

# **Petroteq Energy Inc.**

## **Condensed Consolidated Interim Financial Statements**

**For the three and six months ended February 28, 2018 and 2017**

(Expressed in US dollars)

(Unaudited)

### **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The Company's independent auditor has not performed a review of these condensed consolidated interim financial statements in accordance with standards established by Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

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# **Petroteq Energy Inc.**

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**PETROTEQ ENERGY, INC.****Condensed Consolidated Interim Statements of Financial Position**

As at February 28, 2018 and August 31, 2017

*Expressed in US dollars*

	Notes	February 28, 2018 (Unaudited)	August 31, 2017 (Audited)
<b>ASSETS</b>			
<b>Current assets</b>			
Cash	4	\$ 86,094	\$ 55,420
Trade and other receivables	5	226,881	306,909
Current portion of advanced royalty payments	7(a)	165,681	258,333
Prepaid expenses and other current assets		666,038	92,819
		1,144,694	713,481
<b>Advanced royalty payments</b>	7(a)	525,405	244,790
<b>Notes receivable</b>		76,000	76,000
<b>Mineral lease</b>	8(b)	11,091,388	11,091,388
<b>Investments</b>		168,331	68,331
<b>Investment in Accord GR Energy</b>		1,043,290	1,141,561
<b>Property, plant and equipment</b>	9	16,213,909	14,906,953
<b>Intangible assets</b>	10	680,400	707,671
		\$ 30,943,417	\$ 28,950,175
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Accounts payable	11	\$ 1,211,781	\$ 1,121,327
Accrued expenses	11	1,661,449	1,980,304
Unearned revenue		283,976	283,976
Current portion of long-term debt	12	911,287	1,159,104
Current portion of convertible debentures	13	3,152,981	-
Payable to director	19(c)	492,650	419,322
		7,714,124	4,964,033
<b>Unearned advance royalties received</b>	7(b)	170,000	170,000
<b>Long-term debt</b>	12	1,736,245	717,276
<b>Convertible debentures</b>	13	-	508,500
<b>Reclamation and Restoration provision</b>	14	577,942	572,220
		10,198,311	6,932,029
<b>SHAREHOLDERS' EQUITY</b>			
<b>Share capital</b>	15	62,234,013	60,827,494
<b>Shares to be issued</b>		-	56,800
<b>Share option reserve</b>	16	9,877,199	7,371,552
<b>Share warrant reserve</b>	17	868,504	618,667
<b>Deficit</b>		(52,234,610)	(46,856,367)
		20,745,106	22,018,146
		\$ 30,943,417	\$ 28,950,175

*Approved by the Board of Directors*

"Aleksandr Blyumkin"  
Aleksandr Blyumkin  
Director

"Travis Schneider"  
Travis Schneider  
Director

**MCW ENERGY GROUP LIMITED**

**Condensed Consolidated Interim Statements of Loss and Comprehensive Loss**

**For the six months ended February 28, 2018 and 2017**

*Expressed in US dollars*

**(Unaudited)**

	Notes	Three months ended		Six months ended	
		February 28, 2018	February 28, 2017	February 28, 2018	February 28, 2017
<b>Revenues</b>		\$ -		\$ -	\$ -
<b>Cost of Goods Sold</b>		76,158	105,791	187,408	203,934
<b>Gross Loss</b>		(76,158)	(105,791)	(187,408)	(203,934)
<b>Operating Expenses</b>					
General and administrative		221,147	134,933	294,620	207,069
Travel and promotion		263,655	134,900	343,469	318,436
Professional fees		551,609	307,401	825,895	383,843
Salaries and wages		204,090	132,000	386,090	299,000
Share-based compensation	16(a) 19(b)	-	2,885	2,505,647	15,992
(Gain) loss on settlement of liabilities	13(a) (b)	-	(875,369)	-	(1,345,970)
Interest expense		120,114	273,925	241,598	579,051
Depreciation and amortization		295,758	298,171	593,515	595,069
		1,656,374	408,846	5,190,835	1,052,490
<b>Loss before Income Taxes</b>		1,732,532	514,637	5,378,243	1,256,424
Provision for income taxes		-	-	-	-
<b>Loss and Comprehensive loss</b>		1,732,532	514,637	5,378,243	1,256,424
Net Loss and Comprehensive Loss attributable to:					
Shareholders of the Company		\$ 1,732,532	\$ 495,657	\$ 5,378,243	\$ 1,219,421
Non-Controlling Interest		-	18,980	-	37,003
		\$ 1,732,532	\$ 514,637	\$ 5,378,243	\$ 1,256,424
Weighted Average Number of Shares Outstanding	18	56,594,629	6,873,249	55,646,485	6,808,920
Basic and Diluted Loss per Share		\$ 0.03	\$ 0.07	\$ 0.10	\$ 0.18

*The accompanying notes are an integral part of these condensed consolidated interim financial statements*

**PETROTEQ ENERGY, INC.**

**Condensed Consolidated Interim Statements of Changes in Shareholders' Equity**

**For the three months ended February 28, 2018 and 2017**

*Expressed in US dollars*

**(Unaudited)**

	Notes	Number of Shares Outstanding*	Share Capital	Shares to be Issued	Option Reserve	Warrant Reserve	Deficit	Shareholders' Equity	Non-Controlling Interest	Total Equity
<b>Balance at August 31, 2016</b>		6,723,167	\$ 39,416,380	\$ 100,000	\$ 7,355,559	\$ 512,934	\$ (38,916,724)	\$ 8,468,149	\$ 1,035,690	\$ 9,503,839
Conversion of debentures	13(c)	57,756	94,267	-	-	105,733	-	200,000	-	200,000
Conversion of loans	13(b)	669,760	919,969	-	-	-	-	919,969	-	919,969
Settlement of liabilities		88,029	301,843	(100,000)	-	-	-	201,843	-	201,843
Share-based compensation	19(a)	-	-	-	15,992	-	-	15,992	-	15,992
Shares issued for technology	19(a)	16,667	74,380	-	-	-	-	74,380	-	74,380
Shares subscribed for		12,491	65,000	217,264	-	-	-	282,264	-	282,264
Net loss		-	-	-	-	-	(1,219,421)	(1,219,421)	(37,003)	(1,256,424)
<b>Balance at February 28, 2017</b>		7,567,870	\$ 40,871,839	\$ 217,264	\$ 7,371,551	\$ 618,667	\$ (40,136,145)	\$ 8,943,176	\$ 998,687	\$ 9,941,863
<b>Balance at August 31, 2017</b>		54,220,699	\$ 60,827,494	\$ 56,800	\$ 7,371,552	\$ 618,667	\$ (46,856,367)	\$ 22,018,146	\$ -	\$ 22,018,146
Share-based compensation	16(a) 19(a)	-	-	-	2,505,647	-	-	2,505,647	-	2,505,647
Shares subscribed for	15	2,313,647	1,206,356	(56,800)	-	-	-	1,149,556	-	1,149,556
Conversion of loans		1,551,723	200,163	-	-	\$ 249,837	-	450,000	-	450,000
Net loss		-	-	-	-	-	(5,378,243)	(5,378,243)	-	(5,378,243)
<b>Balance at February 28, 2018</b>		58,086,069	\$ 62,234,013	\$ -	\$ 9,877,199	\$ 868,504	\$ (52,234,610)	\$ 20,745,106	\$ -	\$ 20,745,106

\* Number of shares outstanding has been adjusted retroactively for a 30 to 1 reverse stock split on May 5, 2017

The accompanying notes are an integral part of these condensed consolidated interim financial statements

**PETROTEQ ENERGY, INC.**  
**Condensed Consolidated Interim Statements of Cash Flows**  
**For the six months ended February 28, 2018 and 2017**  
*Expressed in US dollars*  
**(Unaudited)**

	Six months ended	
	February 28, 2018	February 28, 2017
<b>Cash flow used for operating activities:</b>		
Net loss	\$ (5,378,243)	\$ (1,256,424)
Adjustments for non-cash, investing and financing items		
Depreciation and amortization	593,515	595,068
Loss on settlement of liabilities and debt conversions	-	(1,345,970)
Share-based compensation	2,505,647	15,992
Equity share of losses in Accord GR Energy	98,271	-
Other	216,454	307,313
<b>Changes in operating assets and liabilities:</b>		
Accounts payable	90,454	423,309
Accounts receivable	80,028	(154)
Accrued expenses	128,238	1,161,984
Prepaid expenses and deposits	(573,219)	19,232
Unearned revenues	-	70,000
<b>Net cash used for operating activities</b>	<u>(2,238,855)</u>	<u>(9,650)</u>
<b>Cash flows used for investing activities:</b>		
Purchase and construction of property and equipment	(1,873,200)	-
Investment in First Bitcoin	(100,000)	-
Additions to intangibles	-	(259,618)
Additions to mineral lease	-	(237,813)
Advance royalty payments	(358,796)	(140,000)
<b>Net cash used for investing activities</b>	<u>(2,331,996)</u>	<u>(637,431)</u>
<b>Cash flows from financing activities:</b>		
Advances from executive officers	73,328	129,796
Proceeds on private equity placements	1,149,556	282,264
Payments of long-term debt	(928,311)	(93,843)
Proceeds from long-term debt	1,254,906	461,019
Proceeds from convertible debt	3,052,046	-
<b>Net cash from financing activities</b>	<u>4,601,525</u>	<u>779,236</u>
<b>Increase in cash</b>	30,674	132,155
Cash, beginning of the period	55,420	6,129
<b>Cash, end of the period</b>	<u>\$ 86,094</u>	<u>\$ 138,284</u>
<b>Cash composed of:</b>		
Cash	\$ 86,094	\$ 138,284
Bank overdraft	-	-
	<u>\$ 86,094</u>	<u>\$ 138,284</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 3,274	\$ 8,700

*The accompanying notes are an integral part of these condensed consolidated interim financial statements*

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### 1. NATURE OF OPERATIONS

Petroteq Energy Inc. (the “Company”) is an Ontario corporation with one active business segment located in the USA. It operates through its indirectly wholly owned subsidiary company, Petroteq Oil Sands Recovery, LLC (“POSR”), which is engaged in mining and oil extraction from oil sands, and its 44.7% owned and equity accounted company Accord GR Energy, Inc. (“Accord”), which is engaged in using a specialized technology to extract oil from oil wells which have been depleted using conventional extraction methods.

The Company’s registered office is located at Suite 4400, 181 Bay Street, Toronto, Ontario, M5J 2T3, Canada and its principal operating office is located at 4370 Tujunga Avenue, Suite 320, Studio City, California 91604, USA.

POSR is engaged in an oil sands mining and oil processing operation, using a closed-loop solvent based extraction system that recovers bitumen from surface mining, and has completed the construction of the first phase of an oil processing plant in the Asphalt Ridge area of Uintah, Utah. The Company is currently relocating the oil processing facility to its mineral lease in Uintah, Utah in order to improve the viability of the plant by eliminating unnecessary transportation costs of raw materials. The Company also intends to expand the existing plant’s production capacity to at least 1,000 barrels per day.

On July 4, 2016, the Company acquired 57.3% of the issued and outstanding common shares of Accord which, due to additional share subscriptions in Accord by other shareholders since August 31, 2016, was reduced to 44.7% as of February 28, 2018. The investment in Accord has therefore been recorded using the equity method for the six months ended February 28, 2018 and the year ended August 31, 2017 (Note 3(a)).

On May 5, 2017 the shareholders of the Company approved the consolidation its shares on a 30 for one basis (Note 15). The number of shares issued and outstanding have been retroactively adjusted for this consolidation in these financial statements.

The Company has incurred losses for several years and, at February 28, 2018, has an accumulated deficit of \$52,234,610 (August 31, 2017 - \$46,856,367) and a working capital deficiency of \$6,569,429 (August 31, 2017 - \$4,250,552). These condensed consolidated financial statements have been prepared on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The ability of the Company to continue as a going concern is dependent on obtaining additional financing, which it is currently in the process of obtaining. There is a risk that the additional financing will not be available on a timely basis or on terms acceptable to the Company. These consolidated financial statements do not reflect the adjustments or reclassifications that would be necessary if the Company were unable to continue operations in the normal course of business.

### 2. BASIS OF PREPARATION

#### (a) Statement of compliance

The condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”), *Interim Financial Reporting*. They do not include all of the information required for full annual financial statements in compliance with IAS 1 *Presentation of Financial Statements*. The accounting policies used in these condensed consolidated interim financial statements are in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and the interpretations of the IFRS Interpretations Committee (“IFRIC”) as at April 30, 2018, the date the condensed consolidated interim financial statements were authorized for issue by the Board of Directors. Except as noted below, they follow the same accounting policies and methods of application as the most recent annual audited consolidated

**PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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financial statements for the year ended August 31, 2017 and should be read in conjunction with those audited consolidated financial statements.



# **PETROTEQ ENERGY INC.**

## Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### **2. BASIS OF PREPARATION (continued)**

#### **(b) Basis of measurement**

The condensed consolidated interim financial statements have been prepared on a historical cost basis except for certain financial assets and financial liabilities which are measured at fair value.

The Company's reporting currency and the functional currency of all of its operations is the U.S. dollar, as it is the principal currency of the primary economic environment in which the Company operates.

#### **(c) Significant accounting judgments and estimates**

The preparation of the condensed consolidated interim financial statements in accordance with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated interim financial statements and the reported amounts of revenues and expenses during the reporting period. The significant accounting judgments and estimates included in these condensed consolidated interim financial statements are:

##### *Useful lives and depreciation rates for intangible assets and property, plant and equipment*

Depreciation expense is recorded on the basis of the estimated useful lives of intangible assets and property, plant and equipment. Changes in the useful life of assets from the initial estimate could impact the carrying value of intangible assets and property, plant and equipment and an adjustment would be recognized in profit or loss.

##### *Review of carrying value of assets and impairment charges*

When determining possible impairment of the carrying values of assets, management of the Company reviews the recoverable amount (the higher of the fair value less costs to sell or the value in use) of non-financial assets and objective evidence indicating impairment in the case of financial assets. These determinations and their individual assumptions require that management make a decision based on the best available information at each reporting period. Changes in these assumptions may alter the results of the impairment evaluation, the impairment charges recognized in profit or loss and the resulting carrying amounts of assets.

##### *Fair value of share purchase options and warrants*

Share purchase options and warrants granted by the Company are valued at the fair value of the goods or services received unless the fair value cannot be reliably measured. Share purchase options and warrants granted to employees and others providing similar services are valued using the Black-Scholes option pricing model. Estimates and assumptions for inputs to the model, including the expected volatility of the Company's shares and the expected life of options granted, are subject to significant uncertainties and judgment.

##### *Provisions*

Provisions are recorded on the basis of the best estimate of the likelihood, timing, and magnitude of a future outflow of economic resources. Where the effect of the time value of money is material, the present value of the provision is recognized using a discount rate that reflects current market assessments of the time value of money.

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### 2. BASIS OF PREPARATION (continued)

#### (c) Significant accounting judgments and estimates (continued)

##### *Income taxes and recoverability of deferred tax assets*

Actual amounts of income tax expense are not final until tax returns are filed and accepted by taxation authorities. Therefore, profit or loss in future reporting periods may be affected by the difference between the income tax expense estimates and the final tax assessments.

Judgment is required in determining whether deferred tax assets are recognized on the condensed consolidated statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management of the Company to assess the likelihood that the Company will generate sufficient taxable profit in future periods in order to utilize recognized deferred tax assets. Estimates of future taxable profit are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable profit differ from estimates, the ability of the Company to realize the deferred tax assets recorded on the consolidated statement of financial position could be impacted. The Company has not recognized any deferred tax assets as at February 28, 2018 and August 31, 2017.

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of consolidation

The condensed consolidated financial statements include the financial statements of the Company and the entities controlled by the Company (its “subsidiaries”). Control is achieved where the Company has the power to govern the financial and operating policies of an entity and obtain the economic benefits from its activities. The consolidated entities are:

<u>Entity</u>	<u>% of Ownership</u>	<u>Jurisdiction</u>
Petroteq Energy Inc.	Parent	Canada
Petroteq Energy CA, Inc.	100%	USA
MCW OSR Inc.	100%	USA
MCW Oil Sands, Inc.	100%	USA
MCW Fuels Transportation, Inc.	100%	USA
Petroteq Oil Sands Recovery, LLC	100%	USA
TMC Capital, LLC	100%	USA

The Company has accounted for its investment in Accord on the equity basis from March 1, 2017. The Company had previously owned a controlling interest in Accord and the results were consolidated in the Company’s financial statements. However, subsequent cash contributions into Accord reduced the Company’s ownership to 44.7% as of March 1, 2017 and the results of Accord were deconsolidated from that date.

All intercompany transactions, balances, income and expenses are eliminated in full on consolidation.

# **PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### **(b) Business combinations**

The Company accounts for business combinations using the acquisition method, under which the acquirer measures the cost of the business combination as the total of the fair values, at the date of exchange, of the assets obtained, liabilities incurred and equity instruments issued by the acquirer in exchange for control of the acquiree. Goodwill is measured as the fair value of the consideration transferred, including the recognized amount of any non-controlling interest in the acquiree, less the net recognized amount (generally the fair value) of the identifiable assets and liabilities assumed, measured as at the acquisition date.

Transaction costs, other than those associated with issue of debt or equity securities, that the Company incurs in connection with a business combination are expensed as incurred.

#### **(c) Income recognition**

The Company sells hydrocarbon products (bitumen or crude oil) produced by its oil extraction facility at prevailing market prices. The Company also expects to enter into short term supply agreements with customers. Revenues are recognized when the hydrocarbon products are delivered, which occurs when the customer has taken title and has assumed the risks and rewards of ownership, when prices are fixed or determinable and when collectability is reasonably assured.

#### **(d) Investment in associate**

An associate is an entity over which the Company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investment in associate is carried in the consolidated statement of financial position at cost as adjusted for changes in the Company's share of the net assets of the associate, less any impairment in the value of the investment. Losses of an associate in excess of the Company's interest in that associate are not recognized. Additional losses are provided for, and a liability is recognized, only to the extent that the Company has incurred legal or constructive obligations or made payment on behalf of the associate.

#### **(e) Property, plant and equipment**

Property, plant and equipment is recorded at cost and amortized over their useful lives. Maintenance and repairs are expensed as incurred. Major renewals, betterments and start-up costs are capitalized. When items of property, plant or equipment are sold, impaired, or retired, the related costs and accumulated amortization are removed and any gain or loss is included in net income. Amortization is determined on a straight-line method with the following expected useful lives:

Machinery and equipment	5-7 years
Furniture and fixtures	7 years
Leasehold improvements	Lease term
Oil extraction facility	15 years

# **PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### **(f) Oil and gas properties**

##### *Oil and gas property interests*

Assets owned are recorded at cost less accumulated depreciations and accumulated impairment losses. The Company initially capitalizes the costs of acquiring these properties, directly and indirectly, and thereafter expenses exploration activities, pending the evaluation of commercially recoverable reserves. The results of exploratory programs can take considerable time to analyze and the determination that commercial reserves have been discovered requires both judgment and industry experience. All development costs are capitalized after it has been determined that a property has recoverable reserves. On the commencement of commercial production, net capitalized costs are charged to operations on a unit-of-production basis, by property, using estimated proven and probable recoverable reserves as the depletion base.

##### *Oil and gas reserves*

Oil and gas reserves are evaluated by independent qualified reserves evaluators. The estimation of reserves is a subjective process. Estimates are based on projected future rates of production, estimated commodity prices, engineering data and the timing of future expenditures, all of which are subject to uncertainty and interpretation. Reserves estimates can be revised either upwards or downwards based on updated information such as future drilling, testing and production levels. Reserves estimates, although not reported as part of the Company's condensed consolidated financial statements, can have a significant effect on net earnings as a result of their impact on depreciation and depletion rates, asset impairment and goodwill impairment.

#### **(g) Intangible assets**

Intangible assets are recorded at cost less accumulated depreciation and accumulated impairment losses. Amortization of intangible assets is recorded on a straight-line basis over a life determined by the maximum length of the benefits expected from acquired intellectual property, technology and technology licenses. Intangible assets with indefinite useful lives are not amortized and are tested for impairment at least annually. The useful life for the Oil Extraction Technologies has been established as 15 years in these condensed consolidated financial statements as at February 28, 2018:

#### **(h) Impairment of assets**

At the end of each reporting period, the Company's property and equipment, oil and gas properties, and intangible assets are reviewed for indications that the carrying amount may not be recoverable. If any such indication is present, the recoverable amount of the asset is estimated in order to determine whether impairments exist. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount of an asset is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value, using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which estimates of future cash flows have not been adjusted. The cash flows used in the impairment assessment require management to make assumptions and estimates about recoverable resources, production quantities, future commodity prices, operating costs and future development costs. Changes in any of the assumptions, such as a downward revision in reserves, a decrease in future commodity prices or an increase in operating costs, could result in an impairment of carrying values.

**PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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# **PETROTEQ ENERGY INC.**

## Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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### **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### **(h) Impairment of assets (continued)**

If the recoverable amount of an asset or cash generating unit is estimated to be less than its carrying amount, the carrying amount is reduced to the recoverable amount. Impairment is recognized immediately in the consolidated statement of (income) loss and comprehensive (income) loss. Where an impairment subsequently reverses, the carrying amount is increased to the revised estimate of the recoverable amount but only to the carrying value that would have been recorded if no impairment had previously been recognized. A reversal is recognized as a reduction in the impairment charge for the period.

#### **(i) Financial instruments**

Financial instruments consist of financial assets and financial liabilities and are initially recognized at fair value, net of transaction costs if applicable. Measurement in subsequent periods depends on whether the financial instrument is classified as held-to-maturity, loans and receivables, fair value through profit or loss ("FVTPL"), available-for-sale, or other financial liabilities.

Held-to-maturity investments and loans and receivables are measured at amortized cost, with amortization of premiums or discounts, losses and impairment included in current period interest income or expense. Financial assets and liabilities are classified as FVTPL when the financial instrument is held for trading or are designated as FVTPL. Financial instruments at FVTPL are measured at fair market value with all gains and losses included in operations in the period in which they arise. Available-for-sale financial assets are measured at fair market value with revaluation gains and losses included in other comprehensive income until the asset is removed from the consolidated statement of financial position, and losses due to impairment are included in operations. All other financial assets and liabilities, except for cash and cash equivalents, are carried at amortized cost.

The Company's financial instruments are:

- Cash, classified as FVTPL and measured at fair value
- Trade and other receivables and notes receivable, classified as loans and receivables and measured at amortized cost
- Accounts payable, accrued expenses, payable to director, convertible debentures and long-term debt, classified as other financial liabilities and measured at amortized cost

The recorded values of cash, trade and other receivables, notes receivable, accounts payable, accrued expenses and due to director approximate their fair values based on their short term nature. The recorded values of convertible debentures and long-term debt approximate their fair values when the interest rates of the debt approximate market rates.

In accordance with industry practice, the Company includes amounts in current assets and current liabilities for current maturities receivable or payable under contracts which may extend beyond one year.

The Company classifies and discloses fair value measurements based on a three-level hierarchy:

- Level 1 – inputs are unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 – inputs for the asset or liability that are not based on observable market data.

# **PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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## **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

### **(j) Provisions**

Provisions are recorded when a present legal or constructive obligation exists as a result of past events where it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the consolidated statement of financial position date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount receivable can be measured reliably. Over time, the discounted provision is increased for the change in present value based on the discount rates that reflect current market assessments and the risks specific to the liability. The periodic unwinding of the discount is recognized in the consolidated statement of loss (income) as part of interest expense.

When the provision liability is initially recognized, the present value of the estimated costs is capitalized by increasing the carrying amount of the related asset to the extent that it was incurred as a result of the development or construction of the asset. Additional provisions which arise due to further development or construction of assets are recognized as additions or charges to the corresponding asset and provisions when they occur.

Changes in the estimated timing of provisions or changes to the estimated future costs are dealt with prospectively by recognizing an adjustment to the provision and a corresponding adjustment to the asset to which it relates. Any reduction in the provision and, therefore, any deduction from the asset to which it relates may not exceed the carrying amount of that asset. If it does, any excess over the carrying value is recognized immediately in consolidated statement of loss (income).

### **(k) Income taxes**

Provisions for income taxes consist of current and deferred tax expense and are recorded in operations.

Current tax expense is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the end of the period, adjusted for amendments to tax payable for previous years.

Deferred tax assets and liabilities are computed using the asset and liability method on temporary differences between the carrying amounts of assets and liabilities on the consolidated statement of financial position and their corresponding tax values, using the enacted or substantially enacted, income tax rates at each consolidated statement of financial position date. Deferred tax assets also result from unused losses and other deductions carried forward. The valuation of deferred tax assets is reviewed on a regular basis and adjusted to the extent that it is not probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized by use of a valuation allowance to reflect the estimated realizable amount.

# **PETROTEQ ENERGY INC.**

## Notes to the Condensed Consolidated Interim Financial Statements

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*Expressed in US dollars*

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### **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### **(l) Comprehensive income or loss**

Other comprehensive income or loss is the change in net assets arising from transactions and other events and circumstances from non-owner sources. Comprehensive income comprises net income or loss and other comprehensive income or loss. Financial assets that are classified as available-for-sale will have revaluation gains and losses included in other comprehensive income or loss until the asset is removed from the consolidated statement of financial position. At present, the Company has no other comprehensive income or loss.

#### **(m) Earnings per share**

Basic earnings per share is computed by dividing net income or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is determined by adjusting net income or loss attributable to common shareholders of the Company and the weighted average number of common shares outstanding by the effects of potentially dilutive instruments, if such conversion would decrease earnings per share.

#### **(n) Share-based payments**

The Company may grant share purchase options to directors, officers, employees and others providing similar services. The fair value of these share purchase options is measured at grant date using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. Share-based compensation expense is recognized over the period during which the options vest, with a corresponding increase in equity.

The Company may also grant equity instruments to consultants and other parties in exchange for goods and services. Such instruments are measured at the fair value of the goods and services received on the date they are received and are recorded as share-based compensation expense with a corresponding increase in equity. If the fair value of the goods and services received are not reliably determinable, their fair value is measured by reference to the fair value of the equity instruments granted.

#### **(o) Reclamation and restoration obligations**

Liabilities related to environmental protection and reclamation costs are recognized when the obligation is incurred and the fair value of the related costs can be reasonably estimated. This includes future site restoration and other costs as required due to environmental law or contracts. Reclamation and restoration obligations are determined by discounting the expected future cash outflows for reclamation and restoration at a pre-tax rate that reflects current market assessments of the time value of money

#### **(p) Comparative amounts**

The comparative amounts presented in these condensed consolidated financial statements have been reclassified where necessary to conform to the presentation used in the current year.



# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

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### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (q) New accounting standards and interpretations

The following is a summary of new standards, amendments and interpretations that are effective for annual periods beginning on or after January 1, 2016:

(a) *IFRS 11, Joint Arrangements (“IFRS 11”) – amendments*

The amendments to IFRS 11 provide guidance on the accounting for acquisition of interests in joint operations constituting a business. The amendments require all such transactions to be accounted for using the principles on business combination accounting in *IFRS 3, Business Combinations* and other IFRS standards except where those principles conflict with IFRS 11.

(b) *IAS 1, Presentation of Financial Statements (“IAS 1”) - amendments*

The amendments to IAS 1 enhance financial statement disclosures and presentation.

(c) *IAS 16, Property, Plant and Equipment (“IAS 16”) – amendment*

The amendment to IAS 16 provides clarification of acceptable methods of depreciation and amortization.

(d) *IAS 38, Intangible Assets (“IAS 38”) - amendment*

The amendment to IAS 38 provides clarification of acceptable methods of depreciation and amortization.

The application of the above amendments did not have any material impact on the consolidated financial statements presented.

The following is a summary of new standards, amendments and interpretations that have been issued but not yet adopted in these consolidated financial statements:

(a) *IFRS 9, Financial Instruments (“IFRS 9”)*

IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classification options in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. The Company is currently evaluating the impact of the adoption of the amendments on its financial statements; however, the impact, if any, is not expected to be significant.

(b) *IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)*

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

# PETROTEQ ENERGY INC.

Notes to the Condensed Consolidated Interim Financial Statements

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## 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (q) New accounting standards and interpretations (continued)

#### (c) IFRS 16 Leases (IFRS 16")

IFRS 16 provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor IAS 17 Leases. IFRS 16 replaces IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease, SIC -15 Operating Leases – Incentives, and SIC – 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 Revenue from Contracts with Customers is also applied.

#### (d) IFRS 2 Share-based Payment ("IFRS 2") – amendments

The amendments to IFRS 2 provide clarification and guidance on the treatment of vesting and non-vesting conditions related to cash-settled share-based payment transactions, on share-based payment transactions with a net settlement feature for withholding tax obligations, and on accounting for modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled. The amendments to IFRS 2 are effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

The Company is currently assessing the impact that these new and amended standards will have on the condensed consolidated financial statements.

## 4. CASH

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents.

## 5. TRADE AND OTHER RECEIVABLES

The Company's trade and other receivables consist of:

	February 28, 2018	August 31, 2016
Goods and services tax receivable	\$ 181,881	\$ 181,881
Other receivables	45,000	125,028
	<u>\$ 226,881</u>	<u>\$ 306,909</u>

Information about the Company's exposure to credit risks for trade and other receivables is included in Note 23(a)(i).

# **PETROTEQ ENERGY INC.**

## Notes to the Condensed Consolidated Interim Financial Statements

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### **6. CRUSHED ORE INVENTORY**

On May 23, 2012, the Company entered into a five-year agreement with TME Asphalt Ridge, LLC ("TME") for the purchase of crushed ore as feedstock for the Company's oil extraction facility. The agreement requires the Company to purchase 100,000 tons of crushed ore for \$16.00 per ton during the first calendar year and a minimum of 100,000 tons per year at a rate of approximately 8,333 tons per month for \$20.60 per ton, subject to certain price adjustment provisions, after the first year.

On June 1, 2015, the Company acquired a 100% interest in TMC Capital LLC, which holds the rights to mine ore from the Asphalt Ridge deposit and had granted TME a limited right to mine the bituminous sands in the deposit. As the Company obtained the direct right to the Asphalt Ridge deposit and TME was having financial difficulty, the Company allowed the contract with TME to lapse.

### **7. ADVANCED ROYALTY PAYMENTS**

#### **(a) Advance royalty payments to Asphalt Ridge, Inc.**

During the year ended August 31, 2015, the Company acquired TMC Capital, LLC, which has a mining and mineral lease with Asphalt Ridge, Inc. (Note 8(b)). The mining and mineral lease with Asphalt Ridge, Inc. required the Company to make minimum advance royalty payments, subsequently amended, which can be used to offset future production royalties for a maximum of two years following the year the advance royalty payment was made.

On October 1, 2015, the Company and Asphalt Ridge, Inc. amended the advance royalty payments in the mining and mineral lease agreement. All previous advance royalty payments required under the original agreement were deemed to be paid in full. The amended advance royalty payments required were: \$60,000 per quarter from October 1, 2015 to September 30, 2017, \$100,000 per quarter from October 1, 2017 to June 30, 2020 and \$150,000 per quarter thereafter.

Effective March 12, 2016, a second amendment was made to the mining and mineral lease agreement between the Company and Asphalt Ridge, Inc. The amended advanced royalty payments required are \$60,000 per quarter from October 1, 2015 to February 28, 2018, \$100,000 per quarter from March 1, 2018 to December 31, 2020 and \$150,000 per quarter thereafter.

#### **(b) Advance royalty payments to Asphalt Ridge, Inc.**

As at February 28, 2018, the Company has paid advance royalties of \$1,714,836 (August 31, 2017 - \$1,356,040) to the lease holder, of which a total of \$1,023,750 have been used to pay royalties as they have come due under the terms of the mineral lease agreement. During the three months ended February 28, 2018, \$358,796 in advance royalties were paid and \$170,833 have been used to pay royalties which have come due. The royalties expensed have been recognized in cost of goods sold on the consolidated statement of loss and comprehensive loss.

As at February 28, 2018, the Company expects to record minimum royalties paid of \$165,681 from these advance royalties either against production royalties or for the royalties due within a one year period.

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### 7. ADVANCED ROYALTY PAYMENTS (continued)

#### (c) Unearned advance royalty payments from Blackrock Petroleum, Inc.

During the year ended August 31, 2015, the Company entered into a sublease agreement with Blackrock Petroleum, Inc. (“Blackrock”), pursuant to which it received \$170,000 of unearned advance royalties. The sublease was for a portion of the mining and mineral lease with Asphalt Ridge, Inc. (Note 8(b)). Blackrock is a company associated with Accord and the sublease was effectively terminated in the acquisition by the Company of control of Accord on July 4, 2016.

### 8. MINERAL LEASES

	TMC Mineral Lease	Accord Oil and Gas Lease	Total
<b>Cost</b>			
August 31, 2016	\$ 11,091,388	\$ 1,052,350	\$12,143,738
Additions	-	237,813	237,813
Deconsolidation of Accord (Note 3(a))	-	(1,290,163)	(1,290,163)
August 31, 2017	11,091,388	-	11,091,388
Additions	-	-	-
February 28, 2018	<u>\$ 11,091,388</u>	<u>\$ -</u>	<u>\$11,091,388</u>
<b>Accumulated Amortization</b>			
August 31, 2016	\$ -	\$ -	\$ -
Additions	-	-	-
August 31, 2017	-	-	-
Additions	-	-	-
Deconsolidation of Accord (Note 3(a))	-	-	-
February 28, 2018	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Carrying Amount</b>			
August 31, 2016	<u>\$ 11,091,388</u>	<u>\$ 1,052,350</u>	<u>\$12,143,738</u>
August 31, 2017	<u>\$ 11,091,388</u>	<u>\$ -</u>	<u>\$11,091,388</u>
February 28, 2018	<u>\$ 11,091,388</u>	<u>\$ -</u>	<u>\$11,091,388</u>

#### (a) MCW mineral lease

On December 29, 2010, the Company acquired a mineral lease (the “MCW Mineral Lease”), covering 1,138 acres in Uintah County, Utah, for the extraction of bituminous or asphaltic sands (oil sands). The MCW Mineral Lease is valid until August 11, 2018 and has rights for extensions based on reasonable production. This lease was cancelled by the State of Utah on December 30, 2016.

#### (b) TMC mineral lease

On June 1, 2015, the Company acquired TMC Capital, LLC (“TMC”). TMC holds a mining and mineral lease, subleased from Asphalt Ridge, Inc., on the Asphalt Ridge property located in Uintah County, Utah (the “TMC Mineral Lease”).

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

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### 8. MINERAL LEASES (continued)

#### (b) TMC mineral lease (continued)

The primary term of the TMC Mineral Lease is from July 1, 2013 to July 1, 2018. During the primary term, the Company must meet certain requirements for oil production. After July 1, 2018, the TMC Mineral Lease will remain in effect as long as certain requirements for oil production continue to be met by the Company. If the Company fails to meet these requirements, the lease will automatically terminate 90 days after the calendar year in which the requirements are not met. In addition, the Company is required to make certain advance royalty payments to the lessor (Note 7(a)). The TMC Mineral Lease was subject to a 10% royalty for the first three years and varying percentages thereafter based on the price of oil. An additional 1.6% royalty is payable to the previous lessees of the TMC Mineral Lease. The TMC Mineral Lease also required the Company to make minimum expenditures on the property of \$1,000,000 for the first three years, increasing to \$2,000,000 for the next three years.

On October 1, 2015, the Company amended the TMC Mineral Lease to defer the requirements for oil extraction until July 1, 2016 and to include the oil extraction from the MCW Mineral Lease as well. The advance royalty payments required under the TMC Mineral Lease were also amended (Note 7(a)). Production royalties were amended to 7% until June 30, 2020 and a varying percentage thereafter, based on the price of oil. Minimum expenditures were amended to \$1,000,000 per year until June 30, 2020 and \$2,000,000 thereafter if certain operational requirements for oil extraction are not met.

On March 1, 2016, a second amendment to the TMC Mineral Lease amended the termination clause in the lease to:

- (i) Termination will be automatic if there is a lack of a written financial commitment to fund the proposed 3,000 barrel per day production facility prior to March 1, 2018.
- (ii) Cessation of operations or inadequate production due to increased operating costs or decreased marketability and production is not restored to 80% of capacity within six months of such cessation.
- (iii) The proposed 3,000 barrel per day plant fails to produce a minimum of 80% of its rated capacity for at least 180 calendar days during the lease year commencing July 1, 2020 plus any extension periods.
- (iv) The lessee may surrender the lease with 30 days written notice.
- (v) Breach of material terms of the lease, the lessor will inform the lessee in writing and the lessee will have 30 days to cure financial breaches and 150 days to cure any other non-monetary breach.

The term of the lease was extended by the termination clause, providing a written commitment is obtained to fund the 3,000 barrel per day proposed plant. The Company is required to produce a minimum average daily quantity of bitumen, crude oil and/or bitumen products, for a minimum of 180 days during each lease year and 600 days in three consecutive lease years, of:

- (i) By July 1, 2016 plus any extension periods, 80% of 100 barrels per day.
- (ii) By July 1, 2018 plus any extension periods, 80% of 1,500 barrels per day.
- (iii) By July 1, 2020, plus any extension periods, 80% of 3,000 barrels per day.

Advance royalties required are:

- (i) From October 1, 2015 to February 28, 2018, minimum payments of \$60,000 per quarter.
- (ii) From March 1, 2018 to December 31, 2020, minimum payments of \$100,000 per quarter.
- (iii) From January 1, 2021, minimum payments of \$150,000 per quarter.
- (iv) Minimum payments commencing on July 1, 2020 will be adjusted for CPI inflation.

**PETROTEQ ENERGY INC.**

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## **PETROTEQ ENERGY INC.**

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### **8. MINERAL LEASES (continued)**

#### **(b) TMC mineral lease (continued)**

Production royalties payable are amended to 7% of the gross sales revenue, subject to certain adjustments up until June 30, 2020. After that date, royalties will be calculated on a sliding scale based on crude oil prices ranging from 7% to 15% of gross sales revenues, subject to certain adjustments.

Minimum expenditures to be incurred on the properties are \$1,000,000 per year up to June 30, 2020 and \$2,000,000 per year after that if a minimum daily production of 3,000 barrels per day during a 180 day period is not achieved.

#### **(c) Oil and gas leases**

On July 4, 2016, the Company acquired 57.3% of the common shares of Accord (Note 1) and accounted for this investment on a consolidated basis.

Accord holds three oil and gas leases in Edwards County, Texas and certain oil extraction technologies (Note 10(a)). The oil and gas leases are subject to an overriding royalty interest of 5%, which will be reduced to 1% after the Company has incurred and paid \$1,000,000 in royalties to the underlying royalty holder. No royalties are payable until defined revenue thresholds have been achieved from existing and new oil wells developed on the leases.

The Company's interest in Accord, due to additional cash contributions made to Accord by other shareholders and parties, was reduced to 44.7% as of March 1, 2017 and the assets, liabilities and results of operations of Accord were deconsolidated from that date. The Company has accounted for its investment in Accord using the equity method from March 1, 2017.

# PETROTEQ ENERGY INC.

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### 9. PROPERTY, PLANT AND EQUIPMENT

	<b>Oil Extraction Plant</b>	<b>Other Property and Equipment</b>	<b>Total</b>
<b>Cost</b>			
August 31, 2016	\$ 16,678,017	\$ 352,854	\$17,030,871
Additions	290,120	-	290,120
Deconsolidation of Accord (Note 3(a))	-	(1,887)	(1,887)
Disposals and scrapping	(121,637)	(35,000)	(156,637)
August 31, 2017	16,846,500	315,967	17,162,467
Additions	1,873,200	-	1,873,200
February 28, 2018	\$ 18,719,700	\$ 315,967	\$19,035,668
<b>Accumulated Amortization</b>			
August 31, 2016	\$ 1,082,273	\$ 96,114	\$ 1,178,387
Additions	1,082,159	46,814	1,128,973
Deconsolidation of Accord (Note 3(a))	-	(628)	(628)
Disposals and scrapping	(16,218)	(35,000)	(51,218)
August 31, 2017	2,148,214	107,300	2,255,514
Additions	542,942	23,302	566,244
February 28, 2018	\$ 2,691,156	\$ 130,602	\$ 2,821,758
<b>Carrying Amount</b>			
August 31, 2016	\$ 15,595,744	\$ 256,740	\$15,852,484
August 31, 2017	\$ 14,698,286	\$ 208,667	\$14,906,953
February 28, 2018	\$ 16,028,544	\$ 185,365	\$16,213,909

#### (a) Oil Extraction Plant

In June 2011, the Company commenced the development of an oil extraction facility on its mineral lease in Uintah, Utah and entered into construction and equipment fabrication contracts for this purpose. On September 1, 2015, the first phase of the plant was completed and was ready for production of hydrocarbon products for resale to third parties. During the quarter ended August 31, 2017 the Company began the dismantling and relocating the oil extraction facility to its TMC Mineral Lease facility to improve production and logistical efficiencies whilst continuing its project to increase production capacity to a minimum capacity of 1,000 barrels per day.

The Company has relocated its oil extraction plant to the Asphalt Ridge site, where it holds a mineral lease, together with this relocation, the Company embarked on an expansion project to expand the production output of the facility. The Company has spent \$1,873,200 on the expansion at February 28, 2018. The cost of construction includes capitalized borrowing costs for the year ended August 31, 2017 of \$100,000 (2016 - \$137,500) and total capitalized borrowing costs as at February 28, 2018 of \$2,212,080 (August 31, 2017 - \$2,212,080).



# PETROTEQ ENERGY INC.

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### 10. INTANGIBLE ASSETS

	<b>Oil Extraction Technology</b>
<b>Cost</b>	
August 31, 2016	2,291,488
Additions	333,998
Deconsolidation of Accord (Note 3(a))	<u>(1,815,617)</u>
August 31, 2017	809,869
Additions	-
February 28, 2018	<u>\$ 809,869</u>
<b>Accumulated Amortization</b>	
August 31, 2016	49,033
Additions	<u>53,165</u>
August 31, 2017	102,198
Additions	27,271
Deconsolidation of Accord (Note 3(a))	<u>-</u>
February 28, 2018	<u>\$ 129,469</u>
<b>Carrying Amounts</b>	
August 31, 2016	<u>\$ 2,242,455</u>
August 31, 2017	<u>\$ 707,671</u>
February 28, 2018	<u>\$ 680,400</u>

#### (a) Oil extraction technologies

During the year ended August 31, 2012, the Company acquired a closed-loop solvent based oil extraction technology which facilitates the extraction of oil from a wide range of bituminous sands and other hydrocarbon sediments. The Company has filed patents on this technology in the USA and Canada and has employed it in its oil extraction plant. The Company commenced production from its oil extraction plant on September 1, 2015 and is amortizing the cost of the technology over fifteen years, the expected life of the oil extraction plant.

On July 4, 2016, the Company acquired 57.3% of the total issued and outstanding shares of Accord (Note 1). Accord holds the rights to use proprietary technology which may improve the efficiency of oil extraction from certain oil fields and from depth at the Company's bituminous sands lease. Once the proprietary technology is fully operational the Company intends to utilize the technology to extract oil from its oil and gas leases (Note 8(c)) and to amortize the cost over fifteen years, the expected life useful life of the oil and gas leases.

The Company's interest in Accord, due to additional cash contributions made to Accord by other shareholders and parties, was reduced to 44.7% as of March 1, 2017 and the assets, liabilities and results of operations of Accord were deconsolidated from that date. The Company has accounted for its investment in Accord using the equity method from March 1, 2017.

# PETROTEQ ENERGY INC.

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### 11. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable as at February 28, 2018 and August 31, 2017 consist primarily of amounts outstanding for construction and expansion of the oil extraction plant and other operating expenses that are due on demand.

Accrued expenses as at February 28, 2018 and August 31, 2017 consist primarily of other operating expenses and interest accruals on long-term debt (Note 12) and convertible debentures (Note 13).

Information about the Company's exposure to liquidity risk is included in Note 23(c).

### 12. LONG-TERM DEBT

Lender	Maturity Date	Interest Rate	Principal due February 28, 2018	Principal due August 31, 2017
Private lenders	May 1, 2017	15.00%	30,000	100,000
Private lenders	May 1, 2019	5.00%	644,660	1,001,905
Private lenders	July 28, 2020	10.00%	544,306	33,305
Private lenders	August 31, 2020	5.00%	459,490	336,080
Private lenders	On demand	-	241,850	
Equipment loans	April 17, 2020 – April 20, 2020	4.30 - 4.90%	131,834	160,343
Director	August 18, 2020	5.00%	595,392	242,250
Total loans			\$ 2,647,532	\$ 1,873,883
Accrued interest			-	2,497
			<u>\$ 2,647,532</u>	<u>\$ 1,876,380</u>

The maturity of the long-term debt is as follows:

	February 28, 2018	August 31, 2017
Principal classified as repayable within one year	\$ 911,287	\$ 1,159,104
Principal classified as repayable later than one year	1,736,245	717,276
	<u>\$ 2,647,532</u>	<u>\$ 1,876,380</u>

#### (a) Director

On March 18, 2016, the Company issued a promissory note for \$3,000,000 to the Chair of the Board of Directors of the Company. The proceeds from the issuance of the promissory note were used to settle the total outstanding amount of the B&N Bank credit facility.

On August 15, 2017 the promissory note, including accrued interest of \$215,625, was assigned by the Chair of the Board to three related entities and were subsequently converted into 14,391,330 shares of the Company.

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

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### 12. LONG-TERM DEBT (continued)

#### (b) Private lenders

- (i) On December 16, 2013, the Company obtained an on-demand loan from private investors for a total of \$430,000, bearing interest at 15% per annum. The loan is personally guaranteed by the Chair of the Board of Directors. The loan was amended on November 1, 2016 to extend the maturity date to May 1, 2017, and a further extension of this loan is currently being negotiated. During the current year, interest previously overpaid amounting to \$16,800 was offset against the principal and a further principal payment of \$10,000 was made, resulting in a principal balance outstanding of \$100,000. Principal repaid during the year ended August 31, 2016 amounted to \$73,200.
- (ii) On October 10, 2014, the Company issued two secured debentures for an aggregate principal amount of CDN \$1,100,000 to two private lenders. The debentures bear interest at a rate of 12% per annum, maturing on October 15, 2017 and are secured by all of the assets of the Company. In addition, the Company issued common share purchase warrants to acquire an aggregate of 16,667 common shares of the Company. On September 22, 2016, the two secured debentures were amended to extend the maturity date to January 31, 2017. The terms of these debentures were renegotiated with the debenture holders to allow for the conversion of the secured debentures into common shares of the Company at a rate of CDN \$4.50 per common share and to increase the interest rate, starting June 1, 2016, to 15% per annum. On January 31, 2017, the two secured debentures were amended to extend the maturity date to July 31, 2017. Additional transaction costs and penalties incurred for the loan modifications amounted to \$223,510.

The debentures were renegotiated on February 9, 2018, whereby the maturity date of the debentures was extended to May 1, 2019. Each of the debentures was amended to allow for a portion of the debenture, amounting to CDN\$628,585 to be convertible into shares of common stock, the convertible portion of the debentures does not attract interest and is convertible into equity as follows;

- CDN\$314,585 immediately
- CDN\$66,000 on May 1, 2018
- CDN\$66,000 on August 1, 2018
- CDN\$66,000 on November 1, 2018
- CDN\$116,000 on January 1, 2019.

The conversion price will be at the maximum discount allowable at the lower of the average 20 day weighted average share price of the market closing price, as may be permitted by applicable securities legislation or stock exchange rules.

The remaining balance of the debentures amounting to CDN\$825,745 is payable in cash, as follows:

- CDN\$251,124 immediately
- CDN\$49,500 per month, commencing on May 1, 2018 to March 1, 2019, with a final instalment of the remaining principal outstanding together with interest thereon at 5% per annum, interest accrual beginning on April 2, 2018.

# **PETROTEQ ENERGY INC.**

## Notes to the Condensed Consolidated Interim Financial Statements

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### **12. LONG-TERM DEBT (continued)**

#### **(b) Private lenders**

- (iii) The Company received advances from various private lenders during the six months ended February 28, 2018 and the year ended August 31, 2017 in the form of unsecured promissory notes. These promissory notes mature at various dates, between on demand and July 28, 2020, and bear interest at 10% per annum. Various promissory notes, including interest thereon, were converted into common shares on May 19, 2017, under the terms of various Securities Purchase Agreements entered into with the lenders (Note 12(b)(vii)).
- (iv) During the year ended August 31, 2016, the Company obtained a loan from Altlands Overseas Corp. for \$750,000, bearing interest at a rate of 6% per annum and maturing on September 10, 2017. This loan, including all interest thereon was converted into common shares on May 19, 2017 under the terms of a Securities Purchase Agreement entered into with the lender (Note 12(b)(vii)).
- (v) The Company received advances from various private lenders during the six months ended February 28, 2018 and the year ended August 31, 2017 in the form of unsecured promissory notes. These promissory notes mature at various dates, between May 19, 2020 and August 31, 2020 and bear interest at 5% per annum. Various promissory notes, including interest thereon, were converted into common shares on May 19, 2017, under terms of various Securities Purchase Agreements entered into with the lenders (Note 12(b)(vii)).
- (vi) The Company received advances from various private lenders during the year ended August 31, 2016 and 2015 in the form of unsecured promissory notes. On January 20, 2016, the Company issued an aggregate of 882,455 common shares in satisfaction of \$2,447,478 of indebtedness. On July 25, 2016, the Company issued an aggregate of 86,316 common shares in satisfaction of a further \$266,146 of indebtedness.
- (vii) On May 19, 2017, under the terms of Securities Purchase Agreements entered into with various lenders, including the promissory notes in Notes 12(d) and 13(b), the Company issued 31,083,281 common shares at conversion prices ranging from \$0.353 per share to \$0.397 per share in exchange for promissory notes, including interest thereon, amounting to \$12,185,904. These common shares were issued on July 11, 2017.

#### **(c) Equipment loans**

The Company entered into two equipment loan agreements with financial institutions to acquire equipment for the oil extraction facility. The loans had a term of 60 months and bore interest at a rate between 4.3% and 4.9% per annum. Principal and interest were paid in monthly installments. These loans were secured by the acquired assets.

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

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### 12. LONG-TERM DEBT (continued)

#### (d) Promissory notes

On June 1, 2015, the Company issued two promissory notes for \$5,000,000 each for the acquisition of TMC (Note 1). These promissory notes had a five-year term, bore interest at a rate of 5% per annum and were unsecured. These promissory notes were guaranteed by the Chair of the Board of Directors.

During the year ended August 31, 2016, the Company issued 666,667 common shares as repayment of \$2,500,000 of this indebtedness.

The remaining promissory notes were converted into common shares on May 19, 2017 (Note 12(b)(vii)), under the terms of Securities Purchase Agreements entered into with the lenders, at a conversion price of \$0.397 per share.

#### (e) Director

During the years ended August 31, 2017 and 2016, the Company issued unsecured promissory notes to private companies controlled by the Chair of the Board of Directors of the Company (Note 19).

### 13. CONVERTIBLE DEBENTURES

Lender	Maturity Date	Interest Rate	Principal due February 28, 2018	Principal due August 31, 2017
Alpha Capital Anstalt	October 31, 2018	5.00%	115,000	508,500
Deloro Energy LLC	June 1, 2018	0.00%	2,550,982	-
Private lenders	January 1, 2019	0.00%	467,620	-
Total loans			<u>\$ 3,133,602</u>	<u>\$ 508,500</u>

The maturity of the convertible debt is as follows:

	February 28, 2018	August 31, 2017
Principal classified as repayable within one year	\$ 3,133,602	\$ -
Principal classified as repayable later than one year	-	508,500
	<u>\$ 3,133,602</u>	<u>\$ 508,500</u>

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#### **13. CONVERTIBLE DEBENTURES**

##### **(a) Director**

On June 25, 2014, the Company issued a convertible debenture for up to a maximum aggregate principal amount of \$2,000,000 to the Chair of the Board of Directors, which bore interest at a rate of 10% per annum and matured on June 25, 2017. On September 22, 2014, \$1,796,000 of the principal was converted into 64,183 common shares of the Company. The balance of \$204,000 was convertible at a deemed price of CDN \$30.00 per share at any time at the option of the holder and is secured by all of the assets of the Company.

The remaining principal and accrued interest outstanding on this note was converted into common shares on May 19, 2017 at a conversion price of \$0.353 per share (Note 12(b)(vii)).

##### **(b) Altlands Overseas Corp.**

On February 9, 2015, the Company received a loan for an aggregate principal amount of \$2,000,000, which was increased to \$3,500,000 on July 21, 2015. The loan bore interest at a rate of 6% per annum and matured on February 9, 2016. On February 1, 2016, the loan was modified to extend the maturity date to February 9, 2017 and increase the rate of interest to 10% per annum between February 10, 2016 and February 9, 2017. The loan was guaranteed by the Chair of the Board of Directors. In addition, the lender held the option, subject to director, shareholder and regulatory approvals, to convert the loan into a 49.9% ownership interest in POSR.

On February 23, 2017, Altlands converted \$2,300,000 of the principal outstanding on the Altlands debt, into 669,760 common shares at a conversion price of \$3.434 per share.

The remaining principal and accrued interest outstanding on the Altlands debt was converted into common shares on May 19, 2017 at a conversion price of \$0.397 per share (Note 12 (b)(vii)).

##### **(c) Alpha Capital Anstalt**

On December 15, 2015, the Company issued a convertible secured note for \$555,556 to Alpha Capital Anstalt. The convertible secured note bore interest at a rate of 5% per annum, matured on June 15, 2017 and was convertible into units, each unit consisting of one common share of the Company and one common share purchase warrant of the Company, at a conversion price of \$0.34794 per unit. Each warrant would entitle the holder to acquire one additional common share at an exercise price of CDN \$0,4935● per share until ●.

On April 5, 2016, \$55,556 of the principal of the convertible secured note was settled by the issuance of 22,991 common shares of the Company. The remaining \$500,000 of the principal and \$12,577 of accrued interest of the convertible secured note was settled on April 8, 2016 using the proceeds from the issuance of an additional convertible secured note to Alpha Capital Anstalt.

On April 8, 2016, the Company issued an additional convertible secured note for \$600,000 to Alpha Capital Anstalt. The convertible secured note bore interest at a rate of 5% per annum and matured on October 8, 2017. The convertible secured note was convertible into units, consisting of one common share of the Company and one common share purchase warrant of the Company, at a conversion price of \$3.469 per unit. Each warrant would entitle the holder to acquire one additional common share at an exercise price of CAD \$4.725 per share until April 8, 2021. The convertible secured note was secured by all of the assets of the Company.

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Between October 14, 2016 and October 31, 2016, \$200,000 of the principal of the convertible secured notes was converted into 57,756 units.

### **13. CONVERTIBLE DEBENTURES (continued)**

#### **(c) Alpha Capital Anstalt (continued)**

On August 31, 2017, the Company issued a new convertible secured note for \$565,000 to Alpha Capital Anstalt. The remaining convertible loan principal at \$400,000 and interest and early settlement interest at \$59,014 was settled by the proceeds of the newly issued convertible secured note. The convertible secured note bears interest at a rate of 5% per annum and matures on October 31, 2018. The convertible secured note is convertible into units, consisting of one common share of the Company and one common share purchase warrant of the Company, at a conversion price of \$0.29 per unit until August 31, 2022. The convertible secured note is secured by all of the assets of the Company.

On December 19, 2017, January 10, 2018 and February 9, 2018, Alpha Capital converted \$150,000 per instance, totaling \$450,000 of the convertible units into 1,551,723 shares of common stock at a conversion price of \$0.29 per share; and warrants exercisable over 1,551,723 share of common stock at an exercise price of \$0.315 per share.

#### **(d) Deloro Energy LLC**

On September 11, 2017, Petroteq Energy CA, Inc. ("PQE CA") entered into an agreement ("Agreement") with Deloro Energy LLC, ("Deloro"). Under the Agreement, Deloro will provide financing of \$10,000,000 to the Company, in tranches of \$2,500,000, \$3,500,000 and \$4,000,000, to be used primarily for the expansion of the production capacity of the Company's oil extraction plant to 1,000 barrels per day. On the completion of the loan advance of \$10,000,000, Deloro will be entitled to convert its loan into a 49% equity interest in each of POSR") and TMC.

On the signing of the Agreement on September 11, 2017, Deloro paid a non-refundable deposit of \$50,000 to PQE CA, and credited towards the first tranche. On October 20, 2017, a further \$1,205,000 was received by PQE CA for the planned expansion of the of the oil extraction plant processing capacity. At the time the oil extraction plant achieves commercial production of at least 1,000 barrels per day, Deloro will receive a 25% economic royalty interest from PQE Oil and TMC. A further \$1,295,982 was received during the three months ended February 2018.

Deloro will also advance a second tranche of \$3,500,000 which was to take place prior to February 28, 2018 for a further economic royalty interest of 10% (a total of 35%) from PQE Oil and TMC, commencing and calculated from when the oil extraction plant achieves commercial production of at least 1,000 barrels per day. This tranche had not been advanced as of February 28, 2018.

Deloro will advance a third and final tranche of \$3,950,000 on or before June 1, 2018 which will entitle Deloro to receive an additional economic royalty interest of 14% (a total of 49%) from PQE Oil and TMC, commencing and calculated from when the oil extraction plant achieves commercial production of at least 1,000 barrels per day.

If Deloro fails to make any of the advances under the Agreement, PQE CA will have the option to repurchase the royalty interests owned by Deloro within twelve months from the date of the failure to make the advance. If Deloro fails to make all the advances by June 1, 2018, the advances made to date will convert to a loan payable, with interest at 5% per annum, by June 1, 2019.

#### **(e) Private lenders**

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In terms of an agreement entered into with two debenture holders, a portion of their debentures is convertible into shares of common stock, refer note 12(b)(ii) above.



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### 14. RECLAMATION AND RESTORATION PROVISIONS

	Oil Extraction Facility	Site Restoration	Total
Balance at August 31, 2016	357,000	204,000	561,000
Accretion expense	7,140	4,080	11,220
Balance at August 31, 2017	364,140	208,080	572,220
Accretion expense	3,641	2,081	5,722
Balance at February 28, 2018	\$ 367,781	\$ 210,161	\$ 577,942

#### (a) Oil Extraction Plant

In accordance with the terms of the lease agreement, the Company is required to dismantle its oil extraction plant at the end of the lease term, which is expected to be in 25 years. During the year ended August 31, 2015, the Company recorded a provision of \$350,000 for dismantling the facility.

Because of the long-term nature of the liability, the greatest uncertainties in estimating this provision are the costs that will be incurred and the timing of the dismantling of the oil extraction facility. In particular, the Company has assumed that the oil extraction facility will be dismantled using technology and equipment currently available and that the plant will continue to be economically viable until the end of the lease term.

The discount rate used in the calculation of the provision as at February 28, 2018 and August 31, 2017 is 2.0%.

#### (b) Site restoration

In accordance with environmental laws in the United States, the Company's environmental permits and the lease agreement, the Company is required to restore contaminated and disturbed land to its original condition before the end of the lease term, which is expected to be in 25 years. During the year ended August 31, 2015, the Company provided \$200,000 for this purpose.

The site restoration provision represents rehabilitation and restoration costs related to oil extraction sites. This provision has been created based on the Company's internal estimates. Significant assumptions in estimating the provision include the technology and equipment currently available, future environmental laws and restoration requirements, and future market prices for the necessary restoration works required.

The discount rate used in the calculation of the provision as at February 28, 2018 and August 31, 2017 is 2.0%.

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### **15. COMMON SHARES**

Authorized unlimited common shares without par value  
Issued and Outstanding 58,085,669 common shares as at February 28, 2018.

On May 19, 2017 the shareholders of the Company approved the consolidated its shares on a 30 for one basis. The number of shares issued and outstanding have been retroactively adjusted for this consolidation in these financial statements.

During the period from October 21, 2016 to November 8, 2016, the Company issued 57,756 common shares on the conversion of \$200,000 of convertible debt to Alpha Capital Anstalt.

On November 17, 2016, the Company issued 21,496 common shares to two private lenders on modification of the debt terms and extension of the repayment date of the debt.

During the period from November 17, 2016 to August 23, 2017, the Company issued 479,867 common shares of common stock to settle outstanding liabilities with third parties amounting to \$311,442.

During the period from November 17, 2016 to August 30, 2017, the Company issued 694,042 common shares for net proceeds of \$641,528.

On January 17, 2017, the Company issued 16,667 common shares to its Chief Technical Officer and the inventor of a key component of the Company's oil extraction technology.

During the period from February 23, 2017 and August 22, 2017, the Company issued a total of 46,144,371 common shares upon the conversion of several notes and convertible notes totaling \$17,852,548, including interest thereon, and a further \$115,000 of directors' loans (Note 13 (a)).

On June 12, 2017, the Company issued 83,333 common shares as an investment into a joint venture with two unrelated parties (Note 20).

During the period from September 27, 2017 to January 29, 2018, the company issued an additional 2,313,247 shares for net proceeds of \$1,206,356.

During the period December 19, 2017 to February 9, 2018, the Company issued 1,551,723 shares upon the conversion of \$450,000 of convertible notes.

### **16. SHARE PURCHASE OPTIONS**

#### **(a) Stock option plan**

The Company has a stock option plan which allows the Board of Directors of the Company to grant options to acquire common shares of the Company to directors, officers, key employees and consultants. The option price, term and vesting are determined at the discretion of the Board of Directors, subject to certain restrictions as required by the policies of the TMX Venture Exchange. The stock option plan is a 20% fixed number plan with a maximum of 1,513,574 common shares reserved for issuance.

On November 30, 2017, the Company granted 1,425,000 ten year options to three directors at an exercise price of CDN\$2.27 per share. The weighted average fair value of the options granted was estimated at \$2.27 per share at the grant date using the Black-Scholes option pricing model. For the year ended August 31, 2017, the Company did not grant any options.

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### 16. SHARE PURCHASE OPTIONS (continued)

The weighted average assumptions used for the Black-Scholes option pricing model were:

	Six months ended February 28, 2018
Share price	CDN \$ 2.27
Exercise price	CDN \$ 2.27
Expected share price volatility <sup>(1)</sup>	197%
Risk-free interest rate	1.81%
Expected term	10 years

(1) Expected volatility has been calculated based on the Company's historical volatility.

During the six months ended February 28, 2018 the share-based compensation expense of \$2,505,647 relates to the 1,425,000 options granted to the directors.

#### (b) Share purchase options

Share purchase option transactions under the stock option plan were:

	Six months ended February 28, 2018		Year ended August 31, 2017	
	Number of Options	Weighted average exercise price*	Number of options	Weighted average exercise price*
Balance, beginning of period	113,333	\$ 12.57	126,666	\$ 14.70
Options granted	1,425,000	\$1.76	-	-
Options cancelled	-	-	-	-
Options expired	(30,000)	\$ 33.00	(13,333)	\$ 33.00
Balance, end of period	1,508,333	\$ 1.89	113,333	\$ 12.57

\* All option exercise prices are converted to US \$ at period end for purposes of determining the weighted average exercise price.

Share purchase options outstanding and exercisable as at February 28, 2018 are:

Expiry Date	Exercise Price	Options Outstanding	Options Exercisable
December 31, 2018	USD \$4.80	50,000	50,000
February 1, 2026	CDN \$5.85	33,333	33,333
November 30, 2027	CDN \$2.27	1,425,000	1,425,000
		1,508,333	1,508,333
Weighted average remaining contractual life		9.4 years	9.4 years

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#### 17. SHARE PURCHASE WARRANTS

Share purchase warrants outstanding as at February 28, 2018 are:

<b>Expiry Date</b>	<b>Exercise Price</b>	<b>Warrants Outstanding</b>
November 5, 2019	CDN \$28.35	25,327
April 12, 2019	CDN \$5.10	16,667
August 19, 2019	CDN \$7.50	66,666
April 8, 2021	CDN\$4.74	57,756
August 31,2022	\$0.315	1,551,723
		<u>1,718,139</u>
Weighted average remaining contractual life		4.30 years
Weighted average exercise price		CDN \$1.20

Between April 30, 2015 and October 9, 2015, the Company issued 4,221, 8,442, 6,332 and 6,332 share purchase warrants in connection with the conversion of \$100,000, \$200,000, \$150,000 and \$150,000, respectively, of the convertible secured notes (Note 13(c)) into units composed of one common share of the Company and one share purchase warrant of the Company. The fair value of the warrants granted was estimated, using the residual method, of \$0.60, \$2.40, \$4.50 and \$2.70 per warrant, respectively.

On May 9, 2016, the Company issued 16,667 share purchase warrants to settle an outstanding liability of \$75,000. The fair value of the warrants granted was estimated at \$2.10 per warrant at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the Black-Scholes option pricing model were a share price of CDN \$4.20, exercise price of CDN \$4.95, expected share price volatility of 114%, risk-free interest rate of 0.68% and expected term of three years. The expected volatility was calculated based on the Company's historical volatility.

On June 1, 2016, 16,667 share purchase warrants issued to debt holder were cancelled (Note 12(b)(ii)).

On August 19, 2016, the Company issued 66,666 share purchase warrants in connection with the acquisition of 57.3% of the common shares of Accord (Note 1). The fair value of the warrants granted was estimated at \$2.70 per warrant at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the Black-Scholes option pricing model were a share price of CDN \$5.70, exercise price of CDN \$7.50, expected share price volatility of 116%, risk-free interest rate of 0.68% and expected term of three years. The expected volatility was calculated based on the Company's historical volatility.

On October 14, 2016 and October 31, 2016, the Company issued 14,439 and 43,317 share purchase warrants in connection with the conversion of \$50,000 and \$150,000, respectively, of the convertible secured notes (Note 13(c)) into units composed of one common share of the Company and one share purchase warrant of the Company. The fair value of the warrants granted was estimated, using the relative fair value method, at \$1.80 per warrant.

On December 19, 2017, January 10, 2018 and February 9, 2018, the Company issued a total of 1,551,723 share purchase warrants in connection with the conversion of \$150,000 per instance, totaling \$450,000 of the convertible notes (Note 13(c)) into units composed of one common share of the Company and one share purchase warrant of the Company. The fair value of the warrants granted was estimated, using the relative fair value method, at \$0.16 per warrant.

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### 18. DILUTED LOSS PER SHARE

The Company's potentially dilutive instruments are convertible debentures and share purchase options and warrants. Conversion of these instruments would have been anti-dilutive for the periods presented and consequently, no adjustment was made to basic loss per share to determine diluted loss per share. These instruments could potentially dilute earnings per share in future periods.

### 19. RELATED PARTY TRANSACTIONS

Related party transactions not otherwise separately disclosed in these consolidated financial statements are:

#### (a) Key management personnel and director compensation

The remuneration of the Company's directors and other members of key management, who have the authority and responsibility for planning, directing, and controlling the activities of the Company, consist of the following amounts:

	Three months ended	
	February 28, 2018	February 28, 2017
Salaries, fees and other benefits	\$ 187,500	\$ 102,000
Share based compensation	-	2,885
	<u>\$ 187,500</u>	<u>\$ 104,885</u>

  

	Six months ended	
	February 28, 2018	February 28, 2017
Salaries, fees and other benefits	\$ 289,500	\$ 204,000
Share based compensation	2,505,647	15,992
	<u>\$ 2,795,147</u>	<u>\$ 219,992</u>

At February 28, 2018 \$1,396,892 is due to members of key management and directors for unpaid salaries, expenses and directors' fees (August 31, 2017 – \$1,137,392).

#### (b) Due to director

During the six months ended February 28, 2018 and the year ended August 31, 2017 and 2016, the Company received additional advances of \$1,145,440 and \$421,250 from various private companies controlled by the Chair of the Board of Directors of the Company (Notes 12(b)(v) and 12(e)).

On January 20, 2016 and July 25, 2016, the Company entered into an agreement to settle a portion of the principal and accrued and unpaid interest of these advances by issuing 85,160 and 37,581 common shares of the Company, respectively, to the lenders.

As of February 28, 2018 and August 31, 2017, the Company owed the Chair of the Board the aggregate sum of \$1,054,882 and \$242,250, respectively. These loans bear interest at 5% per annum and mature during August 2020.

# **PETROTEQ ENERGY INC.**

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### **19. RELATED PARTY TRANSACTIONS (continued)**

On May 18, 2017, the Company entered into a securities purchase agreement whereby it agreed to convert an aggregate principal debt of \$264,841, including interest thereon, owing to the Chair of the Board or companies controlled by him into 751,681 of common share at a conversion price of \$0.353 per share.

On May 18, 2017, the Company entered into a securities purchase agreement whereby it agreed to convert an aggregate principal debt of \$115,000, including interest thereon, owing to the Chair of the Board or companies controlled by him into 325,779 common shares at a conversion price of \$0.353 per share.

On August 15, 2017, the promissory note of \$3,000,000, owing to the Chair of the Board, including accrued interest thereon up to August 18, 2017 of \$215,625, was assigned to three different entities and in terms of debt conversion agreements entered into on August 18, 2017, was subsequently converted into 14,391,330 common shares at a conversion price of \$0.223 per share,

### **20. INVESTMENTS**

#### **(a) Investment in joint venture**

On November 11, 2016, the Company and three other parties entered into a joint venture for the operation of a site for careers in the oil and gas industry. The Company has a 25% interest in this joint venture and has made advances of \$68,331 to the joint venture as of February 28, 2018. The joint venture has not commenced operations as of February 28, 2018.

#### **(b) Investment in First Bitcoin**

PQE CA formed a new subsidiary Petrobloq, LLC. ("Petrobloq") The Company advanced \$100,000 to Petrobloq which, in terms of an agreement entered into with First Bitcoin Capital Corp. ("FBCC"), a global developer of blockchain-based applications, a further \$400,000 will be advanced to FBCC to design and develop a BlockChain-powered supply chain management platform for the oil and gas industry. The platform will be designed as a "one-stop shop" that will provide both small and large oil and gas producers and operators with the ability to customize their own distributed ledger modules that will permit each company, in a secure "closed" environment, to document, track, and account for the supply of equipment, materials and services in project, field, and lease development.

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### 21. SEGMENT INFORMATION

The Company operated in two reportable segments within the USA during the six months ended February 28, 2018 and the year ended August 31, 2017 and 2016, oil extraction and processing operations and mining operations.

Once more favourable market conditions exist, the Company's oil extraction segment intends to commence commercial production and will generate revenue from the sale of hydrocarbon products to third parties. The Company's mining operations have not commenced and are expected to generate revenues once the Company begins extracting oil from the oil sands.

The presentation of the consolidated statements of loss and comprehensive loss provides information about the oil extraction and processing segment. There were no operations in the mining operations segment during the six months ended February 28, 2018 and 2017.

<b>(in '000s of dollars)</b>	<b>February 28, 2018</b>		
	<b>Oil Extraction</b>	<b>Mining operations</b>	<b>Consolidated</b>
Additions to non-current assets	\$ 1,873	\$ -	\$ 1,873
Reportable segment assets	21,861	9,082	30,943
Reportable segment liabilities	\$ (10,029)	\$ (169)	\$ (10,198)

<b>(in '000s of dollars)</b>	<b>February 28, 2017</b>		
	<b>Oil Extraction</b>	<b>Mining operations</b>	<b>Consolidated</b>
Additions to non-current assets	\$ 497		\$ 497
Reportable segment assets	21,773	9,489	31,262
Reportable segment liabilities	\$ (12,870)	\$ (8,451)	\$ (21,321)



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### 21. SEGMENT INFORMATION (continued)

Other information about reportable segments is:

(in '000s of dollars)	February 28, 2018		
	Oil Extraction	Mining operations	Consolidated
<b>External Revenues</b>	\$ -	\$ -	\$ -
<b>Cost of Goods Sold</b>	17	170	187
<b>Gross Loss</b>	-	(170)	(187)
<b>Operating Expenses</b>			
General and administrative	285	10	295
Travel and promotion	343	-	343
Professional fees	826	-	826
Salaries and wages	386	-	386
Share-based compensation	2,506	-	2,506
Loss on settlement of liabilities	-	-	-
Interest expense	242	-	242
Equity loss	-	-	-
Depreciation and amortization	594	-	594

  

(in '000s of dollars)	February 28, 2017		
	Oil Extraction	Mining operations	Consolidated
<b>External Revenues</b>	\$ -	\$ -	\$ -
<b>Cost of Goods Sold</b>	1	203	204
<b>Gross Loss</b>	(1)	(203)	(204)
<b>Operating Expenses</b>			
General and administrative	202	5	207
Travel and promotion	318	-	318
Professional fees	378	6	384
Salaries and wages	299	-	299
Share-based compensation	16	-	16
Gain on settlement of liabilities	(1,346)	-	(1,346)
Interest expense	393	186	579
Depreciation and amortization	595	-	595

# **PETROTEQ ENERGY INC.**

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### **22. MANAGEMENT OF CAPITAL**

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable level. The Company considers its capital for this purpose to be its shareholders' equity and long-term liabilities.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may seek additional financing or dispose of assets.

In order to facilitate the management of its capital requirements, the Company monitors its cash flows and credit policies and prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The budgets are approved by the Board of Directors. There are no external restrictions on the Company's capital.

### **23. MANAGEMENT OF FINANCIAL RISKS**

The risks to which the Company's financial instruments are exposed to are:

#### **(a) Credit risk**

Credit risk is the risk of unexpected loss if a customer or third party to a financial instrument fails to meet contractual obligations. The Company is exposed to credit risk through its cash held at financial institutions, trade receivables from customers and notes receivable.

The Company has cash balances at various financial institutions. The Company has not experienced any loss on these accounts, although balances in the accounts may exceed the insurable limits. The Company considers credit risk from cash to be minimal.

Credit extension, monitoring and collection are performed for each of the Company's business segments. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current creditworthiness, as determined by a review of the customer's credit information.

Accounts receivable, collections and payments from customers are monitored and the Company maintains an allowance for estimated credit losses based upon historical experience with customers, current market and industry conditions and specific customer collection issues.

At February 28, 2018 and August 31, 2017, the Company had no trade receivables. The Company considers its maximum exposure to credit risk to be its trade and other receivables and notes receivable.

#### **(b) Interest rate risk**

Interest rate risk is the risk that changes in interest rates will affect the fair value or future cash flows of the Company's financial instruments. The Company is exposed to interest rate risk as a result of holding fixed rate borrowings of varying maturities as well as through certain floating rate instruments. The Company considers its exposure to interest rate risk to be minimal.

# PETROTEQ ENERGY INC.

## Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

Expressed in US dollars

### 23. MANAGEMENT OF FINANCIAL RISKS (continued)

#### (c) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses.

The following are the remaining contractual maturities of financial liabilities at the reporting date. The amounts are gross and undiscounted and include estimated interest payments. The Company has included both the interest and principal cash flows in the analysis as it believes this best represents the Company's liquidity risk.

At February 28, 2018

(in '000s of dollars)	Carrying amount	Total	Contractual cash flows		
			1 year or less	2 - 5 years	More than 5 years
Accounts payable	\$ 1,212	\$ 1,212	\$ 1,212	\$ -	\$ -
Accrued liabilities	1,661	1,661	1,661	-	-
Convertible debenture	3,153	3,148	3,148	-	-
Long-term debt	2,648	3,050	994	2,056	-
	\$ 8,674	\$ 9,070	\$ 7,015	\$ 2,056	\$ -

At August 31, 2017

(in '000s of dollars)	Carrying amount	Total	Contractual cash flows		
			1 year or less	2 - 5 years	More than 5 years
Accounts payable	\$ 1,121	\$ 1,121	\$ 1,121	\$ -	\$ -
Accrued liabilities	1,980	1,980	1,980	-	-
Convertible debenture	509	600	21	579	-
Long-term debt	1,876	2,072	1,278	794	-
	\$ 5,486	\$ 5,773	\$ 4,400	\$ 1,373	\$ -

# **PETROTEQ ENERGY INC.**

Notes to the Condensed Consolidated Interim Financial Statements

February 28, 2018 and 2017

*Expressed in US dollars*

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## **24. EVENTS AFTER THE REPORTING DATE**

Events after the reporting date not otherwise separately disclosed in these consolidated financial statements are:

### **(a) Common shares**

Subsequent to February 28, 2018, in terms of various subscription agreements entered into with third parties between February 28, 2018 and March 9, 2018, the Company issued 222,203 shares of common stock for proceeds received.

A further 932,893 shares of common stock was issued in terms of various debt settlement agreements entered into with suppliers of the Company.

### **(b) Warrants**

Subsequent to February 28, 2018, warrants over 1,000,000 shares were exercised by Alpha Capital Anstalt for gross proceeds of \$315,000.