FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*
FINANCIAL				
Oil and natural gas revenues	**14,094**	13,788	**24,769**	28,239
Funds from operations (1)	**4,089**	6,743	**6,800**	13,303
Per share – basic	**0.12**	0.20	**0.20**	0.39
Per share – diluted (2)	**0.12**	0.20	**0.19**	0.39
Net income (loss)	**(361)**	(116)	**(3,714)**	2,384
Per share – basic	**(0.01)**	(0.00)	**(0.11)**	0.07
Per share – diluted (2)	**(0.01)**	(0.00)	**(0.11)**	0.07
Capital expenditures (3)	**5,841**	5,846	**9,302**	10,637
Net debt (4)	**47,072**	35,985	**47,072**	35,985
Shareholders' equity	**192,730**	212,735	**192,730**	212,735
(000s)	*(#)*	*(#)*	*(#)*	*(#)*
SHARE DATA				
At period-end	**34,191**	34,169	**34,191**	34,169
Weighted average – basic	**34,191**	33,804	**34,191**	33,749
Weighted average – diluted	**34,921**	34,046	**34,897**	34,019
OPERATING (5)				
Production				
Natural gas *(mcf/d)*	**121**	448	**204**	588
Crude oil *(bbls/d)*	**2,197**	2,784	**2,177**	2,835
Total *(boe/d)*	**2,217**	2,859	**2,211**	2,933
Average wellhead prices				
Natural gas *($/mcf)*	**0.88**	3.24	**1.80**	2.75
Crude oil and NGLs *($/bbl)*	**70.45**	53.91	**62.69**	54.46
Combined average *($/boe)*	**69.87**	53.01	**61.90**	53.19
Netbacks				
Operating netback *($/boe)* (7)	**28.83**	30.37	**24.51**	29.05
Gross (net) wells drilled				
Oil *(#)*	**2 (2.0)**	3 (3.0)	**3 (3.0)**	6 (6.0)
Total *(#)*	**2 (2.0)**	3 (3.0)	**3 (3.0)**	6 (6.0)
Average working interest *(%)*	**100**	100	**100**	100

(1) Funds from operations and funds from operations per share are not recognized measures under International Financial Reporting Standards (IFRS). Refer to the commentary in the Management's Discussion and Analysis under "Non-GAAP Measurements" for further discussion.

(2) The Company uses the weighted average common shares (basic) when there is a net loss for the period and the weighted average common shares (diluted) when there is net income in the period to calculate net income (loss) per share diluted. The Company uses the weighted average common shares (diluted) to calculate the funds from operations diluted.

(3) Total capital expenditures, excluding acquisitions and excluding non-cash transactions. Refer to commentary in the Management's Discussion and Analysis under "Capital Expenditures and Acquisitions" for further information.

(4) Net debt, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets (excluding derivative financial instruments), is not a recognized measure under IFRS. Please refer to the commentary under "Non-GAAP Measurements" for further discussion.

(5) For a description of the boe conversion ratio, refer to the commentary in the Management's Discussion and Analysis under "Other Measurements".

(6) Combined average realized prices includes all oil, gas and NGL sales revenue, excluding other income.

(7) Operating netback, which is calculated by deducting royalties, operating expenses and transportation expenses from oil and gas revenue and adjusting for any realized hedging on financial instruments, is not a recognized measure under IFRS. Please refer to the commentary under "Non-GAAP Measurements" for further discussion.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) of the financial condition and results of operations for Granite Oil Corp. ("Granite" or "the Company") is dated August 9, 2018, and should be read in conjunction with the Company's unaudited interim financial statements and related notes for the three and six months ended June 30, 2018, as well as the Company's audited financial statements and related notes for the years ended December 31, 2017 and 2016. All financial information is reported in Canadian dollars, unless otherwise noted. The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), in Canadian dollars, except where indicated otherwise. Additional information regarding the Company, including the Annual Information Form, is also available on www.sedar.com and on the Company's website www.graniteoil.ca and by contacting the Company at Granite Oil Corp., 3230, 308 Fourth Avenue S.W., Calgary, Alberta, Canada T2P 0H7.

This MD&A contains additional measures under generally accepted accounting principles (GAAP), non-GAAP measures and forward-looking statements. Readers are cautioned that the MD&A should be read in conjunction with the Company's disclosure under "Non-GAAP Measures" and "Forward-looking Information and Statements" included at the end of this MD&A.

ABOUT GRANITE OIL CORP.

Granite is a dividend-paying, junior oil producer based in Calgary, Alberta, that owns and operates a large Alberta Bakken oil pool in southern Alberta (the "Alberta Bakken Property" or "Alberta Bakken").

The business plan of the Company is to maximize the recoverable portion of the oil-in-place on the Alberta Bakken Property over the long run through responsible reservoir management while achieving and sustaining low annual production decline, pool-wide through utilization of the natural gas injection enhanced oil recovery ("EOR") scheme operated by the Company on its Alberta Bakken Property. The Company aims to generate free cash flow at current commodity prices, focusing on sustainable production volumes. The Company executes its business plan by maintaining low capital expenditure operations while continuing to pursue possible strategic acquisitions.

Granite's Alberta Bakken Property has been substantially de-risked. The property includes complete Company-operated infrastructure to produce and market oil and re-inject gas for enhanced oil recovery. Granite benefits from experienced, technically able, and proven leadership. The team has many of the same senior managers who discovered, delineated and developed the Alberta Bakken Property.

Granite is headquartered in Calgary, Alberta and the common shares of Granite are listed for trading on the Toronto Stock Exchange under the symbol GXO and on the OTCQX under the symbol GXOCF.

2018 SECOND QUARTER FINANCIAL AND OPERATING HIGHLIGHTS

Production during the second quarter averaged 2,217 boe/d (99% oil) resulting in funds from operations of $4.1 million. Capital expenditures for the quarter were $5.8 million which included the drilling and completion of two wells, the first of which was drilled in unfavourable breakup conditions, and the second of which was originally planned for the third quarter. Granite made the decision to accelerate the timing of this well due to better availability of services and associated capital efficiencies.

The Company's net debt at the end of the second quarter was higher than forecast primarily due to the acceleration of Granite's third-quarter well into the second quarter, hedging losses, and the deferred disposition of a minor property referred to in the Granite's news release dated December 18, 2017. Net debt at the end of the quarter was $47.1 million, consisting of bank debt of $44.9 million and negative working capital of $2.2 million.

Granite's cash flow and corporate netbacks continue to be negatively impacted by the combination of widening Western Canada Select ("WCS") differentials and the Company's hedging losses. Hedging losses in the quarter were $2.0 million dollars, totaling $3.4 million for the six months ended June 30, 2018. The Company continues to aggressively pursue various differential mitigation opportunities to protect its go-forward pricing and the balance sheet.

OUTLOOK

With the current WCS differential outlook, the Company is setting forth a calculated, more moderated pace of development of its 100%-owned, early lifecycle Bakken oil pool, with the focus on: (1) sustainable production for the long-term; (2) minimizing costs and reducing debt levels; and (3) minimizing exposure to Canadian pricing risks through the implementation of WCS differential mitigation strategies.

With the continued uncertainty surrounding differentials, Granite is forecasting a budget ranging from 1,900 to 2,100 bbls/d of oil production for the second half of 2018, with capital spending of approximately $1.5 to $3.5 million. The Company will determine whether or not to proceed with drilling and completing a well in the fourth quarter based on prevailing price differentials and/or the success of its differential mitigation strategies. Moving forward, Granite has an inventory of 85 potential well locations with a plan to drill approximately five wells per year, in conjunction with the expansion of the EOR scheme, to ensure the most efficient, long-term recovery from the pool. At this pace, Granite has many years of future drilling, with forecast annual capital spending averaging between $10 and $12 million, and average annual production of 2,000 - 2,300 bbl/d.

Funds from Operations [1]

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s)				
Cash flow from operating activities	**3,791**	4,847	**7,748**	10,930
Changes in non-cash working capital	**298**	1,896	**(948)**	2,373
Funds from operations	**4,089**	6,743	**6,800**	13,303

(1) Funds from operations and funds from operations per share are not recognized measures under International Financial Reporting Standards (IFRS). Refer to "Non-GAAP Measurements" for further discussion.

During the three months ended June 30, 2018, the Company generated funds from operations totaling $4.1 million ($0.12 per basic and diluted share) compared to $6.7 million ($0.20 per basic and diluted share) in the comparative period of 2017. The decrease from the second quarter of 2017 is primarily as a result of the increase in the realized hedging loss in the current quarter as well as higher royalties and operating costs partially offset by an increase in oil and natural gas revenues.

Funds from operations totaled $6.8 million ($0.20 per basic and $0.19 per diluted share) for the six months ended June 30, 2018, compared to $13.3 million ($0.39 per basic and diluted share). The decrease from the six months ended June 30, 2017, reflects decreased revenue mainly as a result of lower sales volumes as well as an increase in realized hedging losses incurred in 2018 and an increase in operating costs. This was partially offset by lower royalties in the current period.

Net Income (Loss)

For the three months ended June 30, 2018, the Company recorded a net loss of $0.4 million ($0.01 per basic and diluted share) compared to a net loss of $0.1 million ($0.00 per basic and diluted share) in the same period of 2017. The change in the net income (loss) over the same period in the prior year is largely due to the change in both the realized and unrealized gain (loss) on financial instruments recorded in the second quarter of 2018 as well as lower exploration and evaluation expenses in the current quarter.

For the six months ended June 30, 2018, the Company recorded a net loss of $3.7 million ($0.11 per basic and diluted share) as compared to net income of $2.4 million ($0.07 per basic and diluted share) for the same period in the prior year. The increase in the net loss for the first six months of 2018 can be primarily attributed to lower oil and gas revenues, net of royalties as a result of lower production in the first six months of 2018 as well as the change in both the realized and unrealized gain (loss) on financial instruments recorded in the first six months of 2018 and lower exploration and evaluation expenses.

FINANCIAL AND OPERATING RESULTS

Sales Volumes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Sales				
Natural gas *(mcf/d)*	**121**	448	**204**	588
Crude oil *(bbls/d)*	**2,197**	2,784	**2,177**	2,835
Total sales *(boe/d)*	**2,217**	2,859	**2,211**	2,933
	(%)	*(%)*	*(%)*	*(%)*
Production Split				
Natural gas	**1**	3	**1**	3
Crude oil	**99**	97	**99**	97
Total	**100**	100	**100**	100

For the second quarter of 2018, the Company's production averaged 2,217 boe/d compared to 2,859 boe/d in the same period of 2017, a decrease of 23 percent. The decrease is the result of natural declines, the conversion of producing wells to gas injectors, a reduced drilling program throughout 2018 as well as lower gas sales in the current quarter.

For the first six months of 2018, the Company's production averaged 2,211 boe/d compared to 2,933 boe/d in the same period in 2017. This 25 percent decrease is the result of natural declines, the conversion of producing wells to gas injectors, a reduced drilling program throughout 2018 as well as lower gas sales.

Revenue

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s)				
Natural gas	**10**	132	**67**	293
Crude oil	**14,084**	13,656	**24,702**	27,946
Total oil and natural gas revenue	**14,094**	13,788	**24,769**	28,239

During the three months ended June 30, 2018, revenue increased by two percent to $14.1 million from $13.8 million in the comparative period of 2017. The year-over-year increase is the result of an increase in crude oil market prices partially offset by a decrease in production volumes in the second quarter of 2018.

For the first six months of 2018, revenue totaled $24.8 million compared to $28.2 million for the same period in 2017. This decrease can be attributed to the decrease in production volumes partially offset by an increase in crude oil market prices in the first six months of 2018.

Pricing for the three and six months ended June 30, 2018 is further discussed below in "Commodity Prices and Foreign Exchange".

Commodity Prices and Foreign Exchange

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Benchmark Prices				
Crude oil				
WTI *(US$/bbl)*	**67.88**	48.28	**65.38**	50.10
Hardisty Bow River *(Cdn$/boe)*	**63.13**	59.94	**56.10**	59.66
Differential – Bow River/WTI *(US$/bbl)*	**(15.79)**	(10.85)	**(18.73)**	(12.65)
Natural gas				
NYMEX *(US$/mmbtu)* [1]	**2.83**	3.18	**2.84**	3.25
AECO *(Cdn$/GJ)* [2]	**1.20**	2.64	**1.63**	2.59
Average Realized Prices				
Natural gas *($/mcf)*	**0.88**	3.24	**1.80**	2.75
Crude oil *($/bbl)*	**70.45**	53.91	**62.69**	54.46
Combined average *($/boe)*	**69.87**	53.01	**61.90**	53.19
Foreign Exchange				
Cdn$/US$	**1.30**	1.33	**1.28**	1.33
US$/Cdn$	**0.77**	0.75	**0.78**	0.75

(1) Mmbtu is the abbreviation for millions of British thermal units. One mcf of natural gas is approximately 1.02 mmbtu.
(2) GJ is the abbreviation for gigajoule. One mcf of natural gas is approximately 1.05 GJ

Crude Oil Pricing

The average realized price of Granite's crude oil was $70.45/bbl for the second quarter of 2018 compared to $53.91/bbl in the second quarter of 2017. Granite's realized oil price increased by 31 percent from the second quarter of 2017 mainly due to the increase in the US$ WTI benchmark price over the same period.

For the six months ended June 30, 2018, the Company's average realized crude oil price was $62.69/bbl compared to $54.46/bbl in the same period in the prior year, a 15 percent increase driven by higher benchmark prices.

Natural Gas Pricing

Granite's average realized natural gas price was $0.88/mcf in the second quarter of 2018 as compared to $3.24/mcf in the second quarter of 2017. The decrease can be attributed to the decrease in the gas index price.

Granite's average realized natural gas price was $1.80/mcf in the first six months of 2018 as compared to $2.75/mcf in the same period of 2017. The decrease can be attributed to the decrease in the gas index price.

Price Risk & Mitigation

Ongoing commodity price volatility may affect Granite's funds from operations and rates of return on capital programs. As continued volatility is expected in 2018, Granite will continue to take steps to mitigate these risks and protect its financial position.

The Company's financial results are significantly influenced by fluctuations in commodity prices, including price differentials and foreign exchange rates. As a means of managing commodity price volatility and its impact on cash flows, the Company seeks to protect itself from fluctuations in prices and exchange rates by maintaining an appropriate hedging strategy. As at June 30, 2018, Granite had 13 crude oil hedges (refer to "Risk Management" below for details). Most commodity prices are based on US dollar benchmarks, which result in the Company's realized prices being influenced by the Canadian/US exchange rates. The Company is affected by foreign currency exchange rate changes related to commodity prices as outlined above.

Royalties

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Oil and natural gas revenue *($000s)*	**14,094**	13,788	**24,769**	28,239
Total royalties *($000s)*	**3,595**	3,114	**6,129**	7,208
Total royalties *($/boe)*	**17.82**	11.97	**15.32**	13.58
Percent of oil and natural gas revenue *(%)*	**26**	23	**25**	26

The Alberta Bakken Property is primarily subject to freehold royalties, which work on a sliding-scale determined monthly on a well-by-well basis using a calculation based on the Alberta crown royalty regulation implemented in 2009 with a range of five to 30 percent. The sliding scale provides varying rates based on productivity (a higher royalty is payable from wells with higher production rates) and commodity prices (a higher royalty is payable in times of higher natural gas and crude oil prices). This area is also subject to freehold mineral taxes (which are included as royalties for financial reporting purposes) and overriding royalties related to farm-in arrangements.

For the second quarter of 2018, royalties totaled $3.6 million or 26 percent of oil and gas sales revenue compared to $3.1 million or 23 percent of revenue for the same quarter in 2017. The year-over-year royalty rate increase is primarily due to a non-recurring royalty amendment in the second quarter of 2017 which reduced the Company's royalties in the prior year.

For the six months ended June 30, 2018, royalties totaled $6.1 million or 25 percent of oil and gas sales revenue compared to $7.2 million or 26 percent of oil and gas sales revenue for the same period in 2017.

Operating and Transportation Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Operating expenses *($000s)*	**2,232**	2,220	**4,658**	4,204
Transportation expenses *($000s)*	**500**	398	**796**	792
Total operating and transportation expenses *($000s)*	**2,732**	2,618	**5,454**	4,996
Operating expenses *($/boe)*	**11.06**	8.53	**11.64**	7.92
Transportation expenses *($/boe)*	**2.48**	1.53	**1.99**	1.49
Total operating and transportation expenses *($/boe)*	**13.54**	10.06	**13.63**	9.41

Operating costs include all costs associated with the production of crude oil and natural gas. The major components of operating costs include charges for contract operating, processing fees, lease rentals, property and pipeline taxes, utilities and well maintenance charges.

Operating expenses for the second quarter of 2018 were $2.2 million or $11.06/boe as compared to $2.2 million or $8.53/boe in the same period of 2017. Operating costs were consistent on an absolute dollar basis quarter-over-quarter.

Transportation expenses for the three months ended June 30, 2018, were $0.5 million or $2.48/boe compared to $0.4 million or $1.53/boe in the second quarter of 2017. Transportation costs increased slightly in the second quarter of 2018 as a result of a mileage surcharge increase on a per boe basis as well as road bans resulting in increased transportation costs in the current quarter.

For the six months ended June 30, 2018, the Company incurred operating expenses of $4.7 million or $11.64/boe compared to $4.2 million or $7.92/boe in the same period in the prior year. Transportation expenses for the first six months of 2018 totaled $0.8 million or $1.99/boe as compared to $0.8 million or $1.49/boe in the same period in 2017. The increase in operating costs as compared to the six months ended June 30, 2017, can be attributed to adverse weather conditions and workover costs. Transportation costs on an absolute dollar basis were consistent year over year and current year costs reflect the mileage surcharge increase on a per boe basis as well as impact of road bans as discussed above.

Risk Management

Granite maintains a risk management program to reduce the volatility of revenues and to increase the certainty of funds from operations. As at June 30, 2018, the Company had the following crude oil risk management contracts, with a total mark-to-market liability of $4.6 million (December 31, 2017 – $2.8 million liability):

Crude Oil Contracts

Remaining Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Remainder of 2018					
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $49.00
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $50.00
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $50.50
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $52.00
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	200 bbls/d	WTI-NYMEX	US $55.40
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $60.15
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $68.30
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	200 bbls/d	WTI-NYMEX	CAD $70.74
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $75.06
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $83.22
Q1 2019					
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $88.55
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $65.72
Front Half 2019					
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.73

Subsequent to June 30, 2018, the Company entered into the following Crude Oil Contracts:

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $83.90/bbl
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $88.44/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $84.25/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.15/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.02/bbl

Gains and losses on risk management contracts are composed both of unrealized gains or losses that represent the change in the mark-to-market position of those contracts throughout the period and of realized gains and losses representing the portion of the contracts that have been settled in cash during the period. The Company has elected not to use hedge accounting for its current risk management contracts.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Unrealized gain (loss) on financial instruments *($000s)*	**(811)**	1,739	**(1,790)**	4,226
Unrealized gain (loss) on financial instruments *($/boe)*	**(4.02)**	6.69	**(4.47)**	7.96

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Realized gain (loss) on financial instruments *($000s)*	**(1,952)**	(158)	**(3,378)**	(611)
Realized gain (loss) on financial instruments *($/boe)*	**(9.68)**	(0.61)	**(8.44)**	(1.15)

During the second quarter of 2018, the Company recorded an unrealized loss on financial instruments of $0.8 million and a realized loss of $2.0 million. In the same period of the prior year, the Company recorded an unrealized gain of $1.7 million and a realized loss of $0.2 million. The unrealized loss for the second quarter of 2018 is a result of the mark-to-market value of financial risk management contracts outstanding as at June 30, 2018. These non-cash unrealized gains (losses) on financial instruments are generated by the change over the reporting period in the mark-to-market valuation of Granite's risk management contracts. The realized gains or losses represent actual cash settlements under the respective commodity contracts in the respective periods.

For the six months ended June 30, 2018, the Company recorded an unrealized loss of $1.8 million and a realized loss of $3.4 million compared to an unrealized gain of $4.2 million and a realized loss of $0.6 million, in the same period of 2017.

Operating Netback [(1)(2)]

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($/boe)				
Average sales price	**69.87**	53.01	**61.90**	53.19
Royalties	**(17.82)**	(11.97)	**(15.32)**	(13.58)
Operating expenses	**(11.06)**	(8.53)	**(11.64)**	(7.92)
Transportation expenses	**(2.48)**	(1.53)	**(1.99)**	(1.49)
Operating netback prior to hedging gain (loss)	**38.51**	30.98	**32.95**	30.20
Realized gain (loss) on financial instruments	**(9.68)**	(0.61)	**(8.44)**	(1.15)
Operating netback [(2)]	**28.83**	30.37	**24.51**	29.05

(1) For a description of the boe conversion ratio, refer to "Other Measurements" below.
(2) Operating netback is a non-GAAP measure which is defined below under "Non-GAAP Measurements - Operating Netback".

The operating netback was $28.83/boe for the three months ended June 30, 2018 compared to $30.37/boe in the same period of 2017. The operating netback prior to hedging loss increased for the three months ended June 30, 2018 as a result of a higher average realized price partially offset by the increase in royalties, operating and transportation expenses in the current quarter. This increase was offset by the realized hedging losses incurred in the second quarter of 2018, resulting in a lower operating netback for the second quarter of 2018.

For the first six months of 2018, the operating netback was $24.51/boe compared to $29.05/boe in the same period of 2017, this decrease is largely attributable to the realized hedging losses incurred in the first six month of 2018.

General and Administrative (G&A) Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s except per boe)				
Gross G&A expense	**820**	820	**1,778**	1,645
Capitalized G&A (direct)	**(146)**	(160)	**(296)**	(337)
G&A expense (net)	**674**	660	**1,482**	1,308
G&A expense (net) *($/boe)*	**3.34**	2.54	**3.70**	2.46

Gross G&A expense totaled $0.8 million for the second quarter of 2018 compared to $0.8 million in the second quarter of 2017. Net G&A costs were $0.7 million or $3.34/boe in the second quarter of 2018 compared to $0.7 million or $2.54/boe in the second quarter of 2017. Both gross and net G&A costs were consistent with the second quarter of 2017.

Net G&A expense for the first six months of 2018 totaled $1.5 million or $3.70/boe compared to $1.3 million or $2.46/boe in the same period of 2017. The increase in net G&A is attributable to bad debt expense incurred as well as higher legal costs in the first quarter of 2018.

The Company capitalized direct G&A expenses amounting to $0.1 million in the second quarter of 2018 as compared to $0.2 million in the second quarter of 2017.

During the six months ended June 30, 2018, the Company capitalized $0.3 million in direct costs related to its exploration and development efforts compared to $0.3 million in the same period of 2017.

Share-Based Compensation

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s except per boe)				
Gross share-based compensation	**59**	1,680	**1,007**	2,876
Capitalized share-based compensation	**(24)**	(792)	**(445)**	(1,355)
Share-based compensation expense (net)	**35**	888	**562**	1,521
Share-based compensation expense (net) *($boe)*	**0.17**	3.41	**1.40**	2.86

The Company's Share Incentive Plan ("SIP") is made up of both time-based awards ("TBA") and performance-based awards ("PBA"). The awards granted under the SIP vest one third on each of the first, second and third anniversaries of the grant date. Each PBA granted is subject to a performance multiplier ranging from 0 to 2, dependent on the performance of Granite at the end of the vesting period relative to corporate performance measures determined at the discretion of Granite's Board of Directors. The fair value of the awards granted under the plan is estimated at the grant date using a binomial pricing model. At June 30, 2018, the Company had 1,164,244 awards outstanding under the SIP.

Share-based compensation expense is a non-cash expense that reflects the amortization over the vesting period of the fair value of stock options and share incentives granted to the Company's employees, consultants and directors.

For the quarter ended June 30, 2018, the Company incurred net share-based compensation expense of $0.04 million or $0.17/boe versus $0.9 million or $3.41/boe in the same period of 2017. The decrease from the second quarter of 2017 is the result of the effect of changes in the estimated performance multiplier as well as the effect of the true-up of the performance multiplier on vested share incentives in 2017. In the second quarter of 2018 the estimated performance multiplier for all PBAs is 1.2.

During the first six months of 2018, Granite incurred net share based compensation of $0.6 million or $1.40/boe compared to $1.5 million or $2.86/boe in the same period in the prior year.

Depletion and Depreciation (D&D) Expense

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Depletion and depreciation expense *($000s)*	**3,509**	4,120	**7,034**	8,476
Depletion and depreciation expense *($/boe)*	**17.39**	15.84	**17.58**	15.97

For the three months ended June 30, 2018, the Company recorded D&D expense of $3.5 million or $17.39/boe compared to $4.1 million or $15.84/boe in the same period of 2017. The change in the D&D expense year-over-year is attributable to lower production in the second quarter of 2018 as well as the impact of the changes in future development costs and total Company reserves over the same period.

For the six months ended June 30, 2018, the Company recorded D&D expense of $7.0 million or $17.58/boe as compared to $8.5 million or $15.97/boe in the same period in the prior year.

Exploration and Evaluation (E&E) Expense

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Exploration and evaluation expense *($000s)*	**393**	3,184	**1,975**	3,477
Exploration and evaluation expense *($/boe)*	**1.95**	12.24	**4.94**	6.55

During the second quarter of 2018, the Company recorded E&E expense of $0.4 million or $1.95/boe compared to $3.2 million or $12.24/boe in the second quarter of 2017. The E&E expense recognized in the current quarter relates entirely to lease expiries.

During the six months ended June 30, 2018, the Company recorded E&E expense of $2.0 million or $4.94/boe compared to $3.5 million or $6.55/boe in the comparable period of 2017.

Accretion and Finance Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s except per boe)				
Accretion expense on decommissioning liabilities	**80**	75	**159**	150
Finance expense	**699**	495	**1,173**	813
Total accretion and finance expenses	**779**	570	**1,332**	963
Accretion expense on decommissioning liabilities *($/boe)*	**0.40**	0.29	**0.40**	0.28
Finance expense *($/boe)*	**3.47**	1.90	**2.93**	1.53
Total accretion and finance expenses *($/boe)*	**3.87**	2.19	**3.33**	1.81

Accretion expense represents the increase in the present value of the Company's decommissioning liabilities. In the second quarter of 2018, the Company recorded accretion expense of $0.08 million or $0.40/boe compared to $0.08 million or $0.29/boe in the same period of 2017.

For the first six months of 2018, the Company recorded accretion expense of $0.2 million or $0.40/boe compared to $0.2 million or $0.28/boe in the comparable period of 2017.

During the three months ended June 30, 2018, the Company recorded interest and finance expenses of $0.7 million or $3.47/boe compared to $0.5 million or $1.90/boe in the same period of 2017.

For both the three and six months ended, the Company incurred interest charges and standby fees related to the Company's credit facility which was drawn to $44.9 million at the end of the quarter (December 31, 2017 – $36.4 million, June 30, 2017 - $35.4 million).

Income Taxes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
Deferred income tax expense (recovery) *($000s)*	**(25)**	331	**(653)**	1,521
Deferred income tax expense (recovery) *($/boe)*	**(0.12)**	1.27	**(1.63)**	2.87

During the second quarter of 2018, the Company recorded a deferred income tax recovery of $0.03 million or $0.12/boe as compared to a $0.3 million expense or $1.27/boe in the same period of 2017. The deferred income tax recovery is a function of the loss incurred in the second quarter of 2018.

During the six months ended June 30, 2018, the Company recorded a deferred income tax recovery of $0.7 million or $1.63/boe compared to a $1.5 million expense or $2.87/boe in the same period in the prior year. The deferred income tax recovery is a function of the loss incurred in the first six months of 2018.

Granite does not have current income taxes payable and does not expect to pay current income taxes in 2018 as the Company had estimated tax pools available at June 30, 2018 of $189.0 million (December 31, 2017 – $187.3 million).

INVESTMENT AND INVESTMENT EFFICIENCIES

Capital Expenditures and Acquisitions

(excluding decommissioning liabilities and capitalized share-based compensation)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s except number of wells)				
Drilling and completions	**4,800**	4,138	**6,579**	8,264
Equipment and facilities	**478**	1,838	**1,136**	2,254
Workovers and gas injection conversion	**432**	369	**1,266**	1,079
Land and lease retention	**–**	–	**18**	–
Capitalized G&A and other	**131**	161	**303**	375
Total exploration and development	**5,841**	6,506	**9,302**	11,972
Property and equipment acquisitions, dispositions and adjustments	**–**	(660)	**–**	(1,335)
Total capital expenditures	**5,841**	5,846	**9,302**	10,637
Total wells drilled *(#)*	**2 (2.0)**	3 (3.0)	**3 (3.0)**	6 (6.0)

During the second quarter of 2018, the Company incurred a total of $5.8 million (second quarter 2017 – $5.8 million) in capital expenditures, excluding non-cash decommissioning liabilities and capitalized share-based compensation. Drilling and completion expenditures totaled $4.8 million in the second quarter of 2018 (second quarter 2017 – $4.1 million), $0.5 million was spent on tie-ins and facilities (second quarter 2017 – $1.8 million) and $0.4 million related to workovers and gas injection conversions (second quarter 2017 – $0.4 million). The remaining $0.1 million in the second quarter of 2018 (second quarter 2017 – $0.2 million) was invested in capitalized G&A and other corporate assets.

During the six months ended June 30, 2018, the Company incurred a total of $9.3 million (2017 – $10.6 million) in capital expenditures, excluding non-cash decommissioning liabilities, capitalized share-based compensation and property and equipment acquisitions, dispositions and adjustments. Drilling and completion expenditures totaled $6.6 million (2017 – $8.3 million), $1.1 million was spent on tie-ins and facilities (2017 – $2.3 million), $1.3 million related to workovers and gas injection conversion (2017 - $1.1 million). The remaining $0.3 million in the six months ended June 30, 2018 (2017 – $0.4 million) was invested in capitalized G&A, other corporate assets and lease and land retention.

Drilling Activity

During the three months ended June 30, 2018, Granite drilled a total of 2 gross (2.0 net) crude oil development wells with a 100 percent success rate. During the three months ended June 30, 2017, Granite drilled a total of 3 gross (3.0 net) crude oil development wells with a 100 percent success rate.

During the six months ended June 30, 2018, Granite drilled a total of 3 gross (3.0 net) crude oil development wells with a 100 percent success rate. During the six months ended June 30, 2017, the Company drilled 6 gross (6.0 net) crude oil development wells with a 100 percent success rate.

LIQUIDITY AND FINANCIAL RESOURCES

Net Debt [1]

The following table summarizes net debt as at June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
($000s)		
Working capital deficiency	**(2,221)**	(3,488)
Bank debt	**(44,851)**	(36,351)
Net debt [1] – end of period	**(47,072)**	(39,839)

(1) Net debt, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets (excluding derivative financial instruments), is not a recognized measure under IFRS. Please refer to the commentary under “Non-GAAP Measurements” for further discussion.

Granite entered 2018 with net debt of $39.8 million. During the six months ended June 30, 2018, the Company generated funds from operations of $6.8 million, invested $9.3 million in capital expenditures and paid $4.7 million in dividends. Granite exited the quarter with net debt of $47.1 million.

As at June 30, 2018, and December 31, 2017, Granite’s credit facility has an authorized borrowing base of $50 million consisting of a $45 million revolving demand credit facility and a $5 million revolving demand operating facility. At June 30, 2018, Granite’s credit facility was drawn to approximately $44.9 million, including letters of credit of $0.3 million, the Company had $45.2 million committed against the facility with $4.8 million of unused borrowing capacity.

Interest is charged at a rate per annum equal to the Canadian prime rate during said period plus the applicable margin, being a range of 1.5 percent to 3.0 percent, as determined by the Company’s debt to cash flow ratio. Standby fees associated with this facility are charged based on an applicable margin, being a range of 0.63 percent to 1.0 percent per annum on the undrawn portion of the facility, based on the Company’s debt to cash flow ratio. Under this credit facility, the Company is required to maintain a current ratio of not less than 1:1. The Company had no defaults or breaches on its bank debt or any of its financial liabilities as at or for the six months ended June 30, 2018.

The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders as well as other factors. The borrowing base of the Company’s demand credit facility is subject to an annual review and semi-annual review. The annual review was completed in April 2018 with the borrowing base unchanged and with two lenders in the syndicate. An additional borrowing base review is currently underway by the syndicate and is expected to be completed on or before August 30, 2018. Indications are that the borrowing base and availability under the facility will remain unchanged following the review and that the next borrowing base review will be the annual review scheduled for April 2019. Collateral for this facility has been provided for by, among other things, a demand debenture in the principal amount of $500,000,000 from Granite granting a floating charge over all present and after-acquired real and personal property of Granite, and a negative pledge and undertaking to provide fixed charges on major producing petroleum and natural gas reserves.

The Company manages its liquidity through continuously monitoring cash flows from operating activities, review of actual capital expenditures against budget, managing maturity profiles of financial assets and financial liabilities and managing its commodity price risk management program. These activities ensure that the Company has sufficient funds to meets its financial obligations when due. The Company anticipates that it will continue to have adequate liquidity to fund its financial liabilities through its future cash flows from operations and available bank debt.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Years Ended December 31,	2018	2019	2020	Total
($000s)				
Operating lease – office	109	218	218	545
Total commitments	109	218	218	545

As at June 30, 2018, the Company had contractual obligations for its office leases totaling approximately $0.5 million to December 2020. The office lease obligations are comprised of the lease payments and an estimate of occupancy costs of the Company's head office space.

SHARE CAPITAL

As at August 9, 2018, the Company had the following equity securities outstanding:

Common shares outstanding	34,190,652
Share incentives outstanding	1,164,244

SELECTED QUARTERLY INFORMATION [1]

Three Months Ended	**Jun. 30, 2018**	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017	Dec. 31, 2016	Sept. 30, 2016
(000s, except per share amounts and production figures)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**14,094**	10,675	11,752	12,676	13,788	14,451	14,072	11,582
Funds from operations	**4,089**	2,711	4,815	6,218	6,743	6,560	6,203	6,061
Per share – basic	**0.12**	0.08	0.14	0.18	0.20	0.19	0.18	0.18
Per share – diluted	**0.12**	0.08	0.14	0.18	0.20	0.19	0.18	0.18
Cash flow from operating activities	**3,791**	3,957	6,952	5,028	4,847	6,086	6,405	8,819
Net income (loss)	**(361)**	(3,353)	(4,896)	(2,996)	(116)	2,500	(1,061)	1,052
Per share – basic	**(0.01)**	(0.10)	(0.14)	(0.09)	(0.00)	0.07	(0.03)	0.03
Per share – diluted	**(0.01)**	(0.10)	(0.14)	(0.09)	(0.00)	0.07	(0.03)	0.03
Total assets	**283,365**	279,417	281,171	287,166	292,618	292,175	291,051	290,594
Capital expenditures [2]	**5,841**	3,461	4,582	3,531	5,846	4,791	5,326	6,244
Net debt [3]	**47,072**	42,949	39,839	36,893	35,985	33,359	31,763	29,323
Shareholders' equity	**192,730**	195,391	200,155	207,266	212,735	214,680	214,346	218,198
Dividends declared (per share)	**0.0690**	0.0690	0.0930	0.1050	0.1050	0.1050	0.1050	0.1050
Production								
Natural gas (mcf/d)	**121**	289	–	499	448	730	299	145
Crude oil (bbls/d)	**2,197**	2,157	2,151	2,579	2,784	2,887	2,928	2,728
Total (boe/d)	**2,217**	2,205	2,151	2,662	2,859	3,009	2,978	2,752

(1) The selected quarterly information was prepared in accordance with the accounting principles described in the notes to the financial statements, except for funds from operations and net debt, which is not prescribed under IFRS (see "Non-GAAP Measurements" below).

(2) Total capital expenditures, excluding acquisitions and non-cash transactions. Refer to commentary under "Capital Expenditures" for further information.

(3) Net debt, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets (excluding derivative financial instruments), is not a recognized measure under IFRS. Please refer to the commentary under "Non-GAAP Measurements" for further discussion.

BUSINESS RISKS AND RISK MITIGATION

The Granite management team conducts focused strategic planning and has identified the key risks, uncertainties and opportunities associated with the Company's business that can affect its financial results. They include, but are not limited to:

Reserves Estimates

There are numerous uncertainties inherent in estimating quantities of crude oil, natural gas and natural gas liquids reserves and the future cash flows attributed to such reserves. The reserves and associated cash flow information set forth are estimates only. Generally, estimates of economically recoverable crude oil, natural gas and natural gas liquids reserves and the future net cash flows from such estimates are based upon a number of variable factors and assumptions, such as:

- historical production from the properties;
- production rates;
- ultimate reserve recovery;
- timing and amount of capital expenditures;
- commodity prices;
- marketability of and demand for oil and natural gas;
- royalty rates and applicable taxation schemes; and
- the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary materially from actual results.

For those reasons, estimates of the economically recoverable crude oil, natural gas and natural gas liquids reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues associated with reserves prepared by different engineers, or by the same engineers at different times may vary. Granite's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material.

The estimation of proved reserves that may be developed and produced in the future is often based upon volumetric calculations and upon analogy to similar types of reserves rather than actual production history. Recovery factors and drainage areas may be estimated by experience and analogy to similar producing horizons. Estimates based on these methods are generally less reliable than those based on actual production history. Subsequent evaluation of the same reserves based upon production history and production practices may result in variations in the estimated reserves. Such variations could be material.

In accordance with Canadian securities laws, Granite's independent qualified reserves evaluator has used forecast prices and costs in estimating the reserves and future net cash flows as summarized. Actual future net cash flows will be affected by other factors, such as actual production levels, supply and demand for oil and natural gas, the market prices of oil and natural gas, curtailments or increases in consumption by oil and natural gas purchasers, changes in governmental regulation or taxation and the impact of inflation on costs.

Actual production and cash flow derived from Granite's crude oil, natural gas and natural gas liquids reserves will vary from the estimates contained in the reserves evaluation, and such variations could be material. The reserves evaluation is based in part on the assumed success of activities undertaken in future years. The reserves and estimated cash flows to be derived therefrom and contained in the Sproule Report will be reduced to the extent that such activities do not achieve the level of success assumed in the reserve evaluation. The Sproule Report is effective as of December 31, 2017 with a preparation date of March 5, 2018, and, except as may be specifically stated or required by Canadian securities laws, has not been updated and therefore does not reflect changes in the reserves since that date.

Prices, Markets and Marketing

There are a number of factors that are beyond Granite's control which affect the price and marketability of oil and natural gas acquired, discovered or produced by the Company. In Canada, the producers of oil are entitled to negotiate sales contracts directly with oil purchasers, with the result that the market determines the price of oil. The Company's ability to market its oil and natural gas may depend upon its ability to acquire capacity on pipelines that deliver natural gas to commercial markets or contract for the delivery of crude oil by rail. Deliverability uncertainties relate to the distance of the Company's reserves from pipelines, railway lines, processing and storage facilities operational problems affecting pipelines, railway lines and facilities; and government regulation relating to prices, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and expansion of pipelines. The Company's financial performance is substantially dependent on the marketability and prevailing prices of crude oil and natural gas.

Minor fluctuations in the supply and demand for oil and natural gas, market uncertainty, and the availability of access to local and foreign markets, among other factors listed below, result in large fluctuations in the price of oil and natural gas. Additional factors affecting the price of oil and natural gas may include, among others, economic and political conditions in the United States, Canada, Europe, China and emerging markets, the actions of the Organization of the Petroleum Exporting Countries ("OPEC"), governmental regulation, political stability in the Middle East, Northern Africa, South America and elsewhere, the foreign supply and demand of oil and natural gas, the price of foreign imports and the availability of alternative fuel sources.

It is anticipated that oil prices will remain volatile as a result of global excess supply due to the increased growth of shale oil production in the United States, the decline in global demand for oil exports, OPEC's recent decisions pertaining to the oil production of OPEC member countries, and non-OPEC member countries' decisions on production levels, and political instability in certain oil and natural gas producing countries, among other factors. Volatile crude oil and natural gas prices make it difficult to estimate the value of producing properties for development and acquisition activities and often cause disruption in the acquisition, divestiture or leasing of petroleum and natural gas producing properties, as buyers, sellers, lessors and lessees have difficulty agreeing on the value or terms of such arrangements. Price volatility also makes it difficult to budget for and project the return on potential acquisitions, development and exploration projects.

The factors discussed above could result in a material decrease in Granite's net production revenue and a reduction in its oil and natural gas acquisition, development, exploration and production activities. Any substantial or extended decline in oil and natural gas prices could result in a reduction of the Company's net revenue and have an adverse effect on the carrying value of its reserves, borrowing capacity, revenue, profitability, cash flow from operations and prospects. Additionally, the economics of production may change as a result of continued lower or volatile commodity prices, which could result in reduced production volumes and a reduction in the general value of the Company's reserves.

In addition to the risks listed and discussed above, Granite is subject to several other risks and uncertainties which are described in detail in the Company's Annual Information Form (AIF) dated March 22, 2018.

Access to Capital

The oil and natural gas industry is a very capital-intensive industry and, in order to fully realize the Company's strategic goals and business plans, Granite will rely on equity markets as a source of new capital in addition to bank financing and internally generated cash flow to fund its ongoing capital investments. Granite's ability to raise additional capital will depend on a number of factors that are beyond the Company's control, such as general economic and market conditions. Internally generated funds will also fluctuate with changing commodity prices.

Granite currently has a demand credit facility with two banks. The amount authorized under Granite's credit facility is dependent on the borrowing base determined by its lenders. Granite is required to comply with covenants under its credit facilities which may, in certain cases, include certain financial ratio tests, which from time to time either affect the availability or price of additional funding and in the event that Granite does not comply with these covenants, its access to capital could be restricted or repayment could be required. Events beyond Granite's control may contribute to a failure to comply with such covenants. A failure to comply with covenants could result in a default under the credit facility, which could result in Granite being required to repay amounts owing thereunder. Even if Granite is able to obtain new financing in such circumstances, it may not be on commercially reasonable terms or on terms that are acceptable to the Company. If Granite is unable to repay amounts owing under the credit facility or other credit agreements, its lenders could proceed to foreclose or otherwise realize upon the collateral granted to them to secure the indebtedness. The acceleration of indebtedness under one agreement may permit acceleration of indebtedness under other agreements that contain cross default or cross-acceleration provisions. In addition, the credit facility and other credit agreements may impose operating and financial restrictions on the Company that could include restrictions on the payment of dividends, the repurchase or making of other distributions with respect to Granite's securities, incurring of additional indebtedness, the provision of guarantees, the assumption of loans, making of capital expenditures, entering into of amalgamations, mergers, take-over bids or disposition of assets, among other restrictions. Granite routinely reviews the covenants under its credit facility based on actual and forecast results and has the ability to make changes to development plans to comply with such covenants. Granite anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and available bank credit. Granite is committed to maintaining a strong balance sheet along with an adaptable capital expenditure program that can be adjusted to capitalize on, or reflect, acquisition opportunities and, if necessary, a tightening of liquidity sources. From its founding to the date of this MD&A, Granite has had no defaults or breaches on its bank debt or any of its financial liabilities.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's financial statements requires management to adopt accounting policies that involve the use of significant estimates and assumptions. They are developed based on the best available information and are believed by management to be reasonable under the circumstances. New events or additional information may result in the revision of these estimates over time. Granite's financial and operating results incorporate certain estimates, including:

- Estimated revenues, royalties and operating expenses on production as at a specific reporting date but for which actual revenues and costs have not yet been received;
- Estimated capital expenditures on projects that are in progress;
- Estimated D&D charges that are based on estimates of oil and gas reserves that Granite expects to recover in the future;
- Estimated fair values of financial instruments that are subject to fluctuation depending on underlying commodity prices, foreign exchange rates and interest rates, volatility curves and the risk of non-performance;
- Estimated value of decommissioning liabilities that depend on estimates of future costs and timing of expenditures;
- Estimated future recoverable value of PP&E and any associated impairment charges or recoveries; and
- Estimated compensation expense under Granite's share-based compensation plan.

Granite has hired individuals and consultants who have the skills required to make such estimates and ensures that individuals or departments with the most knowledge of the activity are responsible for the estimates. Further, past estimates are reviewed and compared to actual results, and actual results are compared to budget in order to make more informed decisions on future estimates. For further information on certain estimates inherent in the financial statements, refer to note 2 in the audited financial statements for the years ended December 31, 2017 and 2016.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting is a process designed to provide reasonable assurance that all the assets are safeguarded and transactions are appropriately authorized, and to facilitate the preparation of relevant, reliable and timely information. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Granite is required to comply with National Instrument 52-109 – "Certification of Disclosure in Issuers' Annual and Interim Filings" and, under the supervision of the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), Granite assessed the effectiveness of the Company's internal control over financial reporting as defined by this instrument. The assessment was based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The certification of interim filings for the interim period ended June 30, 2018 requires that Granite disclose in the interim MD&A any changes in the Company's internal control over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect, Granite's internal control over financial reporting. Granite confirms that no such changes were made to its internal controls over financial reporting during the three or six months ended June 30, 2018.

It should be noted that while Granite's CEO and CFO believe that the Company's internal controls and procedures provide a reasonable level of assurance and are effective, they do not expect that these controls will prevent all errors or fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that its objectives are met.

ACCOUNTING POLICY CHANGES

The Company retrospectively adopted IFRS 9 "Financial Instruments" effective January 1, 2018, and did not result in a change in the carrying value of any of the Company's financial instruments. IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The previous IAS 39 categories of held to maturity, loans and receivables and available for sale are eliminated. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9. IFRS 9 has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial recognition. The adoption of the expected credit loss impairment model did not have an impact on the financial statements of the Company. Accounts receivable, accounts payable, bank debt and dividend payable are classified and measured at amortized cost. Risk management contacts are classified and measured at FVTPL. The Company does not have any asset contracts and debt investments measured at FVOCI. IFRS 9 also contains a new hedge accounting model, however the Company did not apply hedge accounting to any of its risk management contracts.

The Company adopted IFRS 15 "Revenue from Contracts with Customers" on January 1, 2018, using the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue contracts with customers using the principle based five-step model, which did not result in any material impact on the financial statements. The adoption expands disclosures in the notes to the condensed interim financial statements as prescribed by IFRS 15 to provide additional information on the Company's revenue streams and contractual arrangements.

As a result of this adoption, Granite has revised the description of its accounting policy for revenue recognition as follows:

Revenue from the sale of petroleum and natural gas is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when Granite satisfies a performance obligation by transferring a promised good or service to a customer. This is generally at the time when the customer obtains legal title to the product and when it is physically transferred to the custody transfer point agreed with the customer, often terminals, pipelines or other transportation methods.

FUTURE ACCOUNTING POLICY CHANGES

In January 2016, IFRS 16 "Leases" was issued and replaces IAS 17. The standard is required to be adopted either retrospectively or by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application. IFRS 16 is effective for fiscal years beginning on or after January 1, 2019 with earlier adoption permitted if IFRS 15 "Revenue from Contracts with Customers" has also been adopted. The Company is currently identifying contracts that will be identified as leases and evaluating the impact of the standard on the financial statements.

NON- GAAP MEASUREMENTS

Funds from Operations

This MD&A contains the terms "funds from operations" and "funds from operations per share", which should not be considered an alternative to or more meaningful than cash flow from operating activities as determined in accordance with IFRS. These terms do not have any standardized meaning under IFRS. Granite's determination of funds from operations and funds from operations per share may not be comparable to that reported by other companies. Management uses funds from operations to analyze operating performance and leverage, and considers funds from operations to be a key measure as it demonstrates the Company's ability to generate cash necessary to fund future capital investments and to repay debt, if applicable. Funds from operations is calculated using cash flow from operating activities as presented in the statement of cash flows, before changes in non-cash working capital. Granite presents funds from operations per share whereby per share amounts are calculated using weighted-average shares outstanding.

The following table reconciles funds from operations with cash flow from operating activities, which is the most directly comparable measure calculated in accordance with IFRS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s)				
Cash flow from operating activities	**3,791**	4,847	**7,748**	10,930
Changes in non-cash working capital	**298**	1,896	**(948)**	2,373
Funds from operations	**4,089**	6,743	**6,800**	13,303

Operating Netback

Operating netback is a per boe measure used in operational and capital allocation decisions. Management believes that the Company's operating netback is the most useful supplemental measure as compared to other netback measures presented by the Company in previous MD&A's as it assists in analyzing the Company's operating performance. Operating netbacks are determined by deducting royalties, operating expenses and transportation expenses from oil and gas revenue and adjusted for any realized hedging gain (loss) on financial instruments.

Net Debt

Net debt, which represents current liabilities (excluding derivative financial instruments) and bank debt less current assets (excluding derivative financial instruments), is used to assess efficiency, liquidity and the Company's general financial strength. No IFRS measure is reasonably comparable to net debt.

OTHER MEASUREMENTS

All financial figures are in Canadian dollars. Where amounts are expressed on a barrel of oil equivalent (boe) basis, natural gas volumes have been converted to oil equivalence at 6,000 cubic feet of gas to 1 barrel of oil. This conversion ratio of 6:1 is based on an energy-equivalent conversion for the individual products, primarily applicable at the burner tip, and does not represent a value equivalency at the wellhead. Such disclosure of boe may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

FORWARD-LOOKING INFORMATION AND STATEMENTS

Certain statements in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

In particular, this MD&A contains forward-looking statements pertaining to the following: projections of market prices and costs, supply and demand for natural gas and crude oil, the quantity of reserves, natural gas and crude oil production levels, capital expenditure programs, treatment under governmental regulatory and taxation regimes, and expectations regarding the Company's ability to raise capital and to continually add to reserves through acquisitions and development.

With respect to forward-looking statements in this MD&A, the Company has made assumptions regarding, among other things, the legislative and regulatory environments of the jurisdictions where the Company carries on business or has operations, the impact of increasing competition and the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors discussed in this MD&A, such as: volatility in the market prices for natural gas and crude oil; uncertainties associated with estimating reserves; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks inherent in natural gas and crude oil operations; incorrect assessments of the value of acquisitions; and competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel. In addition, test results are not necessarily indicative of long-term performance or of ultimate recovery.

This forward-looking information represents the Company's views as of the date of this MD&A and such information should not be relied upon as representing its views as of any subsequent date. Granite has attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. There may be other factors, however, that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as expressly required by applicable securities legislation.

Additional information regarding the Company and factors that could affect its operations and financial results are included in reports on file with Canadian securities regulatory authorities, including the Company's Annual Information Form, and may be accessed through the SEDAR website (www.sedar.com), or at the Company's website (www.graniteoil.ca). Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

STATEMENTS OF FINANCIAL POSITION
(Unaudited)

As at	**June 30, 2018**	December 31, 2017
(000s)	*($)*	*($)*
ASSETS		
Current assets		
Accounts receivable	**6,281**	5,146
Deposits and prepaid expenses	**803**	671
	7,084	5,817
Non-current assets		
Exploration and evaluation assets (note 4)	**19,078**	21,031
Property and equipment (note 5)	**257,203**	254,323
Total assets	**283,365**	281,171
LIABILITIES		
Current liabilities		
Bank debt (note 6)	**44,851**	36,351
Accounts payable and accrued liabilities	**8,519**	8,519
Dividend payable	**786**	786
Derivative financial instruments (note 12)	**4,606**	2,831
	58,762	48,487
Non-current liabilities		
Decommissioning liabilities (note 7)	**13,688**	13,691
Deferred tax liability	**18,185**	18,838
Total liabilities	**90,635**	81,016
SHAREHOLDERS' EQUITY		
Share capital (note 8)	**413,891**	413,891
Contributed surplus	**19,619**	18,613
Deficit	**(240,780)**	(232,349)
Total shareholders' equity	**192,730**	200,155
Total liabilities and shareholders' equity	**283,365**	281,171

Subsequent Events (Note 12)

See accompanying notes to the condensed interim financial statements.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended June 30, **2018**	2017	Six Months Ended June 30, **2018**	2017
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*
REVENUE				
Oil and natural gas revenues (note 10)	**14,094**	13,788	**24,769**	28,239
Royalties	**(3,595)**	(3,114)	**(6,129)**	(7,208)
Oil and natural gas revenues, net of royalties	**10,499**	10,674	**18,640**	21,031
Unrealized gain (loss) on financial instruments	**(811)**	1,739	**(1,790)**	4,226
Realized gain (loss) on financial instruments	**(1,952)**	(158)	**(3,378)**	(611)
	7,736	12,255	**13,472**	24,646
EXPENSES				
Operating and transportation	**2,732**	2,618	**5,454**	4,996
General and administrative	**674**	660	**1,482**	1,308
Depletion and depreciation (note 5)	**3,509**	4,120	**7,034**	8,476
Share-based compensation (note 9)	**35**	888	**562**	1,521
Exploration and evaluation expense (note 4)	**393**	3,184	**1,975**	3,477
Accretion and finance expenses	**779**	570	**1,332**	963
	8,122	12,040	**17,839**	20,741
Income (loss) before income tax	**(386)**	215	**(4,367)**	3,905
TAXES				
Deferred income tax expense (recovery)	**(25)**	331	**(653)**	1,521
Net income (loss) and comprehensive income (loss) for the period	**(361)**	(116)	**(3,714)**	2,384
Net income (loss) per share (note 8)				
Basic	**(0.01)**	(0.00)	**(0.11)**	0.07
Diluted	**(0.01)**	(0.00)	**(0.11)**	0.07

See accompanying notes to the condensed interim financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

	Share Capital	Contributed Surplus	Deficit	Total Equity
(000s)	*($)*	*($)*	*($)*	*($)*
Balance – January 1, 2018	**413,891**	**18,613**	**(232,349)**	**200,155**
Share-based compensation (note 9)	**–**	**1,006**	**–**	**1,006**
Dividends	**–**	**–**	**(4,717)**	**(4,717)**
Net loss	**–**	**–**	**(3,714)**	**(3,714)**
Balance – June 30, 2018	**413,891**	**19,619**	**(240,780)**	**192,730**
Balance – January 1, 2017	411,036	16,287	(212,977)	214,346
Share-based compensation	–	2,876	–	2,876
Issued on vesting of share incentives	2,453	(2,453)	–	–
Exercise of options	278	(56)	–	222
Dividends	–	–	(7,093)	(7,093)
Net income	–	–	2,384	2,384
Balance – June 30, 2017	413,767	16,654	(217,686)	212,735

See accompanying notes to the condensed interim financial statements.

STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017
(000s)	*($)*	*($)*	*($)*	*($)*
Cash flow from (used in):				
Operating activities				
Net income (loss) for the period	**(361)**	(116)	**(3,714)**	2,384
Adjustments for:				
Depletion and depreciation expense (note 5)	**3,509**	4,120	**7,034**	8,476
Deferred income tax expense (recovery)	**(25)**	331	**(653)**	1,521
Share-based compensation (note 9)	**35**	888	**562**	1,521
Accretion (note 7)	**80**	75	**159**	150
Unrealized (gain) loss on financial instruments	**811**	(1,739)	**1,790**	(4,226)
Exploration and evaluation expense (note 4)	**393**	3,184	**1,975**	3,477
Abandonment and reclamation costs (note 7)	**(353)**	–	**(353)**	–
	4,089	6,743	**6,800**	13,303
Change in non-cash working capital (note 11)	**(298)**	(1,896)	**948**	(2,373)
	3,791	4,847	**7,748**	10,930
Financing activities				
Change in bank debt	**5,107**	7,139	**8,500**	7,489
Dividends paid	**(2,358)**	(3,540)	**(4,717)**	(7,078)
Issuance of share capital	**–**	46	**–**	222
	2,749	3,645	**3,783**	633
Investing activities				
Property and equipment expenditures, net of dispositions	**(5,822)**	(5,806)	**(9,226)**	(10,572)
Exploration and evaluation expenditures, net of dispositions	**(19)**	(40)	**(76)**	(65)
Changes in non-cash working capital (note 11)	**(686)**	(2,632)	**(2,215)**	(912)
	(6,527)	(8,478)	**(11,517)**	(11,549)
Foreign exchange gain on cash and cash equivalents held in foreign currency	**(13)**	(14)	**(14)**	(14)
Change in cash and cash equivalents	**–**	–	**–**	–
Cash and cash equivalents – beginning of period	**–**	–	**–**	–
Cash and cash equivalents – end of period	**–**	–	**–**	–
Interest paid	**532**	302	**1,074**	602

See accompanying notes to the condensed interim financial statements.

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

As at and for the three and six month periods ended June 30, 2018
(Unaudited)

1 REPORTING ENTITY

Granite Oil Corp. ("Granite" or the "Company") is a publicly traded company incorporated under the laws of Alberta. The Company is principally engaged in the exploration for and exploitation, development and production of oil and natural gas, and conducts some of its activities jointly with others. These condensed interim financial statements reflect only the Company's interests in such activities. Granite is registered and domiciled in Canada. Its main office is at 3230, 308 Fourth Avenue S.W., Calgary, Alberta, T2P 0H7.

2 BASIS OF PRESENTATION

(a) Statement of Compliance

These condensed interim financial statements for the three and six months ended June 30, 2018, were prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as issued by the International Accounting Standards Board (IASB).

The condensed interim financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2017.

These condensed interim financial statements were authorized for issuance by the Board of Directors on August 9, 2018.

(b) Basis of Measurement

The condensed interim financial statements of Granite were prepared on the historical cost basis, except for derivative financial instruments, which are measured at fair value. The methods used to measure fair values are discussed in note 12.

(c) Use of Estimates and Judgements

Significant estimates and judgements made by management in the preparation of these condensed interim financial statements remain unchanged and are outlined in Note 2 of the December 31, 2017, audited annual financial statements.

3 SIGNIFICANT ACCOUNTING POLICIES

(a) Current Accounting Policies

The Company's accounting policies are described in Note 3 of the December 31, 2017, audited annual financial statements. Those accounting policies have been applied consistently to all periods presented in these condensed interim financial statements with the exception of the adoption of the following new standards effective as at January 1, 2018:

The Company retrospectively adopted IFRS 9 "Financial Instruments" effective January 1, 2018 and this did not result in a change in the carrying value of any of the Company's financial instruments. IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The previous IAS 39 categories of held to maturity, loans and receivables and available for sale are eliminated. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9. IFRS 9 has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial recognition. The adoption of the expected credit loss impairment model did not have an impact on the financial statements of the Company. Accounts receivable, accounts payable, bank debt and dividend payable are classified and measured at amortized cost. Risk management contacts are classified and measured at FVTPL. The Company does not have any asset contracts and debt investments measured at FVOCI. IFRS 9 also contains a new hedge accounting model, however the Company did not apply hedge accounting to any of its risk management contracts.

The Company adopted IFRS 15 “Revenue from Contracts with Customers” on January 1, 2018, using the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue contracts with customers using the principle based five-step model, which did not result in any material impact on the financial statements. The adoption expands disclosures in the notes to the condensed interim financial statements as prescribed by IFRS 15 to provide additional information on the Company’s revenue streams and contractual arrangements (see Note 10).

As a result of this adoption, Granite has revised the description of its accounting policy for revenue recognition as follows:

Revenue from the sale of petroleum and natural gas is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when Granite satisfies a performance obligation by transferring a promised good or service to a customer. This is generally at the time when the customer obtains legal title to the product and when it is physically transferred to the custody transfer point agreed with the customer, often terminals, pipelines or other transportation methods.

(b) Future Accounting Policy Changes

In January 2016, IFRS 16 “Leases” was issued and replaces IAS 17. The standard is required to be adopted either retrospectively or by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application. IFRS 16 is effective for fiscal years beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 “Revenue from Contracts with Customers” has also been adopted. The Company is currently identifying contracts that will be identified as leases and evaluating the impact of the standard on the financial statements.

4 EXPLORATION AND EVALUATION ASSETS

($000s)	**Six Months Ended June 30, 2018**	Year Ended December 31, 2017
Balance – beginning of period	**21,031**	36,889
Additions	**128**	622
Transfers to property and equipment (note 5)	**(106)**	(2,010)
E&E expenses	**(20)**	(1,318)
Lease expiries	**(1,955)**	(13,152)
Balance – end of period	**19,078**	21,031

E&E assets consist of the Company's exploration projects that are pending the determination of proved or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the year.

During the six month period ended June 30, 2018, the Company expensed $0.02 million in costs related to a dry and abandoned well location (year ended December 31, 2017 - $1.3 million) and expensed $2.0 million related to lease expiries on undeveloped land (year ended December 31, 2017 – $13.2 million).

During the six month period ended June 30, 2018, approximately $0.03 million of directly attributable general and administrative expense and $0.05 million of directly attributable share-based compensation expense were capitalized as expenditures on exploration and evaluation assets (year ended December 31, 2017 – $0.1 million and $0.3 million, respectively).

5 PROPERTY AND EQUIPMENT

($000s)	Oil and Natural Gas Properties	Office Equipment	Total
Cost			
Balance – January 1, 2017	326,121	534	326,655
Additions	20,823	16	20,839
Transfers from E&E assets (note 4)	2,010	–	2,010
Balance – December 31, 2017	**348,954**	**550**	**349,504**
Additions	**9,805**	**3**	**9,808**
Transfers from E&E assets (note 4)	**106**	**–**	**106**
Balance – June 30, 2018	**358,865**	**553**	**359,418**
Accumulated depletion and depreciation			
Balance – January 1, 2017	79,259	341	79,600
Depletion and depreciation for the year	15,534	47	15,581
Balance – December 31, 2017	**94,793**	**388**	**95,181**
Depletion and depreciation for the period	**7,013**	**21**	**7,034**
Balance – June 30, 2018	**101,806**	**409**	**102,215**
Net book value			
December 31, 2017	254,161	162	254,323
June 30, 2018	**257,059**	**144**	**257,203**

(a) Capitalization of General and Administrative & Share-Based Compensation Expenses

During the six month period ended June 30, 2018, approximately $0.3 million of directly attributable general and administrative expense and $0.4 million of directly attributable share-based compensation expense were capitalized as expenditures on property and equipment (year ended December 31, 2017 – $0.5 million and $2.0 million, respectively).

(b) Future Development Costs and Salvage Value

At June 30, 2018, an estimated $62.1 million of future development costs associated with proved plus probable undeveloped reserves were included in the calculation of depletion and depreciation expense and an estimated $9.5 million of salvage value of production equipment was excluded (December 31, 2017 – $68.3 million and $9.5 million, respectively).

6 BANK DEBT

At June 30, 2018, and December 31, 2017, the Company had a revolving demand credit facility (the "Credit Facility") with an authorized borrowing base of $50 million, including a $45 million revolving demand credit facility and a $5 million demand operating facility. Borrowings under the Credit Facility are classified as a current liability due to the demand nature of the Credit Facility.

Interest is charged at a rate per annum equal to the Canadian prime rate during said period plus the applicable margin, being a range of 1.50 percent to 3.00 percent, as determined by the Company's debt to cash flow ratio. Standby fees associated with the facility are charged based on an applicable margin, being a range of 0.63 percent to 1.0 percent per annum on the undrawn portion of the facility, based on the Company's debt to cash flow ratio. Under the Credit Facility, the Company is required to maintain a current ratio of not less than 1:1. The current ratio is calculated as current assets (excluding derivative financial instruments) plus any undrawn availability in the Credit Facility versus current liabilities (excluding derivative financial instruments and any amounts outstanding on the Credit Facility). At June 30, 2018, the Company was in compliance with the current ratio requirement.

At June 30, 2018, $44.9 million was drawn against this facility (December 31, 2017 – $36.4 million). Including letters of credit of $0.3 million, the Company had $45.2 million committed against the facility as at June 30, 2018 (December 31, 2017 - $36.4 million). The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders as well as other factors. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders as well as other factors. The borrowing base of the Company's demand credit facility is subject to an annual review and semi-annual review. The annual review was completed in April 2018 with the borrowing base unchanged and with two lenders in the syndicate. An additional borrowing base review is currently underway by the syndicate and is expected to be completed on or before August 30, 2018. Indications are that the borrowing base and availability under the facility will remain unchanged following the review and that the next borrowing base review will be the annual review scheduled for April 2019. Collateral for this facility has been provided for by, among other things, a demand debenture in the principal amount of $500,000,000 from Granite granting a floating charge over all present and after-acquired real and personal property of Granite, and a negative pledge and undertaking to provide fixed charges on major producing petroleum and natural gas reserves.

7 DECOMMISSIONING LIABILITIES

The Company has estimated the net present value of decommissioning obligations to be $13.7 million as at June 30, 2018 (December 31, 2017 – $13.7 million) based on an undiscounted total future liability of $18.9 million (December 31, 2017 – $19.0 million). These payments are expected to be incurred over a period of one to 20 years with the majority of costs to be incurred between 2028 and 2033. At June 30, 2018, a risk-free rate of 2.25 percent (December 31, 2017 – 2.25 percent) and an inflation rate of 2.00 percent (December 31, 2017 – 2.00 percent) were used to calculate the net present value of the decommissioning liabilities.

($000s)	**Six Months Ended June 30, 2018**	Year Ended December 31, 2017
Balance – beginning of period	**13,691**	13,307
Liabilities incurred	**191**	629
Revisions	**–**	(229)
Settlements	**(353)**	(328)
Accretion of decommissioning liabilities	**159**	312
Balance – end of period	**13,688**	13,691

8 SHARE CAPITAL

(a) Authorized

Unlimited number of common voting shares, no par value.

Unlimited number of preferred shares, no par value, issuable in series.

(b) Issued – Common Shares

	Six Months Ended June 30, 2018		Year Ended December 31, 2017	
	Shares	**Amount**	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period	**34,190,652**	**413,891**	33,671,637	411,036
Exercise of options (i)	**–**	**–**	51,087	278
Issued on vesting of share incentives (Note 9)	**–**	**–**	467,928	2,577
Balance – end of period	**34,190,652**	**413,891**	34,190,652	413,891

i) Exercising of Options

During the year ended December 31, 2017, 51,087 options were exercised with a weighted average exercise price of $4.34 per share for total cash proceeds of $0.2 million and previously recognized share-based compensation expense of $0.06 million.

(c) Per Share Amounts

Per share amounts were calculated on the weighted-average number of shares outstanding. The basic and diluted shares outstanding were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*
Net income (loss) for the period	**(361)**	(116)	**(3,714)**	2,384
Weighted-average number of common shares	*(#)*	*(#)*	*(#)*	*(#)*
– basic	**34,191**	33,804	**34,191**	33,749
– diluted	**34,191**	33,804	**34,191**	34,019
Net income (loss) per weighted average common share	*($)*	*($)*	*($)*	*($)*
– basic	**(0.01)**	(0.00)	**(0.11)**	0.07
– diluted	**(0.01)**	(0.00)	**(0.11)**	0.07

For the six months ended June 30, 2017, 645,958 options, PBAs and TBAs were excluded from the calculation of diluted earnings per share as their effect was anti-dilutive.

9 SHARE- BASED COMPENSATION

(a) Replacement Stock Options

The number and weighted-average exercise prices of replacement stock options are as follows:

	Six Months Ended June 30, 2018		Year Ended December 31, 2017	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
	(#)	*($)*	*(#)*	*($)*
Outstanding – beginning of period	**9,332**	**6.80**	71,720	4.83
Exercised	–	–	(51,087)	4.34
Expired	**(9,332)**	**(6.80)**	(11,301)	5.43
Outstanding – period end	–	–	9,332	6.80
Exercisable – period end	–	–	9.332	6.80

Gross share-based compensation for the options was $nil for the both the six months ended June 30, 2018, and the year ended December 31, 2017.

(b) Share Incentive Plan

The Company's Share Incentive Plan ("SIP") consists of performance based awards (PBAs) and time based awards (TBAs). Both the TBAs and the PBAs vest one third on each of the first, second and third anniversaries of the grant date. The PBAs granted are subject to a performance multiplier ranging from 0 to 2. The payout multiplier is dependent on the performance of Granite at the end of the vesting period relative to corporate performance measures determined at the discretion of Granite's Board of Directors. The number of common shares issued for each PBA and TBA granted is adjusted for the payments of dividends from the date of the grant to the payment date. On the payment date, Granite has sole and absolute discretion to settle the awards in the form of either cash or common shares, or some combination thereof.

The number of PBAs is as follows:

	Six Months Ended June 30, 2018	Year Ended December 31, 2017
	PBAs	PBAs
	(#)	*(#)*
Outstanding – beginning of period	**1,107,697**	956,902
Issued	–	411,739
Redeemed	–	(238,214)
Cancelled	–	(22,730)
Outstanding – end of period	**1,107,697**	1,107,697

The fair value of the PBAs is determined at the grant date using the binomial option-pricing model, multiplied by the estimated performance multiplier. During the year ended December 31, 2017, 411,739 PBAs were granted and 238,214 PBAs were redeemed for 446,381 common shares reflecting the effect of the performance multiplier as well as accumulated dividends from the date of the original grant to the payment date. A performance multiplier of 1.2 has been assumed for PBAs outstanding at June 30, 2018, and 1.5 for PBAs outstanding at December 31, 2017. Fluctuations in share based compensation expense may occur due to changes in estimates of performance outcomes.

Gross share-based compensation related to PBAs was $0.04 million for the three months ended June 30, 2018 (three months ended June 30, 2017 - $1.6 million). Of this amount, $0.02 million was capitalized (three months ended June 30, 2017 – $0.8 million), resulting in total net share-based compensation expense related to PBAs of $0.02 million for the quarter (three months ended June 30, 2017 - $0.8 million).

Gross share-based compensation related to PBAs was $1.0 million for the six months ended June 30, 2018 (six months ended June 30, 2017 - $2.7 million). Of this amount, $0.4 million was capitalized (six months ended June 30, 2017 – $1.3 million), resulting in total net share-based compensation expense related to PBAs of $0.6 million for the six months ended June 30, 2018 (six months ended June 30, 2017 - $1.4 million).

There were 56,547 TBAs outstanding as at June 30, 2018 and December 31, 2017.

The fair value of the TBAs is determined at the grant date using the binomial option-pricing model.

Gross share-based compensation related to TBAs was $0.02 million for the three months ended June 30, 2018 (three months ended June 30, 2017 - $0.07 million). Of this amount, $0.01 million was capitalized (three months ended June 30, 2017 – $0.02 million), resulting in total net share-based compensation expense related to TBAs of $0.01 million for the quarter (three months ended June 30, 2017 - $0.05 million).

Gross share-based compensation related to TBAs was $0.04 million for the six months ended June 30, 2018 (six months ended June 30, 2017 - $0.1 million). Of this amount, $0.01 million was capitalized (six months ended June 30, 2017 – $0.04 million), resulting in total net share-based compensation expense related to TBAs of $0.03 million for the six months ended June 30, 2018 (six months ended June 30, 2017 - $0.96 million).

10 OIL AND NATURAL GAS REVENUES

The Company sells its production pursuant to variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on contract terms. Commodity prices are based on market indices that are determined on a monthly or daily basis.

The contracts generally have a term of one year or less, whereby delivery takes place throughout the contract period. Revenues are typically collected on the 25th day of the month following production.

The following table details the Company's sales by product:

	Three Months Ended June 30,		Six Months Ended June 30	
	2018	2017	**2018**	2017
($000s)				
Natural gas	**10**	132	**67**	293
Crude oil	**14,084**	13,656	**24,702**	27,946
Total oil and natural gas revenues	**14,094**	13,788	**24,769**	28,239

11 SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital are comprised of:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	**2018**	2017
($000s)				
Accounts receivable	**(1,727)**	601	**(1,135)**	300
Deposits and prepaid expenses	**(130)**	(172)	**(132)**	(99)
Accounts payable and accrued liabilities	**875**	(4,957)	**–**	(3,486)
	(984)	(4,528)	**(1,267)**	(3,285)
Related to operating activities	**(298)**	(1,896)	**948**	(2,373)
Related to investing activities	**(686)**	(2,632)	**(2,215)**	(912)
	(984)	(4,528)	**(1,267)**	(3,285)

12 DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value for financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the methods described below. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Granite classifies the fair value of these transactions according to the following hierarchy based on the nature of the observable inputs used to value the instrument.

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

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

c. Level 3 – Valuations are derived from inputs that are not based on observable market data.

(a) Property and Equipment and E&E Assets

The fair value of property and equipment recognized in a business combination is based on market values. The market value of property and equipment is the estimated amount for which property and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of petroleum and natural gas properties (included in property and equipment) and E&E assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions. The market value of other items of property and equipment is based on the quoted market prices for similar items.

(b) Accounts Receivable, Bank Debt, Accounts Payable and Accrued Liabilities and Dividend Payable

The fair value of accounts receivable, bank debt, accounts payable and accrued liabilities and dividend payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value of these balances approximated their carrying value at June 30, 2018, due to their short term to maturity.

(c) Stock Options

The fair value of stock options is measured using the Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted- average historical volatility adjusted for changes expected due to publicly available information), weighted-average expected life of the instruments (based on historical experience and general option-holder behaviour) and the risk- free interest rate (based on Government of Canada bonds).

(d) Performance Based Awards and Time Based Awards

The fair value of awards granted under the SIP is measured using the binomial model. Measurement inputs include share price on measurement date, expected volatility (based on weighted-average historical volatility adjusted for changes expected due to publicly available information), weighted-average expected life of the instruments (based on the terms of the agreement) and the risk-free interest rate (based on Government of Canada bonds) and performance multiplier (based on expected multiplier at date of settlement).

(e) Derivative Financial Instruments

Granite classifies the fair value measurement of the derivative financial instruments as Level 2 based on the nature of the observable inputs used to value the instrument.

As at June 30, 2018, the Company had the following crude oil risk management contracts, with a total mark-to-market liability of $4.6 million (December 31, 2017 – $2.8 million liability):

CRUDE OIL CONTRACTS

Remaining Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price	Fair Value Asset (Liability) ($) (000s)
Remainder of 2018						
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $49.00	US $(450)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $50.00	US $(429)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $50.50	US $(418)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $52.00	US $(387)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	200 bbls/d	WTI-NYMEX	US $55.40	CAD $(733)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $60.15	USD $(192)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $68.30	CAD $(57)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	200 bbls/d	WTI-NYMEX	CAD $70.74	CAD $(805)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $75.06	CAD $(324)
Jul. 1/18 – Dec. 31/18	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $83.22	CAD $(174)
Q1 2019						
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $88.55	CAD $4
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	US $65.72	USD $(15)
Front Half 2019						
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.73	CAD $(27)

Subsequent to June 30, 2018, the Company entered into the following Crude Oil Contracts:

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $83.90/bbl
Jan. 1/19 – Mar. 31/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $88.44/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $84.25/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.15/bbl
Jan. 1/19 – Jun. 30/19	Crude Oil	Fixed	100 bbls/d	WTI-NYMEX	CAD $85.02/bbl

CORPORATE INFORMATION

BOARD OF DIRECTORS

Brendan Carrigy (2)
Chairman
Independent Businessman

Michael Kabanuk
President & Chief Executive Officer
Granite Oil Corp.

Martin Cheyne (3)
Chief Executive Officer
Boulder Energy Ltd.

Kathy Turgeon (1) (3)
Chief Financial Officer
Peyto Exploration

Brad Porter (1) (2)
Independent Businessman

Kevin Andrus (1) (2) (3)
Portfolio Manager of
Energy Investments
GMT Capital Corp.

(1) Audit Committee Member
(2) Reserves Committee Member
(3) Corporate Governance & Compensation Committee Member

OFFICERS

Michael Kabanuk
President & Chief Executive Officer

Gail Hannon
Chief Financial Officer

Tyler Klatt
Vice President, Exploration

Daniel Kenney
Corporate Secretary

HEAD OFFICE

3230 – 308 Fourth Avenue
S.W. Calgary, Alberta T2P 0H7
Telephone: 587-349-9113
Facsimile: 587-349-9129
Website: www.graniteoil.ca

AUDITORS

KPMG LLP
Calgary, Alberta

BANKERS

National Bank of Canada
Calgary, Alberta

ATB Financial
Calgary, Alberta

EVALUATION ENGINEERS

Sproule Associates Limited
Calgary, Alberta

LEGAL COUNSEL

DLA Piper (Canada) LLP
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

AST Trust Company (Canada)

Calgary, Alberta

STOCK TRADING

Toronto Stock Exchange
Trading Symbol: GXO

OTCQX
Trading Symbol: GXOCF