AUDITED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2021

AND DECEMBER 31, 2020

Independent auditor's report

To the Shareholders of Karve Energy Inc.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Karve Energy Inc. and its subsidiary (together, the Company) as at December 31, 2021 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statement of financial position as at December 31, 2021;
- the consolidated statement of net income (loss) and comprehensive income (loss) for the year then ended;
- the consolidated statement of changes in shareholders' equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

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Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

/s/PricewaterhouseCoopers LLP

Chartered Professional Accountants

Calgary, Alberta
April 12, 2022

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian $000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
ASSETS		
Current Assets		
Cash and cash equivalents	5,277	-
Trade and other receivables (NOTE 4)	18,478	10,796
Prepaids and deposits (NOTE 5)	4,768	4,913
TOTAL CURRENT ASSETS	28,523	15,709
Property, plant and equipment (NOTE 7 & 8)	339,764	316,523
Exploration and evaluation (NOTE 7)	18,259	21,125
Right of use asset (NOTE 9)	426	82
Deferred income tax asset (NOTE 16)	-	5,335
TOTAL ASSETS	**386,972**	**358,774**
LIABILITIES		
Current Liabilities		
Trade and other payables (NOTE 6)	19,647	11,119
Operating loan (NOTE 11)	-	5,513
Derivative Liability (NOTE 18)	5,212	2,397
Lease liability (NOTE 10)	253	156
Decommissioning liability (NOTE 12)	4,222	2,502
TOTAL CURRENT LIABILITIES	**29,334**	**21,687**
Long term debt (NOTE 11)	26,823	53,374
Lease liability (NOTE 10)	349	-
Decommissioning liability (NOTE 12)	16,630	19,157
Deferred income tax liability (NOTE 16)	7,483	-
TOTAL LIABILITIES	**80,619**	**94,218**
SHAREHOLDERS' EQUITY		
Share capital (NOTE 13)	225,158	225,158
Contributed surplus (NOTE 13)	30,645	27,948
Accumulated earnings	50,550	11,450
TOTAL SHAREHOLDERS' EQUITY	**306,353**	**264,556**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**386,972**	**358,774**

COMMITMENTS (NOTE 17)

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

Approved on behalf of the Board of Directors:

Signed "Donald A. Engle" *Signed "James C. Lough"*

Donald A. Engle
Chairman of the Board

James C. Lough
Director

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

(Canadian $000s, except per share amounts)	For the year ended Dec. 31, 2021	Dec. 31, 2020
REVENUE		
Petroleum and natural gas sales (NOTE 20)	153,600	88,105
Royalties	(12,989)	(6,660)
PETROLEUM AND NATURAL GAS SALES, NET OF ROYALTIES	140,611	81,445
Other income (NOTE 14)	6,884	5,748
Loss on financial derivative contracts (NOTE 18)	(14,229)	(1,853)
Gain on disposition (NOTE 8)	33,318	-
TOTAL REVENUE AND OTHER INCOME	166,584	85,340
EXPENSES		
Operating	46,334	42,341
Transportation	2,504	3,366
General and administration	9,623	5,629
Depletion, depreciation and amortization (NOTE 7, 9, & 12)	45,592	50,247
Financing (NOTE 11)	2,220	2,382
Accretion (NOTE 12)	2,386	1,545
Share-based compensation (NOTE 15)	2,697	5,724
Exploration and evaluation - expiries (NOTE 7)	2,881	2,844
Transaction costs (NOTE 8)	429	-
NET INCOME (LOSS) BEFORE TAX EXPENSE	51,918	(28,738)
TAX EXPENSE		
Deferred income tax expense (recovery) (NOTE 16)	12,818	(2,954)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	39,100	(25,784)
INCOME (LOSS) PER SHARE ($) (NOTE 13)		
Basic	0.28	(0.18)
Diluted	0.27	(0.18)

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Canadian $000s)	For the year ended Dec. 31, 2021	Dec. 31, 2020
SHARE CAPITAL		
BALANCE, BEGINNING AND END OF YEAR	**225,158**	**225,158**
CONTRIBUTED SURPLUS		
Balance, beginning of year	27,948	22,224
Share-based compensation (NOTE 15)	2,697	5,724
BALANCE, END OF YEAR	**30,645**	**27,948**
EARNINGS		
Balance, beginning of year	11,450	37,234
Net income (loss) and comprehensive income (loss)	39,100	(25,784)
BALANCE, END OF YEAR	**50,550**	**11,450**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Canadian $000s)	For the year ended Dec. 31, 2021	Dec. 31, 2020
CASH PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net income (loss) and comprehensive income (loss)	39,100	(25,784)
ITEMS NOT AFFECTING CASH:		
Depletion, depreciation and amortization (NOTE 7, 9, & 12)	45,592	50,247
Accretion expense (NOTE 12)	2,386	1,545
Exploration and evaluation (NOTE 7)	2,881	2,844
Unrealized (gain) loss on foreign exchange	(2)	78
Share-based compensation (NOTE 15)	2,697	5,724
Gain on disposition (NOTE 8)	(33,318)	-
Unrealized loss on financial derivatives (NOTE 18)	2,814	2,397
Deferred income tax expense (recovery) (NOTE 16)	12,818	(2,954)
Non-cash financing expense (NOTE 11)	167	212
Decommissioning expenditures (NOTE 12)	(1,847)	(766)
FUNDS FLOW FROM OPERATIONS	**73,288**	**33,543**
Change in non-cash working capital (NOTE 20)	(3,436)	8,693
CASH FLOW FROM OPERATING ACTIVITIES	**69,852**	**42,236**
INVESTING ACTIVITIES		
Exploration and evaluation (NOTE 7)	(531)	(1,422)
Property, plant and equipment (NOTE 7)	(70,210)	(29,574)
Property, plant and equipment dispositions (NOTE 8)	34,095	-
Change in non-cash working capital (NOTE 20)	4,430	(5,540)
CASH FLOW USED FOR INVESTING ACTIVITIES	**(32,216)**	**(36,536)**
FINANCING ACTIVITIES		
Operating line (NOTE 11)	(5,513)	(443)
Financing lease expense (NOTE 10)	(164)	(597)
Increase in long term debt (NOTE 11)	3,818	23,840
Repayment of long term debt (NOTE 11)	(30,500)	(28,500)
Change in non-cash working capital (NOTE 20)	-	-
CASH FLOW USED FOR FINANCING ACTIVITIES	**(32,359)**	**(5,700)**
Increase in cash and cash equivalents	5,277	-
Cash and cash equivalents, beginning of year	-	-
CASH AND CASH EQUIVALENTS, END OF YEAR	**5,277**	**-**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

These consolidated financial statements are as at and for the years ended December 31, 2021, and 2020. Tabular amounts in thousands of Canadian dollars, unless otherwise stated. Amounts in text are in Canadian dollars unless otherwise stated.

1. REPORTING ENTITY

Karve Energy Inc. ("Karve" or the "Company") is a growth-oriented, private oil and natural gas company whose principal business activities are the acquisition, exploration and development of oil and gas properties in western Canada.

The Company was incorporated under the laws of the Province of Alberta on January 30, 2014, under the name "1799380 Alberta Ltd.". On June 16, 2014, the Company changed its name to "Bruin Oil & Gas Inc." ("Bruin") and on September 15, 2016, the Company changed its name to "Karve Energy Inc.". On July 15, 2019, the Company amalgamated with High Ground Energy Inc.

The consolidated financial statements of the Company are comprised of Karve and its wholly-owned subsidiary "DTC Energy Inc." which was incorporated under the laws of the Province of Alberta.

Karve's head office is located at Suite 1700, 205 5 Avenue SW, Calgary Alberta, T2P 2V7.

2. BASIS OF PRESENTATION

Statement of Compliance and Authorization

The consolidated financial statements (the "financial statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of financial statements. Certain comparative figures have been reclassified to conform to the current year presentation.

The financial statements were approved and authorized for issue by Karve's Board of Directors on March 23, 2022.

Basis of Measurement

These financial statements have been prepared on the historical cost basis, except for the revaluation to fair value of certain financial assets and financial liabilities, as required under IFRS and described in the significant accounting policies in NOTE 3 below. The financial statements are measured and presented in Canadian dollars as the functional currency of the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of Karve and its subsidiaries. Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. As at December 31, 2021, the Company has one wholly-owned subsidiary, DTC Energy Inc. The financial statements of subsidiaries are prepared for the same reporting period as Karve, using uniform accounting policies. Subsidiaries are consolidated from the date of acquisition of control and continue to be consolidated until the date there is a loss of control. All intercompany balances, transactions, revenue and expenses are eliminated on consolidation.

Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the periods reported. Actual results may differ from such estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are outlined below:

a) Impairment of Financial Assets

The loss allowances for financial assets are based on assumptions about risk of default and expected loss rates. The Company uses judgement in making assumptions and selecting inputs to the impairment calculation based on the Company's history, existing market conditions and forward-looking estimates at the end of each reporting period.

b) Business Combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and petroleum and natural gas assets acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates.

Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill purchase price allocation. Future net earnings can be affected as a result of changes in future depletion and depreciation, asset impairment, decommissioning liability, gains on acquisition or goodwill impairment.

c) Reserve Estimates

Reserve estimates impact a number of key areas, in particular, the valuation of property, plant and equipment and the calculation of depletion and depreciation. Petroleum and natural gas assets are depleted on a unit of production basis at a rate calculated by reference to proved and probable reserves determined in accordance with National Instrument 51-101, *Standards of Disclosure for Oil and Gas Activities* ("NI 51-101") and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reservoir engineering reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Reserve estimates, although not reported as part of the Company's consolidated financial statements, can have a significant effect on net income, assets and liabilities as a result of their impact on depletion and depreciation, decommissioning liabilities, deferred taxes, asset impairments and business combinations. Independent reservoir engineers perform evaluations of the Company's oil and natural gas reserves on an annual basis. The estimation of reserves is an inherently complex process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based upon a number of variables and assumptions such as geoscientific interpretation, production forecasts, commodity prices, costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available or as economic conditions change. See NOTE 7 for further details.

d) Technical Feasibility and Commercial Viability of Exploration and Evaluation Assets ("E&E")

The determination of technical feasibility and commercial viability, based on the presence of proved and probable reserves, results in the transfer of assets from exploration and evaluation assets to petroleum and natural gas assets. As discussed above, the estimate of proved and probable reserves is inherently complex and requires significant judgement. Thus any material change to reserve estimates could affect the technical feasibility and commercial viability of the underlying assets. See NOTE 7 for further details.

e) Impairment Indicators and Discount Rate

For purposes of impairment testing, petroleum and natural gas assets are aggregated into cash-generating units ("CGUs"), based on separately identifiable and largely independent cash inflows. The determination of the Company's CGUs and indicators of impairment are subject to significant judgment. The Company currently has one CGU.

The recoverable amount of CGUs and individual assets have been determined based on the higher of the value-in use calculations and fair value less costs of disposal. These calculations require the use of estimates and assumptions, including the discount rate. It is possible that the commodity price assumptions may change due to multiple factors including a global pandemic, natural disaster, inventory levels, exchange rates, weather, economic and geopolitical factors and supply and demand. These factors could be impacted by the rate at which global energy markets transition to lower carbon-based economies and impact the estimated life of the field and economical reserves recoverable and may require an adjustment to the carrying value of petroleum and natural gas assets. The Company monitors internal and external indicators of impairment relating to its assets and records adjustments, if necessary, at each reporting period date. See NOTE 7 for further details.

f) Decommissioning Liabilities

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. The liability, the related asset and the expense are impacted by estimates with respect to the costs and timing of decommissioning. See NOTE 12 for further details.

g) Measurement of Share-Based Compensation

Share-based compensation amounts are determined based on compensation plans in effect and are subject to estimated fair values, volatility, expected life, discount rate, forfeiture rates and the future attainment of performance criteria. The Company is not listed for trading on a public exchange and share prices and trading volatility are based on limited activity and information available from peer companies. See NOTE 15 for further details.

h) Income Taxes

The Company recognizes the net future tax benefit related to deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operation and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted. Additionally, future changes in tax laws in the jurisdictions in which the Company operates could change the ability of the Company to obtain tax deductions in future periods. See NOTE 16 for further details.

3. SIGNIFICANT ACCOUNTING POLICIES

Business Combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method in accordance with IFRS 3, *Business Combinations*. The consideration for each acquisition is measured at the aggregate of the fair values (at the date of exchange) of assets given up, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the assets or acquiree. Goodwill is recognized when the consideration paid exceeds the aggregate fair values of the assets and liabilities acquired. Acquisition-related transaction costs are recognized in the consolidated statement of net income (loss) and comprehensive income (loss) as incurred.

Joint Arrangements

The Company conducts a substantial amount of their activities by taking 100% ownership interest but conducts some of its activities jointly with others through jointly controlled operations which involve the use of assets and other resources of the Company and other venturers rather than the establishment of a corporation, partnership or other entity. The financial statements include only the Company's proportionate share of jointly controlled sale or use of its share of the joint operation's output, together with its share of the expenses incurred by the joint operation, and any expenses it incurs in relation to its interest in the joint operation.

Property, Plant and Equipment, Exploration and Evaluation Assets

The Company's property, plant and equipment ("PP&E") primarily consists of oil and natural gas development and production assets. PP&E is stated at cost, less accumulated depletion, depreciation, amortization and accumulated impairment losses. Development and production assets represent the cost of developing the commercial reserves and initiating production and are accumulated into major area CGUs for purposes of determining depletion, depreciation, impairment, decommissioning and other financial measurements.

Capitalization, Recognition and Measurement

The capital cost of an asset is the aggregate of its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning provision, and for qualifying assets, borrowing costs. For acquired assets or businesses, the purchase price is the aggregate amount paid and the fair value of any other consideration given up to acquire the asset or business. Expenditures on major maintenance, inspections or overhauls and well workovers are capitalized when the item enhances the life or performance of an asset above its original standard. Where an asset or part of an asset that was separately depreciated is replaced and it is probable that future economic benefits associated with the replacement item will flow to the Company, the replacement expenditure is capitalized and the carrying amount of the replaced asset is charged to the consolidated statement of net income (loss) and comprehensive income (loss).

When an item of property, plant and equipment is disposed of or when there are no net future economic benefits expected from the continued use of the asset, the asset is removed from the accounts (derecognized), and any gain or loss arising on derecognition (calculated as the difference between the net disposal proceeds and the carrying amount of the item), is recognized in the consolidated statement of net income (loss) and comprehensive income (loss).

Exploration and Evaluation Expenditures

Pre-license costs are recognized in the consolidated statement of net income (loss) and comprehensive income (loss) as incurred. All exploratory costs incurred subsequent to acquiring the right to explore for oil and natural gas are capitalized. Such costs can typically include costs to acquire land rights in areas with no proved or probable reserves assigned, geological and geophysical costs, and exploration wells. Exploration and evaluation costs initially are capitalized as either tangible or intangible exploration or evaluation assets according to the nature of the assets acquired. Exploration costs are accumulated in areas by exploration area, field or well pending determination of technical feasibility and commercial viability. If, upon review of the technical feasibility and/or commercial viability data, the facts and circumstances suggest that the carrying amount of the exploration expenditures exceeds the recoverable amount, an impairment charge is recognized in the consolidated statement of net income (loss) and comprehensive income (loss) in the current period. For purposes of impairment testing, exploration and evaluation assets are allocated to CGUs.

The technical feasibility and commercial viability of extracting a mineral resource from exploration and evaluation assets is considered when proved and probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and probable reserves have been discovered. Upon determination of proved and probable reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to development and production assets within property and equipment. If the well or exploration project did not encounter potentially economic oil and gas quantities, the cumulative costs are expensed and reported in exploration and evaluation expense in the current period.

Expired land leases included as undeveloped land in exploration and evaluation are charged to exploration and evaluation expense in the consolidated statement of net income (loss) and comprehensive income (loss) upon expiry.

Development and Production Expenditures

Property, plant and equipment, which includes petroleum and natural gas development and production assets, is measured at cost (including directly attributable general and administrative costs) less accumulated depletion and depreciation and accumulated impairment losses. Cost includes lease acquisition, drilling and completion, production facilities, decommissioning costs, geological and geophysical costs and directly attributable costs related to development and production activities, net of any government incentive programs.

Depletion, Depreciation and Amortization

The costs related to area cost centres for petroleum and natural gas properties, including related pipelines and facilities, are depleted using a unit-of-production method based on the commercial proved and probable reserves allocated to its CGU.

The net carrying value of oil and gas properties is depleted using the unit of production method by reference to the ratio of production in the period to the related proved and probable reserves as per the most recent reserve reports prior to the reporting date, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves as per the most recent reserve reports prior to the reporting date. Proved and probable reserves are estimated using reserve reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Petroleum and natural gas assets are not depleted until production commences in the CGU that they are allocated to.

The Company records corporate capital assets at cost and provides depreciation on a straight-line basis over five years which is designed to amortize the cost of the assets over their estimated useful lives. Depreciation methods, useful and residual values are reviewed at each financial year end and adjustments relating to changes in estimates are recorded prospectively.

Impairment

At each reporting period the Company assesses whether there are impairment indicators for its property, plant and equipment. If indicators exist, the Company determines if the recoverable amount of the asset or CGU is greater than its carrying amount. A CGU is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The Company has used geographical proximity, geological similarities, analysis of shared infrastructure, commodity type, assessment of exposure to market risks and materiality to define its CGUs. If the carrying amount exceeds the recoverable amount, the asset or CGU is recorded at its recoverable amount with the reduction recognized in the consolidated statement of net income (loss) and comprehensive income (loss). The recoverable amount is the greater of the value in use or fair value less costs of disposal. Fair value is the amount the asset could be sold for in an arm's length transaction. The value in use is the present value of the estimated future cash flows of the asset from its continued use. The fair value less costs of disposal considers the continued development of a property and market transactions in a valuation model. The Company uses the present value of the CGUs estimated future cash flows from both proved and probable reserves in its fair value model. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded entities or other available fair value indicators.

Impairment losses previously recognized are assessed at each reporting date for indications that the loss has decreased or no longer exists. Impairments are reversed in subsequent periods when there has been an increase in the recoverable amount of a previously impaired asset or CGU and these reversals are recognized in the consolidated statement of net income (loss) and comprehensive income (loss). The recovery is limited to the original carrying amount less depletion and depreciation that would have been recorded had the asset not been impaired.

Leases

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A lease liability is recognized at the commencement of the lease term at the present value of the lease payments that are not paid at that date. At the commencement date, a corresponding right-of-use asset is recognized at the amount of the lease liability, adjusted for lease incentives received, retirement costs and initial direct costs. Depreciation is recognized on the right-of-use asset over the lease term. Interest expense is recognized on the lease liabilities using the effective interest rate method and payments are applied against the lease liability.

FINANCIAL INSTRUMENTS

Financial Assets and Liabilities

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions that define the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. Financial assets and financial liabilities are initially recognized at fair value. For those at amortized cost this amount is normally the transaction price plus directly attributable transaction costs. All other transaction costs are expensed as incurred.

The subsequent measurement of the Company’s financial instruments depends on their classification determined by the purpose for which the instruments were acquired, as follows:

Financial Derivative Contracts

Financial Derivative Contracts are included in current assets and liabilities except for those with maturities greater than 12 months after the end of the reporting period, which are classified as non-current assets and liabilities. The Company has not designated any of its financial derivative contracts as effective accounting hedges. The Company’s financial derivative contracts are classified as financial assets or liabilities at fair value through profit or loss with changes in fair value recorded in the consolidated statement of net income (loss) and comprehensive income (loss).

The Company has accounted for its forward physical delivery sales contracts, which were entered into and continue to be held for the purpose of delivery of non-financial items, in accordance with its expected sale requirements. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair value on the consolidated statement of financial position. Realized gains or losses from commodity physical delivery sales contracts are recognized in petroleum and natural gas sales as the contracts are settled.

Trade and Other Receivables

Accounts receivable are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortized cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through the amortization process. The Company’s accounts receivable are comprised of trade and other receivables which are included in current assets due to their short-term nature.

Other Financial Liabilities at Amortized Cost

Financial liabilities at amortized cost include trade and other payables. Trade and other payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade and other payables are measured at amortized cost using the effective interest rate method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are classified as non-current liabilities.

Investment in Associates

The Company accounts for investments in associates using the equity method of accounting if the Company is considered to have significant influence. Significant influence is generally regarded as the ability to participate in the financial and operational decisions of the associate without having control or joint-control over the associate. Under the equity method of accounting, the carrying value of investment are increased or decreased for the Company’s share of equity contributions and withdrawals, as well as the Company's share of income and losses, respectively. In the event of a loss of significant influence, the Company remeasures its retained interest at fair market value with any gain or loss recognized in net income. The investment is then remeasured at fair market value at each subsequent reporting period.

Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, deposits held with banks and other short-term highly liquid investments with maturities of three months or less from inception.

Share Capital

Common shares and are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

Decommissioning Liabilities

A decommissioning liability is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be reasonably estimated, and it is probable that a future outflow of economic benefits will be required to settle the obligation. Decommissioning liabilities are determined by discounting the expected future cash flows at a credit-adjusted risk-free rate at the reporting date. The obligation is recorded as a liability on a discounted basis using the relevant credit-adjusted risk-free rate, with a corresponding increase to the carrying amount of the related asset. Over time, the liabilities are accreted for the change in their present value and the capitalized costs are depleted on a unit-of-production basis over the life of the asset. Revisions to the discount rate, estimated timing or amount of future cash flows would also result in an increase or decrease to the decommissioning liability and related asset and the related earnings impact reported in current and future periods.

Revenue Recognition

Revenue associated with the sales of crude oil, natural gas, and natural gas liquids ("NGLs") owned by the Company is recognized when title passes from the Company to its customer, the price is determinable, and collection of the sales price is reasonably assured. This generally occurs when product is physically transferred into a vessel, pipeline or other delivery mechanism. Revenues from processing activities are recognized over time as processing occurs and are generally billed monthly.

Karve has applied the practical expedient to recognize revenue in the amount to which the Company has the right to invoice. As such, no disclosure is included relating to the amount of transaction price allocated to remaining performance obligations and when these amounts are expected to be recognized as revenue.

Share-based Compensation and Other Compensation Plans

The Company follows the fair value method of valuing stock option grants and warrants. Share-based compensation amounts are determined based on the estimated fair value of shares on the date of grant of the option or warrant. Forfeitures are estimated at the grant date and are subsequently adjusted to reflect actual forfeiture realized. The expense is recognized over the service period, with a corresponding increase to contributed surplus.

The fair value of shares issued to officers and employees of the Company at a discount to market prices are recognized as a share based compensation expense over the service period, with a corresponding increase to contributed surplus.

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, deferred tax is recognized for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when the deferred tax asset or liability is settled based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable income will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The effect of a change in income tax rates on deferred income taxes is recognized in net income in the period in which the change occurs.

Earnings per Share

Basic and diluted earnings per share ("EPS") is computed by dividing the net earnings available to common shareholders by the weighted average number of shares outstanding during the reporting period. Diluted net income (loss) per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The Company's potentially dilutive common shares comprise stock options and performance warrants granted. The number of shares included with respect to stock options and performance warrants is computed using the treasury stock method.

4. TRADE AND OTHER RECEIVABLES

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Trade	17,180	9,701
Joint operations	1,626	1,637
Allowance for doubtful accounts	(328)	(542)
TRADE AND OTHER RECEIVABLES	**18,478**	**10,796**

In determining the recoverability of receivables, the Company uses the ECL model and considers the age of the outstanding receivable and the credit worthiness of the counterparties. The Company recorded a provision of $328,000 at December 31, 2021 as it determined certain joint venture receivables were uncollectible using the ECL model (December 31, 2020 - $542,000).

Of the Company's accounts receivable at December 31, 2021, approximately 63% was receivable from two oil marketers (34% and 29%). At December 31, 2020, approximately 47% was receivable from two oil marketers (30% and 17%). Accounts receivable outstanding greater than ninety days at December 31, 2021 was $1.2 million (December 31, 2020 - $1.1 million).

5. PREPAIDS AND DEPOSITS

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Prepaids	4,755	4,815
Deposits	13	98
PREPAIDS AND DEPOSITS	**4,768**	**4,913**

6. TRADE AND OTHER PAYABLES

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Trade	10,958	7,146
Accrued	6,231	2,632
Royalties	1,682	677
GST	338	338
Joint operations	438	326
TRADE AND OTHER PAYABLES	**19,647**	**11,119**

7. CAPITAL ASSETS

The following table reconciles movement of Petroleum and natural gas ("P&NG") assets, corporate assets, and exploration and evaluation ("E&E") assets during the year:

COST ($000s)	Petroleum and Natural Gas Assets	Corporate Assets	Total Property, Plant and Equipment	Exploration & Evaluation Assets
BALANCE AT DECEMBER 31, 2019	458,659	816	459,475	22,837
Additions	29,408	166	29,574	1,422
Transfers to (from) P&NG/E&E assets	290	-	290	(290)
Change in decommissioning provision (NOTE 12)	1,948	-	1,948	-
Expiries	-	-	-	(2,844)
BALANCE AT DECEMBER 31, 2020	**490,305**	**982**	**491,287**	**21,125**
Additions	70,204	6	70,210	531
Transfers to (from) P&NG/E&E assets	516	-	516	(516)
Change in decommissioning provision (NOTE 12)	1,541	-	1,541	-
Expiries	-	-	-	(2,881)
Dispositions (NOTE 8)	(777)	-	(777)	-
BALANCE AT DECEMBER 31, 2021	**561,789**	**988**	**562,777**	**18,259**
ACCUMULATED DD&A ($000s)				
BALANCE AT DECEMBER 31, 2019	124,314	280	124,594	-
Depletion, depreciation and amortization	49,987	183	50,170	-
BALANCE AT DECEMBER 31, 2020	**174,301**	**463**	**174,764**	**-**
Depletion, depreciation and amortization	48,061	188	48,249	-
BALANCE AT DECEMBER 31, 2021	**222,362**	**651**	**223,013**	**-**
NET CARRYING AMOUNT, DECEMBER 31, 2020	**316,004**	**519**	**316,523**	**21,125**
NET CARRYING AMOUNT, DECEMBER 31, 2021	**339,427**	**337**	**339,764**	**18,259**

Petroleum and Natural Gas Assets

At December 31, 2021, future development and production costs of $446.4 million (December 31, 2020 - $448.6 million) are included in costs subject to depletion.

General and administration costs capitalized by the Company during the year ended December 31, 2021 were $1.2 million (year ended December 31, 2020 – $553,000).

The Company assessed for indicators of impairment and there were no indicators of impairment at December 31, 2021 or 2020.

As at March 31, 2020, the Company performed an impairment indicator assessment of its petroleum and natural gas assets and determined that there were impairment indicators based on the significant decrease in oil pricing during March 2020. Based on the reduction in oil pricing, the Company performed an impairment test and it was determined that the recoverable amount was greater than the carrying amount. The recoverable amount was determined based on fair value less costs of disposal (Level 3). The fair values were calculated based on discounted after-tax cash flows of proved and probable reserves using forecasted forward prices and cost estimates at March 31, 2020. Key assumptions used to determine the recoverable amount (future cash flows from reserves) include petroleum and natural gas prices, costs to develop and the discount rate. Discounted future cash flows are determined by applying a discount rate of 11%. The Company used internally prepared reserve estimates.

The forward prices as at March 31, 2020 used to determine future cash flows from petroleum and natural gas reserves were:

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029 (1)
WTI crude oil (USD/bbl)	29.17	40.45	49.17	53.28	55.66	56.87	58.01	59.17	60.35	61.56
AECO natural gas ($/MMBtu)	1.74	2.20	2.38	2.45	2.53	2.60	2.66	2.72	2.79	2.85
Exchange Rate (CAD/USD) (2)	0.71	0.73	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

(1) Forecast benchmark commodity prices are assumed to increase by 2% in each year after 2029 to the end of the reserve life.
(2) Forecast exchange rate is assumed to remain at 0.75 CAD/USD each year after 2029 to the end of the reserve life.

As at March 31, 2020, a one percent increase in the assumed discount rate and/or a five percent decrease in forecast operating cash flows would result in the following pre-tax impairment expense being recognized:

($000s)	Impairment expense
1% increase in discount rate	19,048
5% decrease in cash flow	15,641
1% increase in discount rate and 5% decrease in cash flow	33,846

Exploration and Evaluation

Exploration and evaluation assets consist of the Company's undeveloped land, seismic, geological and geophysical costs and exploration projects that are pending the determination of technical feasibility.

The Company assessed for indicators of impairment and there were no indicators of impairment at December 31, 2021 or 2020.

8. DISPOSITIONS

On August 25, 2021, the Company sold of a majority of its royalty income assets for net proceeds of $34.1 million (after closing adjustments). The disposition was effective July 1, 2021. Transaction costs related to the disposition totalled $429,000. The disposed assets included 275 gross sections of fee title lands and 130 gross sections of gross overriding royalty ("GORR") lands excluding fee title and GORR lands within the Karve core Viking properties. The annualized fee income associated with the disposed assets based on income from the first six months of 2021 was approximately $4.4 million. The estimated carrying value of the assets disposed and gain on disposition are summarized below:

($000s)	
Property, plant and equipment	777
CARRYING VALUE OF NET ASSETS DISPOSED	**777**
CASH PROCEEDS, AFTER CLOSING ADJUSTMENTS	34,095
GAIN ON DISPOSITION	**33,318**

9. RIGHT OF USE ASSETS

The following table reconciles the movement of right of use assets during the year:

($000s)	
Balance at December 31, 2020	738
Additions	574
BALANCE AT DECEMBER 31, 2021	**1,312**
ACCUMULATED DEPRECIATION AND AMORTIZATION	
Balance at December 31, 2020	(656)
Depreciation and amortization	(230)
BALANCE AT DECEMBER 31, 2021	**(886)**
NET CARRYING AMOUNT, DECEMBER 31, 2021	**426**

10. LEASE LIABILITY

The Company has lease liabilities for office space. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Lease liabilities were measured at a discounted value of lease payments using a weighted average incremental borrowing rate of 5% at April 1, 2021.

($000s)	
Balance at December 31, 2020	156
Additions	574
Interest expense	36
Lease payments	(164)
BALANCE AT DECEMBER 31, 2021	**602**

	As at Dec. 31, 2021	As at Dec. 31, 2020
Lease liability - current	253	156
Lease liability - long term	349	-
TOTAL LEASE LIABILITY AT DECEMBER 31, 2021	**602**	**156**

The Company entered into a new office lease agreement effective April 1, 2021 to February 28, 2024.

Undiscounted cash outflows related to lease liabilities are:

($000s)	Within 1 year	1 to 5 years	Total
Lease payments	219	433	652

11. OPERATING LOAN AND LONG TERM DEBT

As at December 31, 2021, the Company had secured bank credit facilities of $55.0 million, comprised of a $48.0 million Credit Facility and a $7.0 million operating loan. The full facility is conforming. The Credit Facility is a committed 364 days + 1 year and extendible upon agreement annually and is shown as long term debt on the Company's balance sheet. The operating loan is shown as a current liability. The Credit Facility and operating loan incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75% and 4.75% depending on the type of borrowing and the Corporation's debt to EBITDA ratio. The Company is also subject to a standby fee of 0.6875% to 1.1875% based on the Corporation's debt to EBITDA ratio. The next annual review date is May 27, 2022.

As at December 31, 2021, $26.8 million (net of unamortized debt issue costs) (December 31, 2020 - $53.4 million) was drawn on the Credit Facility and $nil (December 31, 2020 - $5.5 million) was drawn on the operating loan.

The Company has issued letters of credit of $951,000 as at December 31, 2021 (December 31, 2020 - $781,000), thereby reducing the available bank credit facility by this amount.

Long term debt as at December 31, 2021 and December 31, 2020 is as follows:

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Credit Facility	27,000	53,500
Less: unamortized debt issue costs	(177)	(126)
LONG TERM DEBT	**26,823**	**53,374**
Bank operating loan	-	5,513
TOTAL BANK DEBT	**26,823**	**58,887**

Financing expense for the year ended December 31, 2021 and 2020 is comprised of the following:

($000s)	For the year ended Dec. 31, 2021	Dec. 31, 2020
Credit facility interest and charges	1,945	2,077
Operating loan interest and charges	108	93
Amortization of debt issue costs	131	176
Interest on lease liability (NOTE 10)	36	36
FINANCING EXPENSES	**2,220**	**2,382**

For the year ended December 31, 2021, the effective interest rate on the credit facility was 4.46% (December 31, 2020 – 4.45%).

12. DECOMMISSIONING LIABILITY

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company to abandon and reclaim the wells and facilities. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities and the discount rate applied in measuring the liability. The liability, the related asset and the expense are impacted by estimates with respect to the costs and timing of decommissioning.

The Company estimates its total undiscounted amount of cash flows required to settle its decommissioning liability is approximately $180.4 million ($101.4 million undiscounted, uninflated) (December 31, 2020 - $176.5 million and $101.0 million respectively), which will be incurred over the remaining life of the assets with the costs to be incurred between 2022 and 2065. The estimated future cash flows have been discounted using a credit adjusted rate of 11% (December 31, 2020 – 11%) and an inflation rate of 2% (December 31, 2020 – 2%). The change in estimate for the year ended December 31, 2021, relates to a change in the estimated timing of abandonment and reclamation expenses. The change in estimate for the year ended December 31, 2020 relates to an increase to the credit adjusted discount rate and changes in timing of abandonment and reclamation expenses.

On May 1, 2020, the Alberta Department of Energy initiated the Site Rehabilitation Program ("SRP") whereby it will provide funding in the form of grant payments to the oil field services sector to abandon and/or reclaim upstream oil and gas infrastructure. Pursuant to the SRP, the Company was approved for up to $5.1 million in SRP funding. To date the Company has recognized $3.1 million in SRP funding (December 31, 2020 - $251,000). When work is completed and paid to third party contractors, decommissioning liability is reduced with an off-setting credit to depletion, depreciation and amortization in the consolidated statement of income (loss) and comprehensive income (loss). Subsequent to year end, the Company was approved for an additional $0.7 million of SRP funding.

The following table shows changes in the decommissioning liability:

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Balance, beginning of year	21,659	19,183
Decommissioning liabilities incurred during the year	76	176
Decommissioning liabilities settled during the year	(1,847)	(766)
Decommissioning liabilities settled during the year through SRP	(2,887)	(251)
Accretion expense during the year	2,386	1,545
Change in estimate	1,465	1,772
BALANCE, END OF YEAR	**20,852**	**21,659**
Decommissioning liability - current	4,222	2,502
Decommissioning liability - long term	16,630	19,157
TOTAL DECOMMISSIONING LIABILITY - END OF YEAR	**20,852**	**21,659**

13. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares.

Unlimited number of preferred shares, issuable in series.

b) Issued and Outstanding Common Shares

($000s except for share amounts)	Number	Amount
Common Shares		
Balance at December 31, 2018	137,269,270	216,208
BALANCE AT DECEMBER 31, 2019, 2020 and 2021	**140,529,665**	**225,158**

c) Contributed Surplus

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Balance, beginning of year	27,948	22,224
Share-based compensation - options	1,394	3,131
Share-based compensation - warrants	1,303	2,593
BALANCE, END OF YEAR	**30,645**	**27,948**

d) Per Share Amounts

	For the year ended	
($000s except per share amounts)	Dec. 31, 2021	Dec. 31, 2020
Net income (loss) for the year	39,100	(25,784)
Weighted average number of shares - basic	140,529,665	140,529,665
Dilutive impact of share-based compensation plans	5,411,065	-
Weighted average number of shares - diluted	**145,940,730**	**140,529,665**
Net income (loss) per share - basic	**0.28**	**(0.18)**
Net income (loss) per share - diluted	**0.27**	**(0.18)**

At December 31, 2020, 8,799,335 stock options and 12,560,000 performance warrants were excluded from the fully diluted calculation as they were anti-dilutive.

14. OTHER INCOME

The following table presents the composition of amounts included in Other Income in the consolidated statements of net income (loss) and comprehensive income (loss):

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
Royalty income	3,113	2,538
Processing fee income	3,608	3,003
Other	163	207
TOTAL OTHER INCOME	**6,884**	**5,748**

Royalty income relates to freehold royalties, gross overriding royalties, royalties paid to the Company on fee title lands, and net profit interests. On August 25, 2021, the Company sold of a majority of its royalty income assets, effective July 1, 2021, for net proceeds of $34.1 million (after closing adjustments). See NOTE 8 – Dispositions.

Processing fee income relates to the Company processing third party oil and gas volumes through Karve owned and operated facilities.

15. SHARE-BASED COMPENSATION

The following table summarizes the Company's share-based compensation:

($000s)	For the year ended Dec. 31, 2021	Dec. 31, 2020
Share-based compensation - options	1,394	3,131
Share-based compensation - performance warrants	1,303	2,593
TOTAL SHARE-BASED COMPENSATION	**2,697**	**5,724**

a) Stock Options

Effective June 15, 2016, the Company adopted a new stock option plan under which officers, management, employees, directors and consultants of the Company are eligible to receive grants. Under the stock option plan, which was approved by the Board of Directors, the granted stock options vest to the grantee over a three-year period, the grantee has the right to exercise the stock options for seven years from the date of the grant and the stock options terminate 30 days following the termination of the grantee's employment. All stock options vest and may be exercisable in the event of a change of control or initial public offering. The maximum number of outstanding stock options under the plan is limited to 10% of the common shares outstanding. Stock option grants and the option exercise price are set by the Board of Directors at the time of grant. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for options outstanding was approved by the Board of Directors.

Share-based compensation expense related to stock options during the year ended December 31, 2021 was $1.4 million (year ended December 31, 2020 - $3.1 million).

The following table sets forth a reconciliation of the stock option plan activity from December 31, 2019 through to December 31, 2021:

	Number	Wtd. Avg. Exercise Price ($)
Balance at December 31, 2019	13,684,260	1.78
Granted	250,000	2.25
Forfeited	(86,000)	1.85
BALANCE AT DECEMBER 31, 2020	**13,848,260**	**1.79**
Granted	200,000	2.25
Forfeited	(312,000)	2.19
BALANCE AT DECEMBER 31, 2021	**13,736,260**	**1.79**

There were no stock options exercised during the year ended December 31, 2021. As at December 31, 2021 there were 12,087,078 options exercisable. As at December 31, 2020 there were 10,814,351 options exercisable. There were no stock options exercised during the year ended December 31, 2020.

The range of exercise prices of the outstanding options and weighted average contractual life remaining as at December 31, 2021 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life	Number of options outstanding	Number of options exercisable
$0.85	1.45	2,320,976	2,320,976
$1.00 - $1.99	1.55	1,667,357	1,667,357
$2.00 - $3.00	3.67	9,747,927	8,098,745
	3.04	**13,736,260**	**12,087,078**

The fair value of each option granted or acquired is estimated on the date of grant or acquisition using the Black-Scholes option pricing model with the following weighted average assumptions:

	For the year ended	
	Dec. 31, 2021	Dec. 31, 2020
Weighted average fair value of options granted	1.20	1.15
Risk-free Interest rate (%)	0.92%	0.66%
Expected life (years)	5.0	5.0
Estimated volatility of underlying common shares (%)	63%	61%
Weighted average grant date share price	2.25	2.25
Forfeiture rate	4%	4%
Expected dividend yield (%)	-	-

The expected volatility of the options granted is based on the historical volatility of publicly traded peer companies that in management's judgement have similar characteristics to the Company and are therefore a good indicator of the expected volatility of the Company.

b) Performance Warrants

There were no performance warrants issued by the Board of Directors during the year ended December 31, 2021 (year ended December 31, 2020 – nil).

The performance warrants entitle the holder to purchase one common share of the Company and have the following vesting dates and exercise prices:

	2016 Issuance	**2017 Issuance**
Warrants granted	16,125,000	17,937,500
Issue date	$1.50	$3.00
First anniversary	$1.70	$3.40
Second anniversary	$1.90	$3.80
Third anniversary	$2.10	$4.20
Fourth anniversary	$2.30	$4.60

The right to exercise the performance warrants is subject to a performance event taking place which includes the occurrence of any of the following (i) the Company raising a minimum of $25.0 million through a private placement, excluding the securities issued as part of the recapitalization that occurred in June 2016 (ii) the occurrence of an initial public offering on a recognized Canadian or U.S. stock exchange, or (iii) a change of control. Only vested performance warrants based on the schedule above will become exercisable if the Company achieves performance event (i). In the event of performance event (ii) and (iii), all performance warrants outstanding which have not vested or become exercisable in accordance with their terms shall vest and become exercisable immediately. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for performance warrants was approved by the Board of Directors.

Share-based compensation expense related to performance warrants during the year ended December 31, 2021 was $1.3 million (year ended December 31, 2020 - $2.6 million).

The following table sets forth a reconciliation of performance warrant activity from December 31, 2019 through to December 31, 2021:

	Number	Wtd. Avg. Exercise Price
BALANCE AT DECEMBER 31, 2019	32,129,500	2.87
Forfeited	(62,000)	3.80
BALANCE AT DECEMBER 31, 2020	**32,067,500**	**2.87**
Forfeited	(174,000)	3.80
BALANCE AT DECEMBER 31, 2021	**31,893,500**	**2.87**

There were no performance warrants exercised during the year ended December 31, 2021 (year ended December 31, 2020 - nil) and 6,460,000 performance warrants were exercisable at December 31, 2021 and December 31, 2020.

The range of exercise prices of the outstanding performance warrants and weighted average contractual life remaining as at December 31, 2021 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life	Number of warrants outstanding	Number of warrants exercisable
$1.50 to $2.99	1.56	15,700,000	6,460,000
$3.00 to $3.99	2.74	9,716,100	-
$4.00 to $4.60	2.74	6,477,400	-
	2.16	**31,893,500**	**6,460,000**

16. INCOME TAXES

Income tax expense varies from the amount that would be computed by applying the combined basic federal and provincial statutory income tax rates for Canada at December 31, 2021 at 23% (December 31, 2020 – 24%). A reconciliation to the differences is as follows:

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
Net income before taxes	51,918	(28,738)
Combined federal and provincial tax rate	23.0%	24.0%
Computed "expected" tax expense	11,941	(6,897)
Increase (decrease) in taxes due to:		
Permanent differences	623	1,374
Change in tax rate	-	2,507
True-up	254	62
TOTAL INCOME TAX EXPENSE (RECOVERY)	**12,818**	**(2,954)**
Current income tax	-	-
Deferred income tax expense (recovery)	12,818	(2,954)
TOTAL INCOME TAX EXPENSE (RECOVERY)	**12,818**	**(2,954)**

The following table summarizes Karve's net deferred income tax asset at December 31, 2021:

	Balance at Jan. 1, 2021	Recognized in Income (Loss)	Recognized in Statement of Financial Position	Balance at Dec. 31, 2021
Non-capital losses	22,463	1,045	-	23,508
Share issue costs	509	(368)	-	141
PP&E and E&E assets	(18,204)	(14,168)	-	(32,372)
Other	567	673	-	1,240
TOTAL DEFERRED INCOME TAX ASSET (LIABILITY)	**5,335**	**(12,818)**	**-**	**(7,483)**

The following table summarizes Karve's net deferred income tax asset at December 31, 2020:

	Balance at Jan. 1, 2020	Recognized in Income (Loss)	Recognized in Other	Balance at Dec. 31, 2020
Non-capital losses	11,608	10,855	-	22,463
Share issue costs	254	255	-	509
PP&E and E&E assets	(9,526)	(8,678)	-	(18,204)
Other	45	522	-	567
TOTAL DEFERRED INCOME TAX ASSET	**2,381**	**2,954**	**-**	**5,335**

The following table summarizes Karve's income tax pools available for deduction:

($000s)	Dec. 31, 2021	As at Dec. 31, 2020
Non-capital losses	102,207	97,666
Canadian exploration expense	246	201
Canadian development expense	122,820	120,707
Canadian oil and gas property expense	54,609	92,325
Capital cost allowance	63,430	68,221
Share issue costs	687	1,387
TOTAL TAX POOLS AVAILABLE FOR DEDUCTION	**343,999**	**380,507**

The reduction in Canadian oil and gas property expense year over year is due to the royalty disposition which closed in the third quarter of 2021. The Company's non-capital losses expire between 2035 and 2042.

17. COMMITMENTS

Future minimum payments under operating leases and pipeline transportation agreements as at December 31, 2021 are as follows:

($000s)	2022	2023	Total
Operating leases	78	-	78
Pipeline transportation	985	1,005	1,990
TOTAL COMMITMENTS	**1,063**	**1,005**	**2,068**

18. FINANCIAL INSTRUMENTS

The Company has exposure to credit, liquidity, interest, and foreign currency risk from its use of financial instruments. Further qualitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for identifying the principal risks of the Company and ensuring the policies and procedures are in place to appropriately manage these risks. Karve's management identifies, analyzes and monitors risks and considers the implication of the market condition in relation to the Company's activities.

a) Fair Value of Financial Instruments

Financial instruments comprise cash and cash equivalents, trade and other receivables, deposits, derivative assets (liabilities), trade and other payables, operating loan, and long term debt.

There are three levels of fair value by which a financial instrument can be classified:

Level 1 - Quoted prices in active markets for identical assets and liabilities such as traded securities on a registered exchange where there are a sufficient frequency and volume of transactions to provide ongoing pricing information.

Level 2 - Inputs other than quoted prices that are observable for the asset and liability either directly and indirectly such as quoted forward prices for commodities, time value and volatility factors which can be substantially observed or corroborated in the marketplace; and

Level 3 - Inputs that are not based on observable market data.

The fair values of the derivative contracts used for risk management as at December 31, 2021 were measured using level 2 observable inputs, including quoted prices received from financial institutions based on published forward price curves as at the measurement date, using the remaining contracted oil and natural gas volumes.

The fair value of cash and cash equivalents, trade and other receivables, deposits, and trade and other payables approximate their carrying amounts due to their short-term maturities. The fair value of the amounts drawn on the operating loan and long term debt is equal to its carrying amount as the facilities bear interest at floating rates and credit spreads that are indicative of market rates.

The following table summarizes Karve's financial instruments at December 31, 2021:

($000s)	Amortized cost	Total fair value
Assets		
Cash and cash equivalents	5,277	5,277
Trade and other receivables	18,478	18,478
Deposits	13	13
	23,768	**23,768**
Liabilities		
Trade and other payables	19,647	19,647
Derivative Liability (NOTE 18)	5,212	5,212
Long term debt	26,823	26,823
	51,682	**51,682**

The following table summarizes Karve's financial instruments at December 31, 2020:

($000s)	Amortized cost	Total fair value
Assets		
Trade and other receivables	10,796	10,796
Deposits	98	98
	10,894	**10,894**
Liabilities		
Trade and other payables	11,119	11,119
Operating loan	5,513	5,513
Derivative liability	2,397	5,513
Long term debt	53,374	53,374
	72,403	**75,519**

b) Risk Associated with Financial Assets and Liabilities

Commodity Price Risk

Due to the volatile nature of natural gas and oil commodity prices, the Company is exposed to adverse consequences if commodity prices decline. The Company is exposed to commodity price movements as part of its operations, particularly in relation to the prices received for its oil and gas production. Oil and gas is sensitive to numerous worldwide factors, many of which are beyond the Company's control. Changes in global supply and demand fundamentals in the oil and gas market and geopolitical events can significantly affect oil and gas prices. These factors could be impacted by the rate at which global energy markets transition to lower carbon-based economies. Consequently, these changes could also affect the value of the Company's properties, the level of spending for exploration and development and the ability to meet obligations as they come due. The Company's oil production is sold under short-term contracts, exposing it to the risk of near-term price movements depending on marketing conditions, it is the Company's policy to hedge a portion of its crude oil sales through the use of financial derivative contracts. The Company does not apply hedge accounting to these contracts.

At December 31, 2021, the Company had the following commodity contracts in place:

Type	Term	Basis [1]	Volume (Bbl/d)	Swap Price ($CAD/Bbl)[1]	Current Liability ($000s)
Fixed price swap	Jan. 1/22 - Dec. 31/22	WTI	500	82.75	(1,579)
Fixed price swap	Jan. 1/22 - Dec. 31/22	WTI	500	83.25	(1,488)
Fixed price swap	Jan. 1/22 - Dec. 31/22	WTI	500	85.50	(1,079)
Fixed price swap	Jan. 1/22 - Dec. 31/22	WTI	500	85.50	(1,066)
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE			**2,000**	**84.25**	**(5,212)**

(1) Nymex WTI monthly average in $CAD.

At December 31, 2021 the fair value of the financial derivative contracts was a current liability position of $5.2 million resulting in an unrealized loss of $2.8 million for the year ended December 31, 2021 (December 31, 2020 - $2.4 million current liability and unrealized loss of $2.4 million). The fair value, or mark-to-market value, of these contracts are based on the estimated amount that would have been received or paid to settle the contracts as at December 31, 2021 and may be different from what will eventually be realized. Assuming all other variables remain constant, a $5.00 USD increase in WTI would result in an unrealized loss of $4.9 million and a derivative liability of $9.3 million and a $5.00 USD decrease in WTI would result in an unrealized gain of $2.9 million and a derivative liability of $1.5 million.

The components of the (loss) gain on financial derivative contracts is as follows:

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
Unrealized (loss) on financial derivative contracts	(2,814)	(2,397)
Realized (loss) gain on financial derivative contracts	(11,415)	544
(LOSS) ON FINANCIAL DERIVATIVE CONTRACTS	**(14,229)**	**(1,853)**

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that bank debt is at a floating or short-term rate of interest in relation to interest expense on its long term debt and operating loan facility. The Credit Facility and operating line incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75% and 4.75% depending on the type of borrowing and the Company's debt to EBITDA ratio and is subject to an annual standby fee on the undrawn portion. As at December 31, 2021, $27.0 million (December 31, 2020 - $53.5 million) was drawn on the Credit facility ($26.8 million – net of amortized debt issue costs). Currently the Company has not entered into any agreements to manage this risk. An increase (decrease) in the interest rate by 1% would result in an increase (decrease) to net income (loss) before tax of $460,000 for the year ended December 31, 2021 (year ended December 31, 2020 - $582,000).

Liquidity Risk

The Company's approach to managing liquidity risk is to have sufficient cash and/or credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of 12 months to identify any financing requirements. Liquidity is managed through daily and longer-term cash, debt, and equity management strategies. These include estimating future cash generated from operations based on reasonable production and pricing assumptions, estimating future discretionary and non-discretionary capital expenditures and assessing the amount of equity or debt financing available.

A contractual maturity analysis for the Company's financial liabilities as at December 31, 2021 is as follows:

($000s)	Within 1 year	1 to 5 years	Total
Trade and other payables	19,647	-	19,647
Derivative liability	5,212		5,212
Lease liabilties	219	433	652
Long term debt	-	26,823	26,823
TOTAL	**25,078**	**27,256**	**52,334**

A contractual maturity analysis for the Company's financial liabilities as at December 31, 2020 is as follows:

($000s)	Within 1 year	1 to 5 years	Total
Trade and other payables	11,119	-	11,119
Operating loan	5,513	-	5,513
Derivative liability	2,397	-	2,397
Lease liabilties	164	-	164
Long term debt	-	53,374	53,374
TOTAL	**19,193**	**53,374**	**72,567**

19. CAPITAL MANAGEMENT

a) Capital Base

In order to continue the Company's future exploration and development program, the Company must maintain a strong capital base to enable access to equity and debt markets. The Company continually monitors the risk/reward profile of its exploration and development projects and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. After considering these factors, revisions to the Company's capital budget are made upon the approval of the Board of Directors.

The Company considers shareholders' capital and net debt/adjusted positive working capital (excluding derivative assets and current portion decommissioning liability) as components of its capital base. The Company can access or increase capital through the issuance of shares, through bank borrowings (based on reserves) and by building cash reserves by reducing its capital expenditure program.

The following table represents the net capital of the Company:

($000s)	As at Dec. 31, 2021	As at Dec. 31, 2020
Shareholders' capital	306,353	264,556
Total current assets	28,523	15,709
Trade and other payables	(19,647)	(11,119)
Operating loan	-	(5,513)
Long term debt	(26,823)	(53,374)
NET DEBT	**(17,947)**	**(54,297)**
CAPITAL BASE	**288,406**	**210,259**

The Company monitors its capital based primarily on its Net debt to annualized funds flow ratio. Net debt is defined as long term debt plus any net working capital deficiency excluding derivative contract asset/liability, current portion of decommissioning liability, and current portion of lease liability. Annualized funds flow is calculated as cash flow from operations before changes in non-cash working capital for the Company's most recent quarter, multiplied by four. To facilitate the management and control its' capital base, the Company prepares annual operating and capital expenditure budgets. The budgets are updated when critical factors change. These include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and Company specific factors or assumptions such as the Company's drilling results and its production profile. The Company's Board of Directors approves the budget and changes thereto. At December 31, 2021, the Company had net debt of $17.9 million (December 31, 2020 – $54.3 million).

The Company's share capital is not subject to external restrictions, but the Company does have key covenants of the credit facilities that include standard business operating covenants. As at December 31, 2021, the Company is in compliance with all covenants and management expects to comply with all terms during the subsequent 12-month period.

20. SUPPLEMENTAL INFORMATION

The following table presents the composition of changes in non-cash working capital and the allocation to operating and investing activities:

($000s)	For the year ended Dec. 31, 2021	Dec. 31, 2020
CHANGES IN NON-CASH WORKING CAPITAL:		
Trade and other receivables (NOTE 4)	(7,679)	7,116
Prepaids and deposits (NOTE 5)	145	382
Trade and other payables (NOTE 6)	8,528	(4,345)
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**994**	**3,153**
CHANGES IN NON-CASH WORKING CAPITAL RELATED TO:		
Operating activities	(3,436)	8,693
Investing activities	4,430	(5,540)
Financing activities	-	-
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**994**	**3,153**

The following table provides a detailed breakdown of the cash and non-cash changes in financing liabilities arising from financing activities:

($000s)	Long term debt	Lease liabilties
Balance at December 31,2019	57,858	717
Additions	-	-
Cash flows	(4,660)	(561)
Amortization of debt issuance costs	176	-
Balance at December 31,2020	**53,374**	**156**
Additions	-	574
Cash flows	(26,682)	(128)
Amortization of debt issuance costs	131	-
Balance at December 31,2021	**26,823**	**602**

The following table presents the amount of total employee compensation costs included in the general and administration and operating expense categories, and share-based compensation recognized for the vesting of stock options and performance warrants granted to employees:

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
General and administration	8,748	4,212
Operating	3,293	3,086
Share-based compensation	2,698	5,312
TOTAL EMPLOYEE COMPENSATION COSTS	**14,739**	**12,610**

The following table presents the composition of petroleum & natural gas sales by product:

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
Crude oil	130,947	73,417
Natural gas liquids	6,028	2,931
Natural gas	16,625	11,757
TOTAL PETROLEUM AND NATURAL GAS SALES	**153,600**	**88,105**

21. RELATED PARTY DISCLOSURES

a) Key Management Personnel

Key management is defined as the Board of Directors and Officers of the Company. The table below summarizes the fair value of compensation and other fees paid to key management:

	For the year ended	
($000s)	Dec. 31, 2021	Dec. 31, 2020
Share-based compensation benefit	1,588	3,085
Salaries and benefits	2,720	1,676
TOTAL KEY MANAGEMENT COMPENSATION	**4,308**	**4,761**