KARVE ENERGY INC

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED

MARCH 31, 2023 AND MARCH 31, 2022

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian $000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
ASSETS		
Current Assets		
Trade and other receivables (NOTE 3)	22,841	22,718
Prepaids and deposits (NOTE 4)	8,046	9,073
Derivative asset (NOTE 15)	281	-
TOTAL CURRENT ASSETS	31,168	31,791
Property, plant and equipment (NOTE 6)	412,323	389,177
Exploration and evaluation (NOTE 6)	15,683	15,999
Right of use asset (NOTE 7)	180	229
TOTAL ASSETS	**459,354**	**437,196**
LIABILITIES		
Current Liabilities		
Trade and other payables (NOTE 5)	34,723	34,466
Operating loan (NOTE 9)	3,208	3,119
Derivative liability (NOTE 15)	-	204
Lease liability (NOTE 8)	276	309
Decommissioning liability (NOTE 10)	3,714	4,126
TOTAL CURRENT LIABILITIES	**41,921**	**42,224**
Long term debt (NOTE 9)	25,853	19,795
Lease liability (NOTE 8)	-	40
Decommissioning liability (NOTE 10)	16,326	15,893
Deferred income tax liability	32,781	29,097
TOTAL LIABILITIES	**116,881**	**107,049**
SHAREHOLDERS' EQUITY		
Share capital (NOTE 11)	175,973	175,973
Contributed surplus (NOTE 11)	33,086	32,483
Accumulated earnings	133,414	121,691
TOTAL SHAREHOLDERS' EQUITY	**342,473**	**330,147**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**459,354**	**437,196**

COMMITMENTS (NOTE 14)

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 AND COMPREHENSIVE INCOME

(Canadian $000s, except per share amounts)	For the three months ended Mar. 31, 2023	Mar. 31, 2022
REVENUE		
Petroleum and natural gas sales (NOTE 17)	59,659	66,324
Royalties	(7,539)	(6,726)
PETROLEUM AND NATURAL GAS SALES, NET OF ROYALTIES	52,120	59,598
Other income (NOTE 12)	1,172	1,027
Gain (Loss) on financial derivative contracts (NOTE 15)	154	(18,928)
TOTAL REVENUE AND OTHER INCOME	53,446	41,697
EXPENSES		
Operating	16,998	12,583
Transportation	1,085	841
General and administration	2,317	1,678
Depletion, depreciation and amortization (NOTE 6, 7, & 10)	15,415	13,355
Financing (NOTE 9)	631	291
Accretion (NOTE 10)	651	573
Share-based compensation (NOTE 13)	603	480
Exploration and evaluation - expiries (NOTE 6)	339	362
NET INCOME BEFORE TAX EXPENSE	15,407	11,534
TAX EXPENSE		
Deferred income tax expense	3,684	2,706
NET INCOME AND COMPREHENSIVE INCOME	11,723	8,828
INCOME PER SHARE ($) (NOTE 11)		
Basic	0.08	0.06
Diluted	0.07	0.06

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Canadian $000s)	For the three months ended Mar. 31, 2023	Mar. 31, 2022
SHARE CAPITAL		
BALANCE, BEGINNING AND END OF PERIOD (NOTE 11)	**175,973**	**225,158**
CONTRIBUTED SURPLUS		
Balance, beginning of period	32,483	30,645
Share-based compensation (NOTE 13)	603	480
BALANCE, END OF PERIOD	**33,086**	**31,125**
EARNINGS		
Balance, beginning of period	121,691	50,550
Net income and comprehensive income	11,723	8,828
BALANCE, END OF PERIOD	**133,414**	**59,378**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Canadian $000s)	For the three months ended Mar. 31, 2023	Mar. 31, 2022
CASH PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net income and comprehensive income	11,723	8,828
ITEMS NOT AFFECTING CASH:		
Depletion, depreciation and amortization (NOTE 6, 7, & 10)	15,415	13,355
Accretion expense (NOTE 10)	651	573
Exploration and evaluation (NOTE 6)	339	362
Unrealized loss on foreign exchange	1	31
Share-based compensation (NOTE 13)	603	480
Unrealized (gain) loss on financial derivatives (NOTE 15)	(485)	12,580
Deferred income tax expense	3,684	2,706
Non-cash financing expense (NOTE 9)	62	54
Decommissioning expenditures (NOTE 10)	(650)	(406)
FUNDS FLOW FROM OPERATIONS	**31,343**	**38,563**
Change in non-cash working capital (NOTE 17)	(2,568)	(13,003)
CASH FLOW FROM OPERATING ACTIVITIES	**28,775**	**25,560**
INVESTING ACTIVITIES		
Exploration and evaluation (NOTE 6)	(251)	(340)
Property, plant and equipment (NOTE 6)	(38,264)	(27,339)
Change in non-cash working capital (NOTE 17)	3,728	6,682
CASH FLOW USED FOR INVESTING ACTIVITIES	**(34,787)**	**(20,997)**
FINANCING ACTIVITIES		
Operating line (NOTE 9)	89	2,195
Financing lease expense (NOTE 8)	(77)	(35)
Increase in long term debt (NOTE 9)	8,000	-
Repayment of long term debt (NOTE 9)	(2,000)	(12,000)
CASH FLOW USED FOR FINANCING ACTIVITIES	**6,012**	**(9,840)**
(Decrease) in cash and cash equivalents	-	(5,277)
Cash and cash equivalents, beginning of period	-	5,277
CASH AND CASH EQUIVALENTS, END OF PERIOD	**-**	**-**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

These interim consolidated financial statements are as at March 31, 2023 and for the three months ended March 31, 2023 and 2022. Tabular amounts are 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

These interim consolidated financial statements (the "financial statements") are presented under International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim consolidated financial statements, including International Accounting Standard ("IAS") 34 Interim Financial Reporting and have been prepared following the same accounting policies as the annual consolidated financial statements for the year ended December 31, 2022. Certain information and disclosures included in the notes to the annual consolidated financial statements are condensed herein or are disclosed on an annual basis only. Accordingly, these interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2022.

The financial statements were approved and authorized for issue by Karve's Board of Directors on May 10, 2023.

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. The financial statements are measured and presented in Canadian dollars as the functional currency of the Company.

All accounting policies and methods of computation followed in the preparation of these financial statements are consistent with those in the December 31, 2022 audited consolidated financial statements, except for income taxes. Income taxes for interim periods are accrued using the income tax rate that would be applicable to the expected annual net income (loss).

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 in NOTE 2 of the December 31, 2022 audited consolidated financial statements.

Changes in Accounting Policies and Disclosures

Amendments to IAS 12 *Income Taxes*

IAS 12 has been amended to recognize deferred tax on particular transactions that, on initial recognition, give rise to equal amounts of taxable and deductible temporary differences. These amendments are effective for periods beginning on or after January 1, 2023. The Company adopted the amendments to IAS 12, along with any consequential amendments. These changes were made in accordance with applicable transitional provisions and did not have a material impact on the financial statements.

Amendments to IAS 1 *Presentation of Financial Statements*

The Company plans to adopt the following amendments to accounting standards, issued by the IASB. Each is not expected to have a material impact on the financial statements.

In January 2020, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* ("IAS 1"), to clarify its requirements for the presentation of liabilities as current or non-current in the statement of financial position. This will be effective on January 1, 2024.

In October 2022, the IASB issued amendments to IAS 1, which specify the classification and disclosure of a liability with covenants. This will be effective on January 1, 2024.

3. TRADE AND OTHER RECEIVABLES

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Trade	21,975	21,567
Joint venture	1,041	1,447
Allowance for doubtful accounts	(175)	(296)
TRADE AND OTHER RECEIVABLES	**22,841**	**22,718**

Of the Company's accounts receivable at March 31, 2023, approximately 75% was receivable from three oil marketers (34%, 19% and 22%). At December 31, 2022, approximately 61% was receivable from two oil marketers (33% and 28%). Accounts receivable outstanding greater than ninety days at March 31, 2023 was $693,000 (December 31, 2022 - $755,000).

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 held a provision of $175,000 at March 31, 2023 as it determined certain joint venture receivables were uncollectible using the ECL model (December 31, 2022 - $296,000).

4. PREPAIDS AND DEPOSITS

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Prepaids	7,989	9,016
Deposits	57	57
PREPAIDS AND DEPOSITS	**8,046**	**9,073**

Included in prepaids are deposits on casing and other equipment for the 2023 capital program.

5. TRADE AND OTHER PAYABLES

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Trade	23,567	22,308
Accrued	8,789	7,860
Royalties	1,456	1,820
GST	264	390
Joint venture	647	2,088
TRADE AND OTHER PAYABLES	**34,723**	**34,466**

6. 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 period:

COST ($000s)	Petroleum and Natural Gas Assets	Corporate Assets	Total Property, Plant and Equipment	Exploration & Evalutation Assets
BALANCE AT DECEMBER 31, 2021	561,789	988	562,777	18,259
Additions	103,684	112	103,796	452
Transfers to (from) P&NG/E&E assets	486	-	486	(486)
Change in decommissioning provision (NOTE 10)	748	-	748	-
Expiries	-	-	-	(2,226)
BALANCE AT DECEMBER 31, 2022	**666,707**	**1,100**	**667,807**	**15,999**
Additions	38,152	112	38,264	251
Transfers to (from) P&NG/E&E assets	228	-	228	(228)
Change in decommissioning provision (NOTE 10)	20	-	20	-
Expiries	-	-	-	(339)
BALANCE AT MARCH 31, 2023	**705,107**	**1,212**	**706,319**	**15,683**
ACCUMULATED DD&A ($000s)				
BALANCE AT DECEMBER 31, 2021	222,362	651	223,013	-
Depletion, depreciation and amortization	55,439	178	55,617	-
BALANCE AT DECEMBER 31, 2022	**277,801**	**829**	**278,630**	**-**
Depletion, depreciation and amortization	15,316	50	15,366	-
BALANCE AT MARCH 31, 2023	**293,117**	**879**	**293,996**	**-**
NET CARRYING AMOUNT, DECEMBER 31, 2022	**388,906**	**271**	**389,177**	**15,999**
NET CARRYING AMOUNT, MARCH 31, 2023	**411,990**	**333**	**412,323**	**15,683**

Petroleum and Natural Gas Assets

At March 31, 2023, future development and production costs of $506.6 million (December 31, 2022 - $474.8 million) are included in costs subject to depletion.

General and administration costs capitalized by the Company during the three months ended March 31, 2023 were $827,000 (three months ended March 31, 2022 - $679,000).

The Company assessed for indicators of impairment and there were no indicators of impairment at March 31, 2023 or December 31, 2022.

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 March 31, 2023 or December 31, 2022.

7. RIGHT OF USE ASSETS

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

($000s)	
Balance at December 31, 2022	1,312
Additions	-
BALANCE AT MARCH 31, 2023	**1,312**
ACCUMULATED DEPRECIATION AND AMORTIZATION	
Balance at December 31, 2022	(1,083)
Depreciation and amortization	(49)
BALANCE AT MARCH 31, 2023	**(1,132)**
NET CARRYING AMOUNT, MARCH 31, 2023	**180**

8. 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, 2022	349
Interest expense	4
Lease payments	(77)
BALANCE AT MARCH 31, 2023	**276**

	As at Mar. 31, 2023	As at Dec. 31, 2022
Lease liability - current	276	309
Lease liability - long term	-	40
TOTAL LEASE LIABILITY AT END OF PERIOD	**276**	**349**

The Company has an 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	291	-	291

9. OPERATING LOAN AND LONG TERM DEBT

As at March 31, 2023, the Company had total bank credit facilities of $55.0 million, comprised of a $48.0 million Credit Facility and a $7.0 million operating loan. 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 31, 2023.

As at March 31, 2023, $25.9 million (net of unamortized debt issue costs) (December 31, 2022 - $19.8 million) was drawn on the Credit Facility and $3.2 million (December 31, 2022 - $3.1) was drawn on the operating loan.

The Company has issued letters of credit of $400,000 as at March 31, 2023 (December 31, 2022 - $400,000), thereby reducing the available bank credit facility by this amount.

Bank debt as at March 31, 2023 and December 31, 2022 is as follows:

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Credit Facility	26,000	20,000
Less: unamortized debt issue costs	(147)	(205)
LONG TERM DEBT	**25,853**	**19,795**
Bank operating loan	3,208	3,119
TOTAL BANK DEBT	**29,061**	**22,914**

Financing expense for the three months ended March 31, 2023 and March 31, 2022 is comprised of the following:

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
Credit facility interest and charges	523	180
Operating loan interest and charges	46	57
Amortization of debt issue costs	58	46
Interest on lease liability (NOTE 10)	4	8
FINANCING EXPENSES	**631**	**291**

For the three months ended March 31, 2023, the effective interest rate on the credit facility was 8.3% (March 31, 2022 – 4.9%).

10. 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 $186.5 million ($107.7 million undiscounted, uninflated) (December 31, 2022 - $185.5 million and $107.2 million respectively), which will be incurred over the remaining life of the assets with the costs to be incurred between 2023 and 2065. The estimated future cash flows have been discounted using a credit adjusted rate of 12% (December 31, 2022 – 12%) and an inflation rate of 2% (December 31, 2022 – 2%). The change in estimate for the year ended December 31, 2022 relates to an increase in costs of abandonment for 2023 and 2024; and an increase to the credit adjusted discount rate from 11% to 12%.

On May 1, 2020, the Alberta Department of Energy initiated the Site Rehabilitation Program ("SRP") whereby it provided funding in the form of grant payments to the oil field services sector to abandon and/or reclaim upstream oil and gas infrastructure. As at March 31, 2023, the Company recognized $4.4 million in SRP funding (December 31, 2022 - $4.4 million). 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 and comprehensive income.

The following table shows changes in the decommissioning liability:

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Balance, beginning of period	20,019	20,852
Decommissioning liabilities incurred during the period	20	264
Decommissioning liabilities settled during the period	(650)	(2,547)
Decommissioning liabilities settled during the period through SRP	-	(1,331)
Accretion expense during the period	651	2,297
Change in estimate	-	484
BALANCE, END OF PERIOD	**20,040**	**20,019**
Decommissioning liability - current	3,714	4,126
Decommissioning liability - long term	16,326	15,893
TOTAL DECOMMISSIONING LIABILITY - END OF PERIOD	**20,040**	**20,019**

11. 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, 2021	**140,529,665**	**225,158**
Return of capital	-	(49,185)
BALANCE AT DECEMBER 31, 2022 and MARCH 31, 2023	**140,529,665**	**175,973**

On July 1, 2022, the Company notified its Shareholders that the Company would reduce its stated capital by $49.2 million in the aggregate, representing a Return of Capital of $0.35 per Common Share. The Company distributed that amount to the holders of the Common Shares (the "Return of Capital"). The record date for determining the holders of Common Shares entitled to receive the Return of Capital was the close of business on July 15, 2022 and the Return of Capital was paid on July 29, 2022.

c) Contributed Surplus

($000s)	As at Mar. 31, 2023	As at Dec. 31, 2022
Balance, beginning of period	32,483	30,645
Share-based compensation - options	101	1,188
Share-based compensation - warrants	502	650
BALANCE, END OF PERIOD	**33,086**	**32,483**

d) Per Share Amounts

($000s except per share amounts)	For the three months ended Mar. 31, 2023	Mar. 31, 2022
Net income for the period	11,723	8,828
Weighted average number of shares - basic	140,529,665	140,529,665
Dilutive impact of share-based compensation plans	16,472,508	5,410,732
Weighted average number of shares - diluted	**157,002,173**	**145,940,397**
Net income per share - basic	**0.08**	**0.06**
Net income per share - diluted	**0.07**	**0.06**

12. OTHER INCOME

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

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
Processing fee income	948	960
Royalty income	111	63
Other	113	4
TOTAL OTHER INCOME	**1,172**	**1,027**

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

Royalty income relates to freehold royalties, gross overriding royalties, royalties paid to the Company on fee title lands, and net profit interests.

13. SHARE-BASED COMPENSATION

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

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
Share-based compensation - options	101	175
Share-based compensation - performance warrants	502	305
TOTAL SHARE-BASED COMPENSATION	**603**	**480**

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. On November 25, 2022, an extension of 2 years to the expiry (from 7 years to 9 years) for options outstanding was approved by the Board of Directors.

Share-based compensation expense related to stock options during the three months ended March 31, 2023 was $101,000 (three months ended March 31, 2022 - $175,000).

The following table sets forth a reconciliation of the stock option plan activity from December 31, 2021 through to March 31, 2023:

	Number	Wtd. Avg. Exercise Price ($) (1)
Balance at December 31, 2021	13,736,260	1.44
Granted	297,500	3.09
Forfeited	(81,000)	1.80
BALANCE AT DECEMBER 31, 2022 & MARCH 31, 2023	**13,952,760**	**1.47**

(1) Weighted average exercise prices have been adjusted due to the $0.35 per share return of capital distribution paid on July 29, 2022.

There were no stock options exercised during the three months March 31, 2023. As at March 31, 2023 there were 13,555,259 options exercisable. There were no stock options exercised during the year ended December 31, 2022 and there were 13,438,592 options exercisable as at December 31, 2022.

The range of exercise prices of the outstanding options and weighted average contractual life remaining as at March 31, 2023 were as follows:

Exercise Price Range [1]	Wtd. Avg. Contractual Life Remaining	Number of options outstanding	Number of options exercisable
$0.50	2.09	2,320,976	2,320,976
$0.51 - $1.64	2.26	1,667,357	1,667,357
$1.65 - $3.09	4.17	9,964,427	9,566,926
	3.59	**13,952,760**	**13,555,259**

(1) Exercise prices have been adjusted due to the $0.35 per share return of capital distribution paid on July 29, 2022.

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, 2022
Weighted average fair value of options granted	1.77
Risk-free Interest rate (%)	2.83%
Expected life (years)	5.8
Estimated volatility of underlying common shares (%)	61%
Weighted average grant date share price	3.09
Forfeiture rate	3%
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 three months ended March 31, 2023 (year ended December 31, 2022 – nil).

The performance warrants entitle the holder to purchase one common share of the Company and were originally granted with 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. On November 25, 2022, an extension of 2 years to the expiry (from 7 years to 9 years) for options outstanding was approved by the Board of Directors.

Share-based compensation expense related to performance warrants during the three months ended March 31, 2023 was $502,000 (three months ended March 31, 2022 - $305,000).

The following table sets forth a reconciliation of performance warrant activity from December 31, 2021 through to March 31, 2023:

	Number	Wtd. Avg. Exercise Price ($) (1)
Balance at December 31, 2021	31,893,500	2.51
Forfeited	(62,000)	3.45
BALANCE AT DECEMBER 31, 2022 & MARCH 31, 2023	**31,831,500**	**2.51**

There were no performance warrants exercised during the three months ended March 31, 2023 (year ended December 31, 2022 - nil) and 6,460,000 performance warrants were exercisable at March 31, 2023 and December 31, 2022.

The range of exercise prices of the outstanding performance warrants and weighted average contractual life remaining as at March 31, 2023 were as follows:

Exercise Price Range (1)	Wtd. Avg. Contractual Life Remaining	Number of warrants outstanding	Number of warrants exercisable
$1.15 to $2.64	2.19	15,700,000	6,460,000
$2.65 to $3.64	3.20	9,678,900	-
$3.65 to $4.25	3.20	6,452,600	-
	2.70	**31,831,500**	**6,460,000**

(1) Exercise prices have been adjusted due to the $0.35 per share return of capital distribution paid on July 29, 2022.

14. COMMITMENTS

Future minimum payments under operating leases and pipeline transportation agreements as at March 31, 2023 are as follows:

($000s)	2023	2024	2025	Thereafter	Total
Operating leases	65	17	17	14	113
Pipeline transportation	757	-	-	-	757
TOTAL COMMITMENTS	**822**	**17**	**17**	**14**	870

15. 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, foreign exchange contracts, 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 and foreign exchange contracts used for risk management as at March 31, 2023 were measured using level 2 observable inputs. This includes 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) and forward exchange rates, respectively.

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 March 31, 2023:

($000s)	Amortized cost	Total fair value
Assets		
Trade and other receivables	22,841	22,841
Deposits	57	57
Derivative asset (NOTE 15)	282	282
	23,180	**23,180**
Liabilities		
Operating loan (NOTE 9)	3,208	3,208
Trade and other payables	34,723	34,723
Long term debt	25,853	25,853
	63,784	**63,784**

The following table summarizes Karve's financial instruments at December 31, 2022:

($000s)	Amortized cost	Total fair value
Assets		
Trade and other receivables	22,718	22,718
Deposits	57	57
	22,775	**22,775**
Liabilities		
Operating loan (NOTE 9)	3,119	3,119
Trade and other payables	34,466	34,466
Derivative liability (NOTE 15)	204	204
Long term debt	19,795	19,795
	57,584	**57,584**

b) Risk Associated with Financial Assets and Liabilities

Market Risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates, and interest rates will affect the Company's net income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company utilizes financial derivative contracts to manage certain market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

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

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
Unrealized gain (loss) financial derivative contracts	485	(12,580)
Realized (loss) on financial derivative contracts	(331)	(6,348)
GAIN (LOSS) ON FINANCIAL DERIVATIVE CONTRACTS	**154**	**(18,928)**

i) 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 March 31, 2023 the fair value of the commodity derivative contracts was a $nil, as all outstanding contracts ended on March 31, 2023, resulting in an unrealized gain of $204,000 for the three months ended March 31, 2023 (December 31, 2022 - $204,000 current liability and unrealized gain of $5.0 million). During the three months ended March 31, 2023, the Company realized a loss of $331,000 on the commodity derivative contract (March 31, 2022 - $6.3 million).

ii) Foreign Exchange Risk

The Company is exposed to the risk of changes in the U.S./Canadian dollar exchange rate ("USD/CAD") on crude oil sales based on U.S. dollar benchmark prices. Foreign exchange risk is mitigated by entering into foreign exchange contracts. During the three months ended March 31, 2023, the Company entered into the following foreign exchange contract:

Type	Term	Monthly Notional Amt.	Floor	Ceiling	Current Asset ($000s)
Average rate collar	Apr. 1/23 - Dec. 31/23	US $3.5 million	1.3400	1.3960	281

At March 31, 2023, the fair value of the foreign exchange contract was a current asset position of $281,000 resulting in an unrealized gain of $281,000 for the three months ended March 31, 2023. The fair value, or mark-to-market value, of this contract is based on the estimated amount that would have been received or paid to settle the contracts as at March 31, 2023 and may be different from what will eventually be realized. Assuming all other variables remain constant, an increase of $0.01 in USD/CAD would have resulted in an unrealized gain and a derivative asset of $109,000, and a decrease of $0.01 in USD/CAD would have resulted in an unrealized gain and a derivative asset of $475,000.

iii) 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 March 31, 2023, $26.0 million (December 31, 2022 - $20.0 million) was drawn on the Credit facility ($25.9 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 before tax of $68,000 for the three months ended March 31, 2023 (three months ended March 31, 2022 - $48,000).

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 March 31, 2023 is as follows:

($000s)	Within 1 year	1 to 5 years	Total
Bank indebtedness	3,208	-	3,208
Trade and other payables	34,723	-	34,723
Lease liabilities	291	-	291
Long term debt	-	25,853	25,853
TOTAL	**38,222**	**25,853**	**64,075**

A contractual maturity analysis for the Company's financial liabilities as at December 31, 2022 is as follows:

($000s)	Within 1 year	1 to 5 years	Total
Bank indebtedness	3119	-	3,119
Trade and other payables	34,466	-	34,466
Derivative liability	204	-	204
Lease liabilities	326	43	369
Long term debt	-	19,795	19,795
TOTAL	**38,115**	**19,838**	**57,953**

16. 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 Mar. 31, 2023	As at Dec. 31, 2022
Shareholders' Equity	342,473	330,147
Total current assets	30,887	31,791
Trade and other payables	(34,723)	(34,466)
Operating loan	(3,208)	(3,119)
Long term debt	(25,853)	(19,795)
NET DEBT	**(32,897)**	**(25,589)**
CAPITAL BASE	**309,576**	**304,558**

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 of 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, 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 March 31, 2023, the Company had net debt of $32.9 million (December 31, 2022 – $25.6 million).

The Company's share capital is not subject to external restrictions, but the Company does have key covenants of its credit facilities that include standard business operating covenants. As at March 31, 2023, the Company is in compliance with all covenants and management expects to comply with all terms during the subsequent 12-month period.

17. SUPPLEMENTAL INFORMATION

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

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
CHANGES IN NON-CASH WORKING CAPITAL:		
Trade and other receivables (NOTE 3)	(124)	(11,650)
Prepaids and deposits (NOTE 4)	1,027	(180)
Trade and other payables (NOTE 5)	257	5,509
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**1,160**	**(6,321)**
CHANGES IN NON-CASH WORKING CAPITAL RELATED TO:		
Operating activities	(2,568)	(13,003)
Investing activities	3,728	6,682
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**1,160**	**(6,321)**

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, 2021	26,823	602
Additions	19,972	-
Cash flows	(27,166)	(253)
Amortization of debt issuance costs	166	-
BALANCE AT DECEMBER 31, 2022	**19,795**	**349**
Additions	8,000	-
Cash flows	(2,000)	(73)
Amortization of debt issuance costs	58	-
BALANCE AT MARCH 31, 2023	**25,853**	**276**

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

	For the three months ended	
($000s)	Mar. 31, 2023	Mar. 31, 2022
Crude oil	53,202	57,938
Natural gas liquids	2,119	2,273
Natural gas	4,338	6,113
TOTAL PETROLEUM AND NATURAL GAS SALES	**59,659**	**66,324**