at and for the year ended December 31, 2018.

### New standards adopted on January 1, 2019

***IFRS 16: Leases***

On January 1, 2019, the Company adopted IFRS 16 "Leases" to replace the existing guidance of IAS 17 "Leases". The standard establishes principles and disclosures related to the amount, timing and uncertainty of cash flows arising from a lease. Under IFRS 16, lease arrangements previously classified as operating leases under IAS 17, are recognized on the consolidated statement of financial position as a right-of-use asset and corresponding lease obligation. IAS 17 criteria recognized a lease arrangement as a finance lease when substantially all of the risks and rewards of ownership of the underlying asset are transferred to the lessor, whereas IFRS 16 recognizes a finance lease based on the right to control and the use of an identified asset. The Company has applied IFRS 16 using the modified retrospective approach, under which the cumulative effect of the initial adoption is recognized as at January 1, 2019 and does not impact comparative figures or retained earnings. The Company has also elected going forward not to recognize right-of-use assets and lease obligations for low-value assets or short-term lease arrangements. Given that the Company currently has no lease arrangements, no adjustments were required from the adoption of this standard.

The details of the changes in accounting policy are disclosed below.

The lease arrangements are assessed based on whether they meet the following definition of a lease under IFRS 16:

a) Identified asset - The Company has access to the use of a physically distinct asset and the counterparty does not hold the right to substitute an alternative asset for use;
b) Right to direct the use of an asset - The Company has relevant operational decision-making rights for the use and purpose of the underlying asset; and
c) Substantially all of the economic rights and benefits - The Company obtains sole benefit from the use of the asset throughout the duration of the lease term.

Lease arrangements which meet the criteria of a lease are recognized as right-of-use assets and lease obligations at the lease commencement date.

The right-of-use asset is initially measured at cost. Subsequently it is measured at cost less accumulated depreciation and impairment losses and adjusted for certain re-measurements of the lease obligation. The lease obligation is measured at the present value of the lease payments outstanding at the commencement date, discounted using the implicit rate, and when not determinable, the Company's incremental borrowing rate. The Company has elected to include both lease and non-lease components in the total estimated lease payments outstanding.

The lease obligation is re-measured when there is a change in estimated future payments arising from a change in a lease term, index or rate, residual guarantee or purchase option.

The Company has applied judgment and estimates when determining the estimated lease payments including the lease term. The assessment of whether a renewal, extension, termination or purchase option is reasonably certain to exercise was considered, based on facts and circumstances, and has the potential to significantly impact the amount of right-of-use asset and lease obligation recognized.

## 4. TRANSACTIONS

### a) Settlement and Assignment Agreement with YPF

In February 2019, the Company completed the Settlement and Assignment Agreement with YPF SA, the operator of the Llancanelo Asset, wherein both parties have agreed upon terms of assignment of Alianza's 39% participating interest in the Llancanelo Asset to YPF. In return, YPF has released Alianza from all existing and future financial obligations related to Llancanelo Asset operations. This has resulted in the elimination of approximately $12.4 million of exploration and evaluation assets, $1.0 million of property, plant and equipment assets, $1.0 million of joint venture payables, $8.4 million in liabilities for cash calls assumed on acquisitions, $2.5 million in liabilities for considerations payable on acquisitions, and $1.6 million in decommissioning liabilities. No impairment loss or recovery resulted on account of this transaction for the six months ended June 30, 2019 given that impairments on the carrying value of assets associated with the Llancanelo Asset were previously recognized during the year ended December 31, 2018, reducing the net book value to the assessed recoverable amount, being the equivalent amount of the liabilities that were eliminated on account of this settlement.

YPF assumes all rights and obligations relating to the 39% participating interest which the Company purchased through two transactions that occurred in 2017. The YPF Farm-In that the Company entered into with YPF to earn an additional 11% participating interest, in which the Company was to contribute $54 million in capital expenditures and make cash payments of $12.5 million to YPF, has been cancelled as part of the settlement. YPF will release and hold harmless the Company from any and all commitments, damages or penalties related with this cancelation.

**b) Resolution of Dispute Affecting SN-9 Block**

In May 2019, the Company reached a resolution with Clean Energy Resources S.A.S ("Clean") to the Company's original acquisition of economic beneficial interest in the SN-9 Block. The terms of the resolution are as follows:

- Clean's participation in the SN-9 Block will increase from a 5% to a 13% interest reducing the Company's share from 80% to 72%, which will comprise two components:
- First component - the original carried working interest will increase by 3%, from 5% to 8%
- Second component - Clean will acquire an additional 5% by one of two options:
    - Option 1 - payment of $1.2 million to the Company if Clean chooses to only participate in the first phase of the exploration program.
    - Option 2 - payment of $2.9 million to the Company if Clean chooses to participate in both phases of the exploration program.

  Payment to the Company for either option will be received through the sale of 62.5% of Clean's production on the SN-9 Block corresponding to this 5% interest. Furthermore, the share of Net Profit Interest and Overriding Royalties (as defined in the SN-9 PSA and discussed further below) related to this additional 5% working interest will be the obligation of Clean and not carried by the Company.

**c) Resolution of Dispute Affecting Tiburon Block**

In May 2019, the Company reached a resolution with ColPan Oil & Gas Limited ("ColPan"), to the Company's original acquisition of economic beneficial interest in the Tiburon Block. The terms of the resolution are as follows:

- CruzSur will earn its economic beneficial interest based on the executed work program as follows:
    - 10% working interest on the completion of the Phase 3 3D seismic commitment
    - An additional 15% working interest on the drilling and testing of one exploration well
    - A further 15% working interest on the drilling and testing of a second exploration well
- After completing the 3D seismic commitment, CruzSur is not obligated to drill any of the exploration wells and can exit the contract with no further commitments, but will lose the original $0.3 million performance guarantee currently held in deposit with the ANH (see Note 6); alternatively, CruzSur may elect to stay in the license with a 10% working interest.
- CruzSur will cover unpaid management fees of $120,000 arising from the dispute period. This money will be returned to CruzSur if the Company is still participating in the block when the ANH performance guarantee is returned at the end of the Phase 3 commitment.

- In the event that CruzSur does not fulfill the Phase 3 commitment, except for reasons beyond its control, CruzSur will cede a 1.5% carried working interest in the SN-9 Block to Clean, and forfeit the aforementioned $120,000 payment.

**d) Negotiations with Panacol for the Development of the SN-9 Block**

In May 2019, in parallel with resolving the above-mentioned disputes, the Company agreed to a non-binding letter of intent with Panacol Oil & Gas (“Panacol”) whereby Panacol would take certain responsibilities under the Company’s existing exploration commitments for the SN-9 Block in exchange for a working interest of up to 37.5% in the SN-9 Block. The parties continue to negotiate the terms initially proposed under the aforementioned letter of intent with the objective of reaching a mutually beneficial definitive agreement.

**e) Settlement Agreement Regarding the Alianza Acquisition**

In June 2019, the Company reached a settlement agreement with the selling parties in relation to the original acquisition in August 2017 of the Company’s Argentina subsidiary, Alianza Petrolera Argentina S.A. Pursuant to the original purchase agreement, the Company withheld payment of $5 million of the purchase price (the “Holdback Amount”) and withheld transfer of the real estate property owned by Alianza located in the city of Buenos Aires (the “Buenos Aires Property”) to cover adjustments to the purchase price and potential losses. Subsequent to the acquisition, the selling parties have requested from CruzSur the immediate release of the Holdback Amount and the transfer of the Buenos Aires Property as set forth under the purchase agreement. Under the settlement agreement, the Company has agreed to the following terms with the selling parties, as follows:

- Payment by the Company of $472,000 (“Settlement Amount”), for which the Buenos Aires Property is retained by the Company and the claims on the Holdback Amount are relinquished by the selling parties. Payment of the Settlement Amount was completed in June 2019.
- The selling parties’ withdrawal of any and all disputes arising, resulting or derived from the purchase agreement.
- The Company and the selling parties give reciprocal releases from any and all claims and obligations of every kind and nature, resulting from or derived from the purchase agreement.

With the completion of this settlement agreement, the Company eliminates $5 million in consideration payables and acquires title to the Buenos Aires Property.

## 5. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

Accounts receivable may include certain amounts identified as joint venture receivables, which are comprised of funds advanced towards joint venture operations with respect to exploration and development activities in blocks in which the Company is a joint venture partner. As these funds are expended, recognition of these expenditures is realized as they are booked to exploration and evaluation assets.

Conversely, joint venture payables are amounts owed on account of capital activities in blocks that exceed funds advanced by the Company towards joint venture operations to date. The amounts are included in accounts payable when they exist at the end of a reporting period. The table below represents the composition of the accounts receivable and accounts payable balances as at June 30, 2019 and December 31, 2018.

| | **2019** | 2018 |
|---|---|---|
| Value-added tax receivable | **1,132,293** | 1,129,943 |
| Prepaid expenses | **97,516** | 104,447 |
| Sales receivable | **400,263** | 696,571 |
| Other receivables | **298,281** | 320,201 |
| **Accounts receivable and prepaid expenses** | **1,928,353** | 2,251,162 |

| | | |
|---|---|---|
| Trade accounts payable and accruals (1) | **3,442,865** | 2,823,760 |
| Joint venture payables | **91,567** | 1,014,137 |
| Capital accruals | **300,000** | 513,290 |
| Interest payable on convertible debentures | **37,686** | - |
| Consideration payable on Acquisitions | **-** | 7,500,000 |
| **Accounts payable and accrued liabilities** | **3,872,118** | 11,851,187 |

1) Amounts of approximately $1.8 million in trade accounts payable are currently being negotiated by Company management with the respective counterparties.

## 6. RESTRICTED CASH

As of June 30, 2019, funds totaling $2,841,340 (December 31, 2018 - $2,782,368) comprised the balance represented in restricted cash. The composition of this amount is as follows:

| | **2019** | 2018 |
|---|---|---|
| SN-9 ANH Guarantee Deposit | **2,482,968** | 2,387,518 |
| Tiburon ANH Guarantee Deposit | **358,372** | 343,377 |
| TPIC Escrow | **-** | 51,473 |
| **Restricted cash** | **2,841,340** | 2,782,368 |

Term deposits of $2.4 million and $0.3 million were established to secure performance guarantees required by the Colombian National Hydrocarbon Agency (“ANH”) under the E&P Contracts for the SN-9 and Tiburon Block. The SN-9 and Tiburon deposits amounts are defined in US dollars by the ANH but are held in Colombian pesos with Colombian banks and are subject to foreign currency fluctuation risks in relation to the US dollar. These deposits are to be released to the Company once current phase commitments under each E&P Contract are completed. As of June 30, 2019, the balances of the SN-9 term deposit and Tiburon term deposit were $2,482,968 and $358,372, respectively.

As part of the of the acquisition of the Maria Conchita Block, the Company was required to deposit $9.0 million into escrow that was to directly fund the drilling of the first well under the purchase agreement.

The related costs to drill the first well were paid from the escrow account as they were incurred. The remaining balance in the escrow account of $51,473 existing as of December 31, 2018 was released to the former operator of Maria Conchita Block, TPIC, in March 2019 as part of the final transfer of operatorship and liquidation of former joint venture operations (see Note 7). As of June 30, 2019, no balance remains in escrow.

## 7. EXPLORATION AND EVALUATION ASSETS

Exploration and Evaluation ("E&E") assets consists of the following amounts:

| | |
|---|---|
| **Balance as at December 31, 2017** | **67,609,348** |
| Additions | 10,632,369 |
| Acquisition purchase price adjustments | (46,988) |
| Capitalized general and administrative | 409,037 |
| Asset retirement cost addition | 296,007 |
| Revision of asset retirement estimate | (156,335) |
| Capitalized share-based compensation | 84,866 |
| Impairment loss | (58,900,000) |
| **Balance as at December 31, 2018** | **19,928,304** |
| Additions | 30,000 |
| Recovery from TPIC liquidation | (176,301) |
| Revision of asset retirement estimate | (256,956) |
| Reduction from YPF settlement | (12,362,245) |
| **Balance as at June 30, 2019** | **7,162,802** |

The Company's exploration and evaluation assets represent costs incurred in relation to three exploration blocks in Colombia and three exploration blocks in Argentina. In March 2019, the Company completed the transfer of operatorship and liquidation of former joint venture operations relating to the Maria Conchita Block with the former operator, TPIC. Liquidation terms agreed upon included the release of the remaining balance of escrow funds to TPIC of $51,273 (after bank fees), with an offset liquidation of the remaining joint venture funds resulting in payment to the Company of $227,574. The net result of these terms was a net recovery of $176,301, which was recognized as a reduction of former exploration and evaluation expenditures on the Maria Conchita Block.

As previously discussed, in February 2019 the Company completed the Settlement and Assignment Agreement with YPF wherein both parties agreed upon terms of assignment of Alianza's participating interest in the Llancanelo Asset to YPF. As a result of this settlement agreement, the remaining balance of $12.4 million related to the Llancanelo Asset was eliminated from the E&E assets balance.

### Impairment Test of Exploration and Evaluation Assets

As of June 30, 2019, the Company completed an impairment review of its E&E assets. It was determined that potential impairment indicators exist as of June 30, 2019 when considering i) the outcome of the dispute resolutions for the SN-9 and Tiburon Blocks (see Notes 4d and 4e), and ii) existing uncertainty as of June 30, 2019 that the carrying value of E&E assets will be recovered in full from successful development or by sale.

As a result, an impairment calculation was performed by comparing the E&E assets carrying amount for each CGU to the recoverable amount. The recoverable amount was estimated using fair value less costs of disposal based on market transactions for the purchase of all oil and gas properties, including both E&E and PP&E assets. A portion of the estimated recoverable amount was calculated using a 20% discount rate (level 3 input) on financial instruments included as consideration within the market transactions. As described in Note 8, impairment from this calculation resulted in no impairment recognized for PP&E assets as the discounted cash flow model associated with PP&E assets revealed the recoverable value was greater than the carrying value. Furthermore, the calculated recoverable value attributable to E&E assets was assessed to be greater than the carrying value, resulting in no impairment being recorded for the six months ended June 30, 2019.

During the six months ended June 30, 2018, the Company recognized impairments relating to the Llancanelo Asset of $25.0 million. These impairments were the result of the difference between the period-end E&E net book value and management's assessment of the recoverable amount of the Llancanelo Asset as of June 30, 2018 on account of the formal notification received from YPF regarding the relinquishment of the Company's working interest in the Llancanelo Asset and the termination of the YPF Farm-In Agreement.

## 8. PROPERTY, PLANT, AND EQUIPMENT

The components of the Company's property, plant and equipment ("PP&E") assets are as follows:

| **Cost** | **Oil and natural gas assets** | **Corporate** | **Total** |
|---|---|---|---|
| As at December 31, 2017 | 5,067,954 | 173,245 | 5,241,199 |
| Capital additions | (29,635) | 139,388 | 109,753 |
| Disposals | - | (99,541) | (99,541) |
| As at December 31, 2018 | 5,038,319 | 213,092 | 5,251,411 |
| Capital additions | - | 481,390 | 481,390 |
| Reduction from YPF settlement | (1,035,986) | - | (1,035,986) |
| **As at June 30, 2019** | **4,002,333** | **694,482** | **4,696,815** |
| **Accumulated depletion and depreciation** | | | |
| As at December 31, 2017 | 933,153 | 24,935 | 958,088 |
| Additions | 1,438,565 | 98,984 | 1,537,549 |
| As at December 31, 2018 | 2,371,718 | 123,919 | 2,495,637 |
| Additions | 236,682 | 37,083 | 273,765 |
| **As at June 30, 2019** | **2,608,400** | **161,002** | **2,769,402** |
| **Net book value** | | | |
| As at December 31, 2017 | 4,134,801 | 148,310 | 4,283,111 |
| As at December 31, 2018 | 2,666,601 | 89,173 | 2,755,774 |
| **As at June 30, 2019** | **1,393,933** | **533,480** | **1,927,413** |

The Company's property, plant and equipment assets represent costs incurred in relation to two blocks in Argentina as well as certain corporate fixed assets held in Colombia and Argentina. Capital additions for the six months ended June 30, 2019 primarily consist of the addition of the Buenos Aires Property recognized for the value of the Settlement Amount paid of $472,000 (see Note 4e).

**Impairment Test of PP&E Assets**

As of June 30, 2019, the Company completed an impairment review of its PP&E assets. It was determined that potential impairment indicators exist at June 30, 2019 as the net assets were greater than the Company's market capitalization.

The recoverable amount of PP&E for the Mariposa asset is determined as the fair value less costs of disposal using a discounted cash flow method (level 3 inputs). Using a discount rate of 20%, an impairment test was performed, which did not result in an impairment loss being recorded in the statement of loss and comprehensive loss. If the discount rate was one percent higher, this would result in no additional impairment. If cash flows were five percent lower, still no additional impairment would be required.

As previously discussed, during the six months ended June 30, 2019, the Company completed the Settlement and Assignment Agreement with YPF wherein both parties agreed upon terms of assignment of Alianza's participating interest in the Llancanelo Asset to YPF. As a result of this settlement agreement, the remaining balance of $1.0 million related to the Llancanelo Asset was eliminated from the PP&E assets balance. As such, no further impairment analysis is required regarding the Llancanelo Asset.

## 9. CONVERTIBLE DEBENTURES

In May 2019, the Company completed a non-brokered private placement of secured convertible debentures for aggregate proceeds of $2.5 million (C$3,350,000). The debentures are denominated in Canadian dollars, mature five years from the date of issuance, bear interest at the rate of 10% per annum and are secured by a general security agreement on the assets of the Company. Under the terms of the debentures, the lenders may, at any time prior to the maturity date convert any or all of the principal amount of the debentures into units of the Company at a conversion price of C$0.15 per unit. Each unit is comprised of one common share of the Company and one share purchase warrant. Each warrant entitles the holder to purchase one common share of the Company at a price of C$0.15 for a period of five years. At the option of the Company, accrued interest may be paid in cash or converted into common shares of the Company at the then-market price of the Company's common shares, subject to TSX-V approval.

These debentures are a level 3 financial liability with an embedded conversion feature. As a result, the equity and debt components must be bifurcated. The value assigned to the liability on the date of issuance was the present value of the contractually determined stream of future cash flows discounted at 20%, being the estimated rate the market would apply to an instrument with comparable credit status and provide substantially the same cash flows, on the same terms, but without the conversion option. From the date of issuance, the liability component accretes up to its principal value using the effective interest method, with the charge recorded in finance (income) expenses in the consolidated statement of loss.

The components of the Company's convertible debentures as of June 30, 2019 are as follows:

| | Liability Component | Equity Component | Total |
|---|---|---|---|
| On date of issuances, net of transaction costs | 1,630,501 | 748,188 | 2,378,689 |
| Accretion (Note 11) | 14,608 | - | 14,608 |
| Impact of foreign exchange | 48,743 | - | 48,743 |
| **Balance, June 30, 2019** | **1,693,852** | **748,188** | **2,442,040** |

## 10. REVENUE

The following table presents the Company's oil and natural gas revenue disaggregated by product type for the three and six months ended June 30, 2019 and 2018:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** |
| **Production revenue:** | | | | |
| Oil and condensate sales | 248,303 | 2,255,336 | 420,192 | 4,525,579 |
| **Total oil and natural gas production revenue** | **248,303** | **2,255,336** | **420,192** | **4,525,579** |
| Net revenue on carried working interest | 207,678 | 189,049 | 423,286 | 540,655 |
| **Total oil and natural gas revenue** | **455,981** | **2,444,385** | **843,478** | **5,066,234** |

As at June 30, 2019, receivables from contracts with customers, which are included in accounts receivable, were $400,263 (December 31, 2018 - $696,571).

## 11. SHARE CAPITAL

### Common Shares

As at June 30, 2019, the Company was authorized to issue an unlimited number of common shares, with no par value, with holders of common shares entitled to one vote per share and to dividends, if declared. As of June 30, 2019 and December 31, 2018 and 2017, the Company had 24,220,160 common shares outstanding for a share capital balance of $63,799,393.

### Stock Options

The Company's stock option plan provides for the issue of stock options to directors, officers, employees, charities and consultants, who are all considered related parties to the Company. The plan provides that stock options may be granted up to a number equal to 10% of the Company's outstanding shares. Vesting terms are determined by the Board of Directors as they are granted and currently include periods ranging from immediately to one-third on each anniversary date over three years. The options' maximum term is ten years.

As at June 30, 2019, a total of 414,100 (December 31, 2018 – 1,542,100) options were issued and outstanding under this plan. Options which are forfeited/expired are available for reissue.

A summary of the changes in stock options is presented below:

| | Stock options | Weighted average exercise price (C$) |
|---|---|---|
| **Balance, December 31, 2017** | 2,289,643 | 7.97 |
| Options issued | 515,600 | 4.45 |
| Options forfeited | (673,393) | 8.18 |
| Expired options | (589,750) | 7.82 |
| **Balance, December 31, 2018** | **1,542,100** | **6.76** |
| Options forfeited | (1,128,000) | 6.37 |
| **Balance, June 30, 2019** | **414,100** | **7.83** |

The following summarizes information about stock options outstanding as at June 30, 2019:

| Exercise prices (C$) | Number of options outstanding | Weighted average term to expiry (years) | Number of options exercisable |
|---|---|---|---|
| 6.10 | 36,600 | 7.15 | 36,600 |
| 8.00 | 377,500 | 8.11 | 377,500 |
| | **414,100** | **8.03** | **414,100** |

No stock options were issued during the six months ended June 30, 2019. For the six months ended June 30, 2019, a recovery on the vesting of stock options of $100,078 was recognized, which was recorded as part of share-based payments on the consolidated statement of loss.

**Warrants**

***Broker Warrants***

Pursuant to the brokered private placement of common shares in February 2017, the Company issued 196,800 warrants to brokers of the private placement based on the terms of the agency agreement (the “Broker Warrants”). These Broker Warrants were for a two-year term, which expired on January 31, 2019.

***Purchase Warrants***

Pursuant to various transactions in 2017, the Company issued a total of 5,625,000 Units, each consisting of one common share and one share purchase warrant, each exercisable into one additional common share at a price of C$10.50 per share until July 31, 2022 (the “Purchase Warrants”). A fair value of $10,201,910 (C$12,754,916), net of issue costs, was recognized at the time of the issuance of the Purchase Warrants.

The 5,625,000 Purchase Warrants are publicly listed for trading on the TSX-V under the symbol “CZR.WT”.

**Loss per Share**

For purposes of the loss per share calculations for the periods ended June 30, 2019 and 2018, there is no difference between the basic loss per share and the diluted loss per share amounts. For the period ended June 30, 2019, 414,100 stock options and 5,625,000 Purchase Warrants were excluded as their impact was anti-dilutive.

## 12. FINANCE

The components of finance expenses/income for the three and six months ended June 30, 2019 and 2018 are as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** |
| **Cash:** | | | | |
| Interest income | (52,350) | (60,533) | (97,530) | (138,518) |
| Interest expenses and bank charges | 46,915 | 20,984 | 54,897 | 118,466 |
| | (5,435) | (39,549) | (42,633) | (20,052) |
| **Non-cash:** | | | | |
| Accretion on decommissioning obligation | 23,019 | 29,905 | 47,623 | 58,250 |
| Accretion on liability component of convertible debentures issued | 14,608 | - | 14,608 | - |
| | 37,627 | 29,905 | 62,231 | 58,250 |
| **Total finance expenses (income)** | **32,192** | **(9,644)** | **19,598** | **38,198** |

## 13. ASSETS HELD FOR SALE

**Horizon Investment**

The investment of the shares of Horizon Petroleum Ltd. held by the Company have been classified as held for sale. At June 30, 2019, the fair market value of the 12,250,000 Horizon Shares was $608,428 (C$796,250) resulting in an unrealized gain on assets held for sale of $275,564 (C$367,500) representing the increase in share value for the six months ended June 30, 2019 between the closing price as of December 31, 2018 of $0.0257 (C$0.035) per share and the closing price as of June 30, 2019 of $0.0497 (C$0.065) per share, net of foreign exchange.

## 14. RELATED PARTIES

During the period ended June 30, 2019, the Company paid a monthly advisory fee to a firm affiliated with a director of CruzSur. As per the consulting agreement with this firm, CruzSur pays a monthly fee of

C$10,000 plus reimbursable expenses. Furthermore, additional fees are to be paid pursuant to the closing of successful financing arrangements, divestitures, or acquisitions for which the firm provides advisory services.

In May 2019, the Company completed a non-brokered private placement of secured convertible debentures for proceeds of $2.5 million before transaction costs (see Note 9). Of the total debenture proceeds, approximately $1.3 million were issued to directors of the Company.

## 15. COMMITMENTS

A summary of the Company's estimated capital commitments (in millions of dollars) are as follows:

| Block | 2019 | 2020 | 2021 | Total |
|---|---|---|---|---|
| SN-9 Block (1) | - | 22.3 | - | **22.3** |
| Tiburon Block (2) | 3.0 | - | - | **3.0** |
| **Total** | **3.0** | **22.3** | **-** | **25.3** |

1) CruzSur's ANH commitment to carry out the minimum requirement to process and interpret 204.4 km of 2D seismic and drill one exploration well (for which the Company will pay 100% of the costs on the terms of the SN-9 Acquisition) according to Phase 1 of the contractual exploration program, which must be fulfilled by mid-year 2020.
2) Relates to CruzSur's share of the ANH commitment to carry out the minimum requirement to acquire, process, and interpret 69.75 $km^2$ of 3D seismic instead according to Phase 3 of the contractual exploration program. Currently, operations are delayed due to disputes in the region, with current ANH deadline of 2019 with extensions if disputes were resolved in 2019. The commencement date for seismic acquisition is unknown at this time. The Company assumes that operations will commence in 2019.

The expenditures provided in the above table only represent the Company's estimated cost to satisfy contract requirements. Actual expenditures to satisfy these commitments, initiate production or create reserves may differ from these estimates. The expenditures in the above table are based on the latest possible date required per contract and may be incurred at an earlier date.

## 16. SEGMENTED INFORMATION

The Company is engaged in the exploration and development of oil and gas. Management has defined the operating segments of the Company based on geographical areas, identifying operations held in Argentina and Colombia as separate reporting segments. The Corporate segment reflects balances and expenses related to all Company operations outside of Argentina and Colombia, which collectively represent the corporate operations of the Company. Management finds that each of the defined reporting segments have distinct economic characteristics and regulatory environments.

The following tables show information regarding the Company's segments for three and six months ended June 30, 2019 and 2018.

| **For the six months ended June 30, 2019** | **Argentina** | **Colombia** | **Corporate** | **Total** |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Oil and natural gas revenue | 420,192 | - | - | 420,192 |
| Net revenue on carried working interest | 423,286 | - | - | 423,286 |
| Royalty expense | (45,552) | - | - | (45,552) |
| **Net oil and natural gas revenue** | **797,926** | **-** | **-** | **797,926** |
| **Expenses:** | | | | |
| Operating expenses | 374,764 | - | - | 374,764 |
| Inventory revaluation | 439,054 | - | - | 439,054 |
| General and administrative | 449,750 | 469,429 | 1,701,055 | 2,620,234 |
| Business development | - | - | 7,935 | 7,935 |
| Share based payments | - | - | (100,078) | (100,078) |
| Gain on settlement | (5,000,000) | - | - | (5,000,000) |
| Depletion and depreciation | 263,990 | 9,775 | - | 273,765 |
| Finance | 36,898 | (63,760) | 46,460 | 19,598 |
| Foreign exchange loss (gain) | 130,426 | (58,563) | (91,798) | (19,935) |
| Gain on revaluation of asset held for sale | - | - | (275,564) | (275,564) |
| | **(3,305,118)** | **356,881** | **1,288,010** | **(1,660,227)** |
| **Income (loss) before income taxes** | **4,103,044** | **(356,881)** | **(1,288,010)** | **2,458,153** |
| **Assets, June 30, 2019** | **8,077,441** | **6,449,169** | **1,984,572** | **16,511,182** |
| **Liabilities, June 30, 2019** | **3,984,673** | **339,708** | **4,633,273** | **8,957,654** |

| **For the six months ended June 30, 2018** | **Argentina** | **Colombia** | **Corporate** | **Total** |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Oil and natural gas revenue | 4,525,579 | - | - | 4,525,579 |
| Net revenue on carried working interest | 540,655 | - | - | 540,655 |
| Royalty expense | (929,779) | - | - | (929,779) |
| **Net oil and natural gas revenue** | **4,136,455** | **-** | **-** | **4,136,455** |
| **Expenses:** | | | | |
| Operating expenses | 2,752,553 | - | - | 2,752,553 |
| Inventory revaluation | 376,003 | - | - | 376,003 |
| General and administrative | 323,667 | 449,031 | 2,356,267 | 3,128,965 |
| Business development | 25,759 | 7,186 | 136,537 | 169,482 |
| Share based payments | - | - | 362,955 | 362,955 |
| Depletion and depreciation | 1,206,522 | 16,313 | - | 1,222,835 |
| Impairment loss | 25,000,000 | - | - | 25,000,000 |
| Finance | 75,886 | (120,011) | 82,323 | 38,198 |
| Foreign exchange loss (gain) | 1,863,778 | (91,504) | (295,124) | 1,477,150 |
| Loss on revaluation of asset held for sale | - | - | 143,821 | 143,821 |
| | **31,624,168** | **261,015** | **2,786,779** | **34,671,962** |
| **Loss before income taxes** | **(27,487,713)** | **(261,015)** | **(2,786,779)** | **(30,535,507)** |
| **Assets, June 30, 2018** | **32,843,864** | **27,458,112** | **9,082,073** | **69,384,049** |
| **Liabilities, June 30, 2018** | **22,506,883** | **2,812,354** | **5,335,507** | **30,654,744** |

| **For the three months ended June 30, 2019** | **Argentina** | **Colombia** | **Corporate** | **Total** |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Oil and natural gas revenue | 248,303 | - | - | 248,303 |
| Net revenue on carried working interest | 207,678 | - | - | 207,678 |
| Royalty expense | (25,398) | - | - | (25,398) |
| **Net oil and natural gas revenue** | **430,583** | **-** | **-** | **430,583** |
| **Expenses:** | | | | |
| Operating expenses | 222,906 | - | - | 222,906 |
| Inventory revaluation | 148,456 | - | - | 148,456 |
| General and administrative | 228,328 | 247,564 | 1,463,379 | 1,939,271 |
| Share based payments | - | - | (167,517) | (167,517) |
| Gain on settlement | (5,000,000) | - | - | (5,000,000) |
| Depletion and depreciation | 129,675 | 2,443 | - | 132,118 |
| Finance | 15,641 | (29,481) | 46,032 | 32,192 |
| Foreign exchange loss (gain) | (46,535) | 43,687 | 21,738 | 18,890 |
| Gain on revaluation of asset held for sale | - | - | (183,424) | (183,424) |
| | **(4,301,529)** | **264,213** | **1,180,208** | **(2,857,108)** |
| **Income (loss) before income taxes** | **4,732,112** | **(264,213)** | **(1,180,208)** | **3,287,691** |

| **For the three months ended June 30, 2018** | **Argentina** | **Colombia** | **Corporate** | **Total** |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Oil and natural gas revenue | 2,255,336 | - | - | 2,255,336 |
| Net revenue on carried working interest | 189,049 | - | - | 189,049 |
| Royalty expense | (483,301) | - | - | (483,301) |
| **Net oil and natural gas revenue** | **1,961,084** | **-** | **-** | **1,961,084** |
| **Expenses:** | | | | |
| Operating expenses | 1,351,745 | - | - | 1,351,745 |
| Inventory revaluation | 189,274 | - | - | 189,274 |
| General and administrative | 263,058 | 177,860 | 966,376 | 1,407,294 |
| Business development | 25,759 | - | 53,920 | 79,679 |
| Share based payments | - | - | 202,671 | 202,671 |
| Depletion and depreciation | 573,991 | 6,414 | - | 580,405 |
| Impairment loss | 25,000,000 | - | - | 25,000,000 |
| Finance | 33,332 | (56,686) | 13,710 | (9,644) |
| Foreign exchange loss (gain) | 1,650,731 | 138,539 | (212,491) | 1,576,779 |
| Loss on revaluation of asset held for sale | - | - | 46,926 | 46,926 |
| | **29,087,890** | **266,127** | **1,071,112** | **30,425,129** |
| **Loss before income taxes** | **(27,126,806)** | **(266,127)** | **(1,071,112)** | **(28,464,045)** |

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

| For periods ended June 30 | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Accounts receivable | (215,377) | 1,239,642 | 322,809 | 1,383,417 |
| Inventory | (10,600) | (138,197) | 12,413 | 480,993 |
| Accounts payable and accrued liabilities | (4,631,781) | (2,924,432) | (16,423,671) | 575,132 |
| Working capital adjustments for capital accrual reversals | 210,000 | - | 210,000 | - |
| Working capital adjustments for YPF settlement | - | - | 11,801,832 | - |
| Working capital adjustments for Alianza settlement | 5,000,000 | - | 5,000,000 | - |
| Woking capital adjustments for Bochica acquisition | - | 112,104 | - | 2,237,104 |
| **Change in non-cash working capital** | **352,242** | **(1,710,883)** | **923,383** | **4,676,646** |
| | | | | |
| Relating to: | | | | |
| Operating activities | 337,394 | (738,719) | 916,872 | (144,257) |
| Investing activities | 14,848 | (972,164) | 6,511 | 4,820,903 |
| **Change in non-cash working capital** | **352,242** | **(1,710,883)** | **923,383** | **4,676,646** |

## 18. SUBSEQUENT EVENTS

### Grant of Stock Option and Re-Pricing

In July 2019, the Company granted an aggregate of 2,462,500 stock options under the Company's stock option plan to directors, officers, employees, and consultants of the Company and charities with an exercise price of C$0.45 per stock option, exercisable for a period of ten years from the date of grant.

The Company also re-priced a total of 72,500 stock options which were previously granted to consultants of the Company to an exercise price of C$0.45 per share. Except for the amendment of the exercise price, all original terms of the stock options remain in effect.

### Share Issuance for Debt Payment

In July 2019, the Company issued 3,692,481 common shares as payment of severance amounts of C$1.0 million owed to former members of management. The Company also issued 925,925 common shares as payment towards contractual amounts owed of C$250,000. Trading restrictions on the issued shares are in place until November 2019.