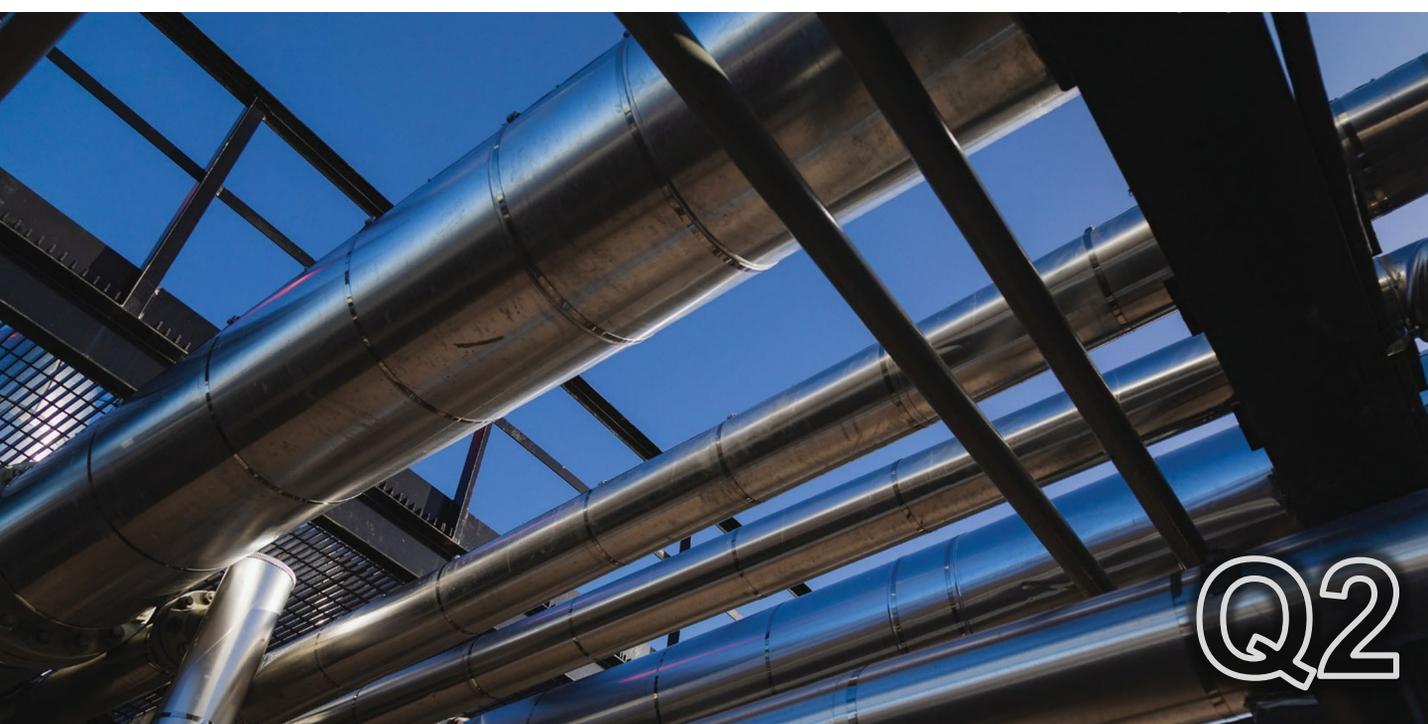


CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS



PIPESTONE
ENERGY CORP.



Q2

RESPONSIBLY GROWING THE EXCEPTIONAL PIPESTONE MONTNEY PLAY

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2023

Pipestone Energy Corp.
Condensed Interim Consolidated Statements of Financial Position

(amounts in thousands of Canadian dollars) (unaudited)

	Note	June 30, 2023	December 31, 2022
		\$	\$
Assets			
Current assets			
Accounts receivable	4(a)	52,451	72,657
Risk management contracts	4(c)	4,500	7,242
Prepaid expenses and deposits		14,619	7,617
Total current assets		71,570	87,516
Non-current assets			
Exploration and evaluation assets	5	17,539	17,278
Property and equipment	5	1,003,984	894,851
Right-of-use assets	5	92,401	98,388
Total assets		1,185,494	1,098,033
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		101,781	92,614
Lease liabilities	7	8,455	7,766
Dividend Payable	10(d)	-	8,368
Total current liabilities		110,236	108,748
Non-current liabilities			
Bank debt	6	137,683	105,095
Lease liabilities	7	94,525	98,706
Decommissioning provisions	8	15,477	13,846
Deferred tax liabilities		103,326	88,165
Total liabilities		461,247	414,560
Shareholders' Equity			
Share capital	10	440,747	439,041
Contributed surplus	10(e)	9,336	7,992
Retained earnings		274,164	236,440
Total shareholders' equity		724,247	683,473
Total liabilities and shareholders' equity		1,185,494	1,098,033
Commitments and contingencies (note 14)			
Subsequent events (note 15)			

Approved by the Board of Directors.

(Signed) "Gordon Ritchie", Director

(Signed) "Kimberly Anderson", Director

See accompanying notes to the financial statements.

Pipestone Energy Corp.

Condensed Interim Consolidated Statements of Income and Comprehensive Income

(amounts in thousands of Canadian dollars, except for per share amounts) (unaudited)

	Note	Three months ended June 30,		Six months ended June 30,	
		2023	2022	2023	2022
		\$	\$	\$	\$
Revenue					
Sales of liquids and natural gas	11	121,346	210,380	270,355	363,910
Royalties		(9,899)	(16,698)	(22,409)	(27,147)
Liquids and natural gas revenue		111,447	193,682	247,946	336,763
Realized gain (loss) on commodity risk management contracts	4(c)	3,020	(29,431)	11,806	(41,684)
Unrealized gain (loss) on commodity risk management contracts	4(c)	2,296	23,031	(2,108)	(8,582)
Total revenue		116,763	187,282	257,644	286,497
Expenses					
Operating		40,939	36,053	83,619	63,418
Transportation		11,671	10,660	21,973	20,572
General and administrative		3,031	2,494	5,987	5,006
Share-based compensation	10(e)	1,318	4,641	2,731	6,077
Exploration and evaluation	5	-	829	829	829
Depletion and depreciation	5	34,217	19,807	69,972	37,750
Total expenses		91,176	74,484	185,111	133,652
Operating Income		25,587	112,798	72,533	152,845
Financing expense	12	(5,798)	(6,150)	(11,258)	(12,240)
Realized gain (loss) on interest rate risk management contracts	4(c)	-	(59)	642	(272)
Unrealized gain (loss) on interest rate risk management contracts	4(c)	-	591	(634)	1,477
Income Before Income Taxes		19,789	107,180	61,283	141,810
Deferred income tax expense		(4,549)	(25,085)	(15,161)	(32,663)
Income and Comprehensive Income for the Period		15,240	82,095	46,122	109,147
Income per Share					
Basic	10(b)	0.05	0.43	0.17	0.57
Diluted	10(b)	0.05	0.29	0.16	0.39

See accompanying notes to the financial statements.

Pipestone Energy Corp.

Condensed Interim Consolidated Statements of Changes in Equity

(amounts in thousands of Canadian dollars) (unaudited)

	Note	Common shares (000s)	Share capital \$	Contributed surplus \$	Retained earnings (deficit) \$	Total \$
Balance at January 1, 2022		191,446	394,159	4,789	24,691	423,639
Conversion of restricted share units	10(e)	862	939	(939)	-	-
Exercise of stock options	10(e)	345	700	(133)	-	567
Non-cash share-based compensation	10(e)	-	234	1,548	-	1,782
Employee share purchase plan	10(e)	95	235	-	-	235
Purchase of common shares under NCIB	10(c)	(4,311)	(21,230)	-	-	(21,230)
Income for the period		-	-	-	109,147	109,147
Balance at June 30, 2022		188,437	375,037	5,265	133,838	514,140
Conversion of restricted share units	10(e)	305	444	(444)	-	-
Exercise of stock options	10(e)	469	1,323	(249)	-	1,074
Non-cash share-based compensation	10(e)	-	261	1,998	-	2,259
Employee share purchase plan	10(e)	134	259	-	-	259
Tax deduction on excess value of share awards		-	-	1,422	-	1,422
Purchase of common shares under NCIB	10(c)	(4,338)	(18,133)	-	-	(18,133)
Conversion of preferred shares	9	93,942	79,850	-	-	79,850
Dividends	10(d)	-	-	-	(8,368)	(8,368)
Income for the period		-	-	-	110,970	110,970
Balance at December 31, 2022		278,949	439,041	7,992	236,440	683,473
Conversion of restricted share units	10(e)	456	1,093	(1,093)	-	-
Exercise of stock options	10(e)	37	77	(26)	-	51
Non-cash share-based compensation	10(e)	-	268	2,463	-	2,731
Employee share purchase plan	10(e)	196	268	-	-	268
Dividends	10(d)	-	-	-	(8,398)	(8,398)
Income for the period		-	-	-	46,122	46,122
Balance at June 30, 2023		279,638	440,747	9,336	274,164	724,247

See accompanying notes to the financial statements.

Pipestone Energy Corp.

Condensed Interim Consolidated Statements of Cash Flows

(amounts in thousands of Canadian dollars) (unaudited)

	Note	Three months ended		Six months ended	
		2023	June 30, 2022	2023	June 30, 2022
		\$	\$	\$	\$
Cash flows related to:					
Operating Activities					
Income		15,240	82,095	46,122	109,147
Add (deduct) items not involving cash:					
Unrealized (gain) loss on interest rate risk management contracts	4(c)	-	(591)	634	(1,477)
Unrealized (gain) loss on commodity risk management contracts	4(c)	(2,296)	(23,031)	2,108	8,582
Non-cash share-based compensation	10(e)	1,318	346	2,731	1,782
Exploration and evaluation	5	-	829	829	829
Depletion and depreciation	5	34,217	19,807	69,972	37,750
Deferred income tax expense		4,549	25,085	15,161	32,663
Non-cash financing expense	12	331	1,603	683	3,184
Decommissioning provision costs incurred	8	(14)	-	(75)	-
Change in non-cash working capital	13	(12,388)	23,456	(19,208)	1,151
Cash from operating activities		40,957	129,599	118,957	193,611
Investing Activities					
Exploration and evaluation asset expenditures	5	(706)	(14)	(1,090)	(110)
Property and equipment expenditures	5	(64,139)	(77,776)	(171,251)	(155,639)
Property and equipment acquisitions	5	(101)	-	(101)	(96)
Change in non-cash working capital	13	(5,177)	18,370	41,579	34,657
Cash used in investing activities		(70,123)	(59,420)	(130,863)	(121,188)
Financing Activities					
Advances (repayments) of bank debt	6(a)	40,018	(54,217)	32,817	(48,271)
Bank debt issuance costs	6(a)	(684)	(631)	(684)	(677)
Principal portion of lease payments	7	(1,932)	(1,480)	(3,780)	(3,047)
Exercise of stock options	10(e)	15	76	51	567
Proceeds from issuance of common shares under employee purchase plan	10(e)	137	122	268	235
Dividends	10(d)	(8,388)	-	(8,398)	-
Purchase of common shares under NCIB	10(c)	-	(14,049)	-	(21,230)
Change in non-cash working capital	13	-	-	(8,368)	-
Cash from (used in) financing activities		29,166	(70,179)	11,906	(72,423)
Change in cash and cash equivalents		-	-	-	-
Cash and cash equivalents, beginning of period		-	-	-	-
Cash and cash equivalents, end of period		-	-	-	-

Supplemental cash flow information (note 13)

See accompanying notes to the financial statements.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

1. Reporting entity and description of the business

Pipestone Energy Corp. (“Pipestone Energy” or the “Company”) is engaged in the responsible exploration for, and development and production of, oil and natural gas liquids (including condensate, pentane, butane, propane and ethane) herein collectively referenced as “Liquids” and natural gas in Western Canada, with substantially all of its activities and assets focused in the Montney resource play in Alberta. The Company is incorporated under the Business Corporations Act (Alberta) and its shares are listed on the Toronto Stock Exchange (“TSX”) under the ticker symbol PIPE. The address and principal place of business of the Company is Suite 3700, 888 – 3rd Street S.W., Calgary, Alberta, T2P 5C5.

2. Basis of preparation

a) Statement of compliance

The unaudited condensed interim consolidated financial statements were prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (IASB), including International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*. The unaudited condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2022, which were prepared in accordance with IFRS. The disclosures provided herein are incremental to that in the annual consolidated financial statements. Certain information and disclosure required in the notes to the annual consolidated financial statements is condensed in these interim consolidated financial statements or disclosed only on an annual basis.

The condensed interim consolidated financial statements were approved and authorized for issuance by Pipestone Energy’s Board of Directors (the “Board”) on August 8, 2023.

b) Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. These estimates are reviewed periodically and, as adjustments become necessary, are reported in the period in which they become known. By their nature, these estimates and related future cash flows are subject to measurement uncertainty, and the impact on future consolidated financial statements could be material. A full list of the key sources of estimation uncertainty can be found in the Company’s annual financial statements for the year ended December 31, 2022.

3. New accounting policies

These condensed interim consolidated financial statements follow the same accounting policies as the audited consolidated financial statements for the year ended December 31, 2022, other than the following amendments to accounting standards, as issued by the IASB, that became effective for and were adopted on January 1, 2023. These amendments have not had a material impact on the consolidated financial statements.

IAS 12 Income Taxes

In May 2021, the IASB issued an amendment to IAS 12 Income Taxes to clarify the accounting for deferred tax on transactions such as leases and decommissioning obligations. The scope of the recognition exemption in IAS 12 no longer applies to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

IAS 1 Presentation of Financial Statements

In January 2020, the IASB issued amendments to IAS 1 Presentation of Financial Statements, to clarify its requirements for the presentation of liabilities as current or non-current in the statement of financial position.

4. Financial instruments and risk management

a) Credit risk

Pipestone Energy is exposed to credit risk on accounts receivable and risk management contract assets in the event that customers, joint interest partners, or counterparties fail to discharge their contractual obligations. As at June 30, 2023, Pipestone Energy's maximum exposure to receivable credit risk was \$57.0 million (December 31, 2022 – \$79.9 million) which is the value of accounts receivable and any risk management contract assets on the statement of financial position. The Company considers all accounts receivable greater than 90 days to be past due. At June 30, 2023, \$Nil is past due (December 31, 2022 – \$Nil). The Company believes that the credit risk associated with its risk management contracts is low given that the contracts are all held with large Canadian financial institutions. The Company continuously monitors the creditworthiness of customers and joint operations to limit exposure to this risk and considers all its current accounts receivable and risk management contract balances to be collectible.

b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

While the Company believes it will be successful in meeting its liquidity requirements, significant uncertainty exists due to the volatility of commodity prices; future reserve and production risks; and the ability of the Company, if required; to raise additional debt or equity financing.

See note 14 for the timing of undiscounted cash flows relating to the financial liabilities outstanding at June 30, 2023.

c) Market risk

Market risks are as follows:

Foreign currency risk

At June 30, 2023 and December 31, 2022, the Company had no forward exchange rate contracts nor any working capital denominated in foreign currencies. The Company has indirect exposure to foreign currency risk due to the fact that WTI oil prices and a subset of its natural gas production volumes sold are benchmarked against the United States dollar. Condensate prices are also influenced by WTI prices.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate because of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears variable rates of interest. The Company had a floating-to-fixed interest rate swap with a term that ended on March 31, 2023. This contract was held with a lender of the Company.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

A reconciliation of changes of fair value in Pipestone Energy's interest rate risk management contract asset (liability) and its carrying value is as follows:

	June 30, 2023	December 31, 2022
	\$	\$
Fair value of contracts, beginning of period	634	(439)
Change in the fair value of contracts	8	1,616
Fair value of contracts realized – gain	(642)	(543)
Fair value of contracts, end of period	-	634
Current asset	-	634

Commodity price risk

The following table summarizes the carrying value of Pipestone Energy's outstanding commodity risk management contract assets by product type:

	June 30, 2023	December 31, 2022
	\$	\$
Crude oil	3,187	889
Natural gas	1,313	5,719
Net commodity risk management contract asset	4,500	6,608

The Company has offset the following commodity risk management contracts where it has a legal right to settle on a net basis with its counterparties:

	June 30, 2023			December 31, 2022		
	\$ Asset	\$ Liability	\$ Net	\$ Asset	\$ Liability	\$ Net
Current asset	4,500	-	4,500	6,613	(5)	6,608
Net position	4,500	-	4,500	6,613	(5)	6,608

At June 30, 2023, Pipestone Energy had the following commodity risk management contracts in place:

Term	C\$ WTI swaps ⁽¹⁾⁽²⁾		AECO 5A swaps ⁽¹⁾⁽²⁾	
	bbls/d	C\$/bbl	GJ/d	C\$/GJ
Jul. – Sept. '23	1,917	105.48	6,250	3.98
Oct. – Dec. '23	1,250	102.93	2,083	3.98

⁽¹⁾ Weighted-average volumes and prices are presented.

⁽²⁾ WTI refers to the West Texas Intermediate crude oil price and AECO refers to the Alberta Energy Company natural gas price (5A is a simple average of the daily spot prices).

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

A reconciliation of changes of fair value in Pipestone Energy's commodity risk management contracts is as follows:

	June 30, 2023	December 31, 2022
	\$	\$
Fair value of contracts, beginning of period	6,608	(5,498)
Change in the fair value of contracts	9,698	(39,780)
Fair value of contracts realized – (gain) loss	(11,806)	51,886
Fair value of contracts, end of period	4,500	6,608

Commodity price sensitivities – risk management positions

The following summarizes the sensitivity of the fair value of Pipestone Energy's commodity risk management contracts to fluctuations in commodity prices, with all other variables held constant. Management believes the price fluctuations identified below are a reasonable measure of volatility. Fluctuating commodity prices could have resulted in unrealized gains or losses on the Company's risk management contracts at June 30, 2023, affecting profit or loss for the three months ended as follows:

Commodity	Sensitivity range	Increase	Decrease
		\$	\$
Crude oil	± Cdn\$1 per bbl – WTI NYMEX	(193)	193
Natural gas	± Cdn\$0.10 per GJ – AECO 5A	(32)	32

d) Capital management

The Company's objective for managing capital is to maintain a strong balance sheet and available funding while providing financial flexibility to fund sustaining capital, high-return development growth and shareholder returns, which includes dividends and share buybacks. Future expenditures are anticipated to be funded by the Company's adjusted funds flow from operations and draws under the credit facility to the extent necessary.

Pipestone Energy manages its liquidity risk through its capital structure, cash flow forecasting, available credit and commodity hedging programs. The Company believes that it has sufficient available funding and will generate enough future cash flow to meet its foreseeable liquidity requirements.

The Company strives for a proportion of debt to future cashflow which appropriately balances the level of risk being incurred by its capital investments. Pipestone Energy's long-term strategy is to maintain a net debt to adjusted funds flow from operations ratio of less than 1.0 times. The actual ratio may fluctuate due to several factors including commodity prices, production levels, timing of expenditures and shareholder returns, such as dividends and share buybacks.

Adjusted funds flow from operations

Pipestone Energy uses adjusted funds flow from operations to provide an understanding of the Company's ability to generate cash flow necessary for financing its capital expenditures, financial obligations and shareholder distributions, including dividends and share buybacks.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

The following table reconciles cash from operating activities to adjusted funds flow from operations:

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
	\$	\$	\$	\$
Cash from operating activities	40,957	129,599	118,957	193,611
Change in non-cash working capital	12,388	(23,456)	19,208	(1,151)
Decommissioning provision costs incurred	14	-	75	-
Cash share-based compensation	-	4,295	-	4,295
Adjusted funds flow from operations ⁽¹⁾	53,359	110,438	138,240	196,755
Annualized trailing period adjusted funds flow from operations ⁽¹⁾⁽²⁾	213,436	441,752	276,480	393,510

⁽¹⁾ Adjusted funds flow from operations is not defined under IFRS and therefore may not be comparable with the calculation of similar measures by other entities and should not be considered an alternative to, or more meaningful than, cash from operating activities.

⁽²⁾ Annualized factor 4x for the three months ended June 30, 2023 and 2022. Annualized factor 2x for the six months ended June 30, 2023 and 2022.

Net debt

Pipestone Energy considers net debt to be a useful measure in understanding the Company's capital structure and, when considered with adjusted funds flow from operations, an indicator of leverage and overall financial strength.

The following table summarizes net debt balances and the net debt to adjusted funds flow from operations ratio for the periods disclosed:

As at June 30,	2023	2022
	\$	\$
Current assets	71,570	64,512
Current liabilities	(110,236)	(152,336)
Working capital deficit	(38,666)	(87,824)
Less: current asset risk management contracts	(4,500)	(1,038)
Plus: current lease liabilities	8,455	6,422
Plus: current liability risk management contracts	-	14,080
Adjusted working capital deficit ⁽¹⁾	(34,711)	(68,360)
Bank debt	(137,683)	(123,203)
Net debt ⁽²⁾	(172,394)	(191,563)
Net debt to annualized adjusted funds flow from operations for the trailing three months ended	0.8x	0.4x
Net debt to annualized adjusted funds flow from operations for the trailing six months ended	0.6x	0.5x

⁽¹⁾ Adjusted working capital deficit is not defined under IFRS and therefore may not be comparable with the calculation of similar measures by other entities and should not be considered an alternative to, or more meaningful than, working capital deficit.

⁽²⁾ Net debt is not defined under IFRS and therefore may not be comparable with the calculation of similar measures by other entities.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

The net debt to adjusted funds flow from operations ratio represents the time in years that it would take Pipestone Energy to repay its net debt if no further capital expenditures and shareholder distributions, such as dividends and share buybacks, were incurred and if adjusted funds flow from operations remained constant.

5. Exploration and evaluation (“E&E”), property and equipment (“P&E”) and right-of-use (“ROU”) assets

	E&E assets	Liquids and natural gas interests	Corporate	Total P&E assets	ROU assets
Cost	\$	\$	\$	\$	\$
Balance, January 1, 2022	29,752	845,759	972	846,731	97,659
Additions	134	245,197 ⁽¹⁾	396	245,593	26,046
Property acquisitions	-	96	-	96	-
Transfers	(10,225)	10,225	-	10,225	-
Decommissioning provisions (note 8)	-	(1,679)	-	(1,679)	-
Expiries	(2,383)	-	-	-	-
Balance, December 31, 2022	17,278	1,099,598	1,368	1,100,966	123,705
Additions	1,090	171,207 ⁽¹⁾	44	171,251	288
Property acquisition	-	101	-	101	-
Decommissioning provisions (note 8)	-	1,478	-	1,478	-
Expiries	(829)	-	-	-	-
Balance, June 30, 2023	17,539	1,272,384	1,412	1,273,796	123,993
Accumulated depletion and depreciation					
Balance, January 1, 2022	-	122,521	258	122,779	14,967
Depletion and depreciation	-	83,260	76	83,336	10,350
Balance, December 31, 2022	-	205,781	334	206,115	25,317
Depletion and depreciation	-	63,661	36	63,697	6,275
Balance, June 30, 2023	-	269,442	370	269,812	31,592
Carrying amount					
Balance, December 31, 2022	17,278	893,817	1,034	894,851	98,388
Balance, June 30, 2023	17,539	1,002,942	1,042	1,003,984	92,401

⁽¹⁾ Pipestone Energy capitalized direct general and administrative expenses of \$1.0 million and \$1.9 million during the respective three and six months ended June 30, 2023 (year ended December 31, 2022 - \$3.3 million).

Pipestone Energy has a single CGU.

At June 30, 2023, the Company did not identify any indicators of impairment.

The majority of the Company’s ROU assets at June 30, 2023 relate to compressor, pipeline and water infrastructure leases with midstream partners. Pipestone Energy has entered long-term fixed fee commitments with these third parties in exchange for the right to use and operate the assets. This infrastructure remains under third-party ownership.

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

6. Bank debt

a) Reserve-based loan ("RBL")

	June 30, 2023	December 31, 2022
	\$	\$
Balance, beginning of period	105,095	171,866
Increase (decrease) in borrowing	32,817	(66,795)
Issuance costs	(684)	(730)
Amortization of debt issuance costs	455	754
Balance, end of period	137,683	105,095

On May 10, 2023, the Company redetermined its RBL. The total borrowing capacity of \$280.0 million (comprised of a \$250.0 million Senior Facility and \$30.0 million Operating Line) and the pricing grid remained unchanged, and the covenants of the credit facility were amended to allow for additional permitted distributions. Pipestone Energy is permitted to make limited distributions, which includes share repurchases under its Normal Course Issuer Bid ("NCIB") and dividends, provided that (i) the aggregate amount of all such purchases made between any two scheduled borrowing base dates does not exceed \$30.0 million and (ii) upon such purchases being made, the net debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio of the Company (calculated on a pro forma basis, taking into account such purchases) would be less than 1.50:1.00. The Company is also permitted to make other permitted distributions (in excess of limited distributions), provided that (i) upon such other distribution being made, the net debt to EBITDA ratio of the Company (calculated on a pro forma basis) would be less than 1.50:1.00, (ii) the aggregate principal amount outstanding under the credit facilities, on a pro forma basis after giving effect to such other distribution, does not exceed 80% of the commitment amount and (iii) not less than 20% of the Company's average daily forecasted production of crude oil, condensate and natural gas (determined on a combined basis, and net of royalties) is hedged and subject to commodity swap contracts for the immediately following twelve month period. Collectively, the distributions cannot exceed \$100.0 million between scheduled borrowing base dates.

The maturity date for the RBL was extended to May 30, 2025. The borrowing base is based on the lenders' assessment of the Company's reserves and future commodity prices. If not extended by any or all lenders, the commitments of such non-extending lenders under the RBL will cease to revolve, and all outstanding advances thereunder owing to such non-extending lenders will become repayable in one year from the term date and the margins owing on such outstanding advances will increase by 0.5 percent. In the event the borrowing base is extended but the capacity is reduced below amounts outstanding, any excess will become due and payable 60 days subsequently.

At June 30, 2023, the Company had \$137.5 million drawn against the Senior Facility (December 31, 2022 - \$104.0 million) and \$0.8 million drawn on the Operating Line (December 31, 2022 - \$1.5 million), for an aggregate draw on the RBL of \$138.3 million (December 31, 2022 - \$105.5 million).

As at June 30,	2023
	\$
RBL – portion drawn	138,265
Unamortized debt issuance costs	(582)
Balance, end of period	137,683

Pipestone Energy Corp.

Notes to the Condensed Interim Consolidated Financial Statements

As at and for the three and six months ended June 30, 2023 and 2022

(tabular amounts in thousands of Canadian dollars unless otherwise indicated) (unaudited)

As at June 30, 2023, Pipestone Energy's applicable pricing included a 1.8 percent per annum margin on prime loans, a 2.8 percent per annum stamping fee and margin on bankers' acceptances along with a 0.7 percent per annum standby fee on the portion of the RBL that is not drawn. Borrowing margins and fees are reviewed annually as part of the bank syndicate's annual renewal. For the three and six months ended June 30, 2023 borrowing costs averaged 8.4 percent and 8.7 percent, respectively (three and six months ended June 30, 2022 – 5.3 percent and 4.9 percent, respectively).

b) Letter of credit facility

Pipestone Energy has a \$22.5 million unsecured letter of credit facility (the "EDC Letter of Credit Facility") under Export Development Canada's ("EDC") performance security guarantee program. At June 30, 2023, the Company had \$13.6 million of letters of credit issued and outstanding against the EDC Letter of Credit Facility (December 31, 2022 - \$13.7 million). Letters of credit issued under the EDC Letter of Credit Facility do not impact Pipestone Energy's borrowing capacity under the RBL, and as such provides the Company with additional liquidity. The term of the EDC Letter of Credit Facility currently ends on June 30, 2024.

7. Lease liabilities

	June 30, 2023	December 31, 2022
	\$	\$
Balance, beginning of period	106,472	88,218
Additions	288	24,337
Interest expense (note 12)	5,928	10,301
Lease payments	(9,708)	(16,384)
Balance, end of period	102,980	106,472
Current portion	8,455	7,766
Long-term portion	94,525	98,706

Leases are negotiated on an individual basis and contain a range of terms and conditions. The discount rates used to determine lease liabilities by asset class was as follows: offices (5.0 - 8.0 percent), compressors (12.0 percent), pipelines (10.1 percent) and water infrastructure (11.5 percent).

See note 14 for details of Pipestone Energy's future contractual lease payments.

The Company included extension options in the calculation of lease liabilities, where Pipestone Energy has the right to extend the lease term at its discretion and is more than likely to exercise the extension option. The Company does not have any significant termination options and the residual amounts are not material.

Lease payments that were expensed under short-term and low dollar value exemptions in the three and six months ended June 30, 2023 and 2022 were trivial.

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8. Decommissioning provisions

The Company's decommissioning provisions result from its ownership interest in liquids and natural gas assets, including well sites, facilities and gathering systems. The total decommissioning provision is estimated based on the Company's net ownership interest, estimated costs to reclaim and abandon its wells, facilities and gathering systems and the estimated timing of the costs to be incurred in future years. The estimated cash flows required to settle the provisions are approximately \$21.2 million at June 30, 2023 (December 31, 2022 – \$19.3 million). This was inflated using a rate of 2.0 percent (December 31, 2022 – 2.1 percent) to arrive at undiscounted future cash flows of approximately \$37.4 million (December 31, 2022 – \$35.0 million) and then discounted using a risk-free rate of 3.1 percent at June 30, 2023 (December 31, 2022 – 3.3 percent) to arrive at the present value of the decommissioning provision as disclosed below. The risk-free rate is based on Government of Canada benchmark bond rates. These obligations are to be settled based on the estimated economic lives of the underlying assets, which currently extend up to 34 years, with the majority of the costs expected to be incurred between 2045 and 2057 and are expected to be funded from general corporate resources at the time of abandonment.

The Company believes that a 2.0 percent inflation rate applied to the decommissioning provision at June 30, 2023 is reasonable and indicative of a normalized target rate in a long-term context. A 0.1 percent change in the inflation or risk-free discount rate used for calculating the decommissioning provision would impact the carrying value of the liability by approximately \$0.5 million at June 30, 2023. A 10.0 percent change to the abandonment and reclamation cost estimates used for calculating the decommissioning provision would impact the carrying value of the liability by approximately \$1.6 million at June 30, 2023.

The following reconciles the decommissioning provisions:

	June 30, 2023	December 31, 2022
	\$	\$
Balance, beginning of period	13,846	15,283
Additions	1,256	2,611
Accretion	228	327
Changes in estimates	(478)	1,140
Change in discount rates	700	(5,430)
Costs incurred	(75)	(85)
Balance, end of period	15,477	13,846

9. Convertible preferred shares

On September 15, 2020, Pipestone Energy issued 70,000 convertible preferred shares ("CP Shares") to existing common shareholders at a price of \$970 per share for gross proceeds of \$67.9 million. The Company incurred \$1.2 million of issuance costs related to the transaction for net proceeds received of \$66.7 million. The CP Shares had a face value of \$1,000 per share or \$70.0 million (issued at a 3.0 percent or \$2.1 million discount) and entitled the holders to an annual dividend of 6.5 percent per year that was payable quarterly in-kind, or in cash after 2 years from issuance, at the sole option of Pipestone Energy. Dividends paid in-kind were accrued and compounded on a quarterly basis using a twelve-month calendar consisting of 30-day months. The CP Shares had a term of five years ending on September 15, 2025.

Holders of the CP Shares submitted voluntary conversion notices to the Company with an effective date of September 30, 2022. All 70,000 CP Shares were subsequently converted to 93,941,655 common shares on October 5, 2022. On October 5, 2022, the expensing of the CP Shares' unamortized discount and issuance costs was accelerated, and their face value of \$70.0 million plus accrued dividends paid in-kind of \$9.9 million, totalling \$79.9 million, was reclassified from a liability to equity on the statement of financial position.

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10. Share capital

a) **Authorized** – Unlimited number of common shares with no par value.

b) **Income per share**

The following sets forth the computation of per-share amounts:

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
Numerator				
Income attributable to common shares for basic calculation (\$)	15,240	82,095	46,122	109,147
Effect of convertible preferred shares	-	968	-	1,920
Income attributable to common shares for diluted calculation (\$)	15,240	83,063	46,122	111,067
Denominator				
Weighted-average number of shares outstanding for basic per-share calculation (000s)	279,568	190,224	279,408	190,862
Effect of share-based compensation	2,506	3,302	2,552	3,261
Effect of convertible preferred shares	-	92,440	-	92,440
Weighted-average number of shares outstanding for diluted per-share calculation (000s)	282,074	285,966	281,960	286,563
Basic income per share attributable to common shares (\$/share)	0.05	0.43	0.17	0.57
Diluted income per share attributable to common shares (\$/share)	0.05	0.29	0.16	0.39

For the three and six months ended June 30, 2023, 2,444,056 common shares which are contingently issuable under the Company's performance share unit plan and 1,130,732 stock options that were anti-dilutive were excluded from the diluted weighted average number of shares calculation (three and six months ended June 30, 2022 – 2,398,619 performance share units and 3,000 stock options that were anti-dilutive were excluded from the calculation).

c) **Normal course issuer bid ("NCIB")**

On November 23, 2022, the Company announced the renewal of its NCIB. The renewed NCIB allows the Company to purchase up to 13,936,907 common shares, representing 5 percent of its 278,738,148 common shares outstanding at November 14, 2022, over a period of twelve months commencing on November 25, 2022. The total number of common shares that Pipestone Energy is permitted to purchase is subject to a daily limit of 156,214 common shares; however, the Company may make one block purchase per calendar week which exceeds this daily restriction. As of June 30, 2023, the Company has not utilized its renewed NCIB to make any further purchases to date.

In the three months ended June 30, 2022, the Company purchased 2,826,100 common shares for cancellation at a weighted-average price of \$4.95 per share and total consideration of \$14.0 million, which includes related commissions and fees. In the six months ended June 30, 2022, the Company purchased 4,310,700 common shares for cancellation at a weighted-average price of \$4.90 per share and total consideration of \$21.2 million. The total amount paid is charged against share capital.

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d) Dividends

See note 15 for details of a dividend declared subsequent to June 30, 2023.

On May 10, 2023, the Company's Board declared a second quarterly dividend of \$0.030 per common share, which was paid on June 30, 2023, to shareholders of record at the close of business on June 15, 2023.

On November 9, 2022, the Company's Board declared an inaugural quarterly dividend of \$0.030 per common share, which was paid on March 31, 2023, to shareholders of record at the close of business on March 15, 2023.

e) Share-based compensation

Pipestone Energy's long-term incentive plan ("LTIP") allows for the granting of equity incentive units to its directors, officers, employees and consultants. The Company's current share-based compensation plan consists of stock options, performance share units ("PSUs") and restricted share units ("RSUs"). Share-based compensation paid to directors of the Company only includes RSUs.

The Company also has an employee share purchase plan ("ESPP") which allows employees to voluntarily contribute up to 10 percent of their base salary, which is then matched by the Company, and exchanged for Pipestone Energy common shares. To date all common shares have been issued from treasury for funding the ESPP. During the six months ended June 30, 2023, the Company issued 195,568 common shares at an average price of \$2.73 per share (six months ended June 30, 2022 – 95,317 common shares at an average price of \$4.92 per share) pursuant to the ESPP.

The following table summarizes share-based compensation expense recognized:

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
	\$	\$	\$	\$
Non-cash share-based compensation	1,318	346	2,731	1,782
Cash share-based compensation	-	4,295	-	4,295
Total share-based compensation	1,318	4,641	2,731	6,077

The following provides information with respect to outstanding equity compensation units at June 30, 2023:

	Units outstanding ⁽¹⁾	Weighted-average remaining contractual life (years)	Units outstanding – weighted-average exercise price (\$)	Units exercisable	Units exercisable – weighted-average exercise price (\$)
Stock options	2,143,365	3.2	2.64	977,134	1.94
PSUs	2,444,056	1.0			
RSUs	2,041,741	1.6			
Units outstanding	6,629,162	1.9			

⁽¹⁾ In May 2023, the Board approved the dollar value equivalent of annual equity compensation payable to the directors and officers of the Company, comprised of \$0.4 million to be issued to directors and \$2.9 million to be issued to officers. At June 30, 2023, the equity compensation units have not yet been granted and are not reflected in the equity unit counts above. The number of units is not determinable as it will be based on a future 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX preceding the date when the units are granted. There has been no share-based compensation recognized to date on the ungranted awards.

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During the six months ended June 30, 2023, the Company granted 1,097,500 equity compensation units, consisting of 499,500 stock options and 598,000 RSUs (six months ended June 30, 2022 – granted 1,473,401 equity compensation units, consisting of 572,486 stock options, 385,003 PSUs and 515,912 RSUs). In the six months ended June 30, 2023, there were also 94,032 dividend share units issued, of which, 45,437 units were related to PSUs and 48,595 units were related to RSUs (six months ended June 30, 2022 – no dividend share units issued). The dividend share units become part of the related equity awards and follow the same vesting conditions. The dividend share units are included with their respective outstanding PSU and RSU balances as disclosed above.

During the six months ended June 30, 2023, 37,200 stock options were exercised, 30,000 stock options expired and 456,978 RSUs vested and were converted into common shares (six months ended June 30, 2022 – 344,459 stock options were exercised, 17,674 stock options were forfeited / cancelled, 861,890 RSUs vested and were converted into common shares and 8,274 RSUs were forfeited / cancelled).

During the six months ended June 30, 2023, no PSUs were settled (six months ended June 30, 2022 - 582,794 PSUs were cash settled for \$4.3 million, a payout multiplier of 1.4x and preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from the vesting date of \$5.25 per share was applied in determining the cash equivalent value of the PSUs).

The Company estimates the fair value of stock options granted using the Black-Scholes pricing model. The weighted average inputs used in the Black-Scholes pricing model during the six months ended June 30, 2023 were as follows:

Exercise / share price (\$)	2.96
Risk-free interest rate (%)	3.4
Expected life (years)	2.7
Expected forfeiture rate (%)	5.0
Expected volatility (%)	68.4
Expected annual dividend yield (%)	4.0

The fair value of PSUs and RSUs granted is determined with reference to the preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from their grant date.

During the six months ended June 30, 2023, the weighted-average fair value of stock options, RSUs and dividend share units granted was \$1.10, \$2.96 and \$2.41, respectively (six months ended June 30, 2022 – weighted-average fair value of stock options, PSUs and RSUs granted was \$2.34, \$4.58 and \$4.58, respectively).

11. Sales of liquids and natural gas

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
	\$	\$	\$	\$
Product type				
Condensate	79,058	102,335	167,628	189,309
Other natural gas liquids	12,378	23,028	29,150	42,299
Total natural gas liquids	91,436	125,363	196,778	231,608
Crude oil	2,064	921	4,981	1,236
Natural gas	27,846	84,096	68,596	131,066
Sales of liquids and natural gas	121,346	210,380	270,355	363,910

Pipestone Energy's sales are comprised of liquids and natural gas to various customers. Sales from the transfer of liquids and natural gas volumes to customers are recognized at the time when Pipestone Energy's performance obligations are fully satisfied upon transfer of these volumes to customers.

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Included in accounts receivable at June 30, 2023 is \$48.6 million (December 31, 2022 - \$67.2 million) of accrued liquids and natural gas sales which have been settled subsequent to the period end.

12. Financing expense

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
	\$	\$	\$	\$
Lease liabilities interest expense (note 7)	2,938	2,422	5,928	4,887
Interest on bank debt	2,116	1,802	3,750	3,527
Letter of credit fees	126	110	241	220
Standby and bank charges	287	213	656	422
Cash financing expense	5,467	4,547	10,575	9,056
Amortization of bank debt issuance costs (note 6)	216	126	455	285
Accretion on decommissioning provisions (note 8)	115	79	228	143
Preferred share dividends paid in-kind (note 9)	-	1,257	-	2,493
Accretion of preferred share discount (note 9)	-	88	-	162
Amortization of preferred share issuance costs (note 9)	-	53	-	101
Non-cash financing expense	331	1,603	683	3,184
Total financing expense	5,798	6,150	11,258	12,240

13. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

	Three months ended		Six months ended	
	2023	June 30, 2022	2023	June 30, 2022
	\$	\$	\$	\$
Cash flows relating to:				
Accounts receivable	15,136	10,794	20,206	(11,311)
Prepaid expenses and deposits	(6,695)	(2,869)	(7,002)	(2,588)
Accounts payable and accrued liabilities	(26,006)	33,901	9,167	49,707
Dividends payable	-	-	(8,368)	-
Changes in non-cash working capital	(17,565)	41,826	14,003	35,808
Changes in non-cash working capital relating to:				
Operating activities	(12,388)	23,456	(19,208)	23,456
Investing activities	(5,177)	18,370	41,579	18,370
Financing activities	-	-	(8,368)	-
	(17,565)	41,826	14,003	41,826

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During the three and six months ended June 30, 2023, the Company paid \$Nil in income taxes (three and six months ended June 30, 2022 - \$Nil). See note 12 for details of interest paid during the three and six months ended June 30, 2023 and 2022.

14. Commitments and contingencies

The following is a summary of when Pipestone Energy's financial liabilities and commitments become due at June 30, 2023:

	2023	2024	2025	2026	2027	Thereafter	Total
	\$	\$	\$	\$	\$	\$	\$
Accounts payable and accrued liabilities	101,781	-	-	-	-	-	101,781
Bank debt ⁽¹⁾	-	-	137,683	-	-	-	137,683
Lease payments ⁽²⁾	9,766	19,590	18,906	18,984	19,088	80,439	166,773
Gathering agreements	8,651	12,251	12,245	12,245	12,245	22,358	79,995
Processing agreements	20,091	40,104	40,142	40,290	40,438	102,442	283,507
Transport agreements	16,870	32,658	30,270	30,282	29,897	130,786	270,763
Total	157,159	104,603	239,246	101,801	101,668	336,025	1,040,502

⁽¹⁾ Excludes future interest payable on bank debt balances drawn as these amounts are variable and indeterminable.

⁽²⁾ Represents total undiscounted future lease payments due. Includes \$63.8 million of lease interest expense and \$103.0 million of lease liability principal.

Legal, regulatory and tax

In the normal course of Pipestone Energy's operations, the Company may become involved in, named as a party to, or be the subject of, various legal, regulatory and tax proceedings. The outcome of outstanding, pending or future proceedings cannot be predicted with certainty. Further, tax legislation and regulations, and government interpretation and administration thereof, frequently change. As a result, the Company is occasionally under review by relevant government authorities and its tax filings are subject to potential reassessments. The final outcome of these assessments may differ materially from any amounts currently estimated and recorded. Should any loss result from the resolution of these claims in excess of the amounts provided for, such additional loss will be charged to earnings in the period of resolution.

15. Subsequent events

Dividend

On August 9, 2023, the Company's Board declared its third quarterly dividend of \$0.030 per common share, which will be payable on September 29, 2023, to shareholders of record at the close of business on September 15, 2023.

Strategic transaction

On July 31, 2023, Pipestone Energy entered into a definitive agreement (the "Arrangement Agreement") with Strathcona Resources Ltd. ("Strathcona"), pursuant to which Strathcona has agreed, subject to satisfaction of certain closing conditions, to acquire all the issued and outstanding common shares of Pipestone Energy for 100% share consideration (the "Transaction"). Pursuant to the Transaction, Strathcona and Pipestone Energy will be amalgamated and will continue as "Strathcona Resources Ltd." ("AmalCo"). Upon completion of the Transaction, existing Pipestone Energy shareholders will receive approximately 9.05% of the equity in AmalCo on a fully diluted basis (approximately 8.87% basic), equating to an exchange ratio of 0.067967 AmalCo shares per Pipestone Energy share. AmalCo is expected to become a public

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reporting issuer in Canada following completion of the Transaction.

The Transaction will be effected by a plan of arrangement under the *Business Corporations Act* (Alberta). The Transaction requires the approval of at least $66\frac{2}{3}\%$ of the votes cast by Pipestone Energy shareholders, present in person or represented by proxy, at a special meeting of Pipestone Energy shareholders to be held on September 27, 2023 to consider and, if thought advisable, approve the Transaction and, if applicable, the approval of a majority of the votes cast by Pipestone Energy shareholders after excluding the votes cast by those persons whose votes may not be included pursuant to Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions*. The board of directors of the Company has approved the Transaction. Pipestone Energy expects to mail the proxy circular and other materials related to the meeting by early September 2023.

Pursuant to the Arrangement Agreement, the completion of the Transaction will also be conditional on, among other things, (i) the approval of the Court of King's Bench of Alberta, (ii) the receipt of approval under the *Competition Act* (Canada), (iii) approval of the Toronto Stock Exchange with respect to the listing of AmalCo's shares, and (iv) other customary closing conditions. The Company and Strathcona are in the process of obtaining the various regulatory approvals. For further details regarding the Transaction, refer to the joint press release of the Company and Strathcona dated July 31, 2023 and the material change report of Pipestone Energy in connection with the Transaction, which is available under the Company's SEDAR+ profile at www.sedarplus.ca.