

Condensed Interim Consolidated Financial Statements of

SOUTHERN ENERGY CORP.

For the three and nine months ended September 30, 2023 and 2022

(unaudited)

(U.S. Dollars)

SOUTHERN ENERGY CORP.

Condensed Interim Consolidated Statement of Financial Position (unaudited)



(in thousands of U.S. Dollars)	September 30, 2023	December 31, 2022
Assets		
Current assets		
Cash and cash equivalents	\$ 1,872	\$ 28,350
Accounts receivable and other	2,349	3,739
Prepaid expenses and deposits	1,313	5,532
Derivative assets (Note 9)	352	17
	<u>5,886</u>	<u>37,638</u>
Property, plant and equipment (Note 3)	96,254	59,800
Right-of-use assets	131	214
Derivative assets (Note 9)	130	-
Total assets	<u>\$ 102,401</u>	<u>\$ 97,652</u>
Liabilities and Equity		
Current liabilities		
Accounts payable and accrued liabilities	6,731	11,147
Royalties payable (Note 10)	5,626	5,073
Current portion of lease liabilities	98	107
Current portion of long-term debt (Note 5)	4,317	1,106
Convertible debentures (Note 6)	3,105	-
Derivative liabilities (Note 9)	127	-
	<u>20,004</u>	<u>17,433</u>
Long-term liabilities		
Derivative liabilities (Note 9)	155	-
Convertible debentures (Note 6)	-	3,041
Long-term debt (Note 5)	12,737	3,071
Lease liabilities	50	126
Decommissioning provisions (Note 4)	8,431	6,579
Total liabilities	<u>41,377</u>	<u>30,250</u>
Shareholders' equity (Note 7)		
Share capital	75,580	75,271
Equity component of convertible debenture	245	245
Warrants	2,089	2,154
Contributed surplus	5,761	5,117
Deficit	(21,849)	(14,595)
Accumulated other comprehensive loss	(802)	(790)
	<u>61,024</u>	<u>67,402</u>
Total liabilities and shareholders' equity	<u>\$ 102,401</u>	<u>\$ 97,652</u>

(See accompanying Notes to the Condensed Interim Consolidated Financial Statements)

SOUTHERN ENERGY CORP.



Condensed Interim Consolidated Statement of Earnings (Loss) & Comprehensive Income (Loss) (unaudited)

(in thousands of U.S. Dollars, except for per share amounts)	Three months ended		Nine months ended	
	September 30, 2023	2022	September 30, 2023	2022
Revenues				
Petroleum and natural gas revenue (Note 11)	\$ 5,285	\$ 19,151	\$ 14,215	\$ 35,387
Royalties	(1,046)	(4,318)	(2,755)	(7,619)
	<u>4,239</u>	<u>14,833</u>	<u>11,460</u>	<u>27,768</u>
Expenses				
Production and operating	1,759	1,904	4,663	4,793
Transportation	407	36	764	107
Depletion, depreciation and amortization (Note 3)	2,604	1,818	7,307	4,095
(Gain) loss on derivatives (Note 9)	(115)	2,808	(326)	7,029
Gain on dispositions (Note 3)	-	-	-	(398)
Financing, net (Note 12)	816	423	1,661	1,259
General and administrative	977	946	3,640	2,953
Share-based compensation (Note 7)	279	704	813	782
Transaction costs	-	23	199	81
Gain on foreign exchange	(121)	(396)	(7)	(483)
	<u>6,606</u>	<u>8,266</u>	<u>18,714</u>	<u>20,218</u>
Total net (loss) earnings for the period	(2,367)	6,567	(7,254)	7,550
Currency translation adjustment	(46)	(144)	(12)	(152)
Comprehensive (loss) income for the period	<u>\$ (2,413)</u>	<u>\$ 6,423</u>	<u>\$ (7,266)</u>	<u>\$ 7,398</u>
Net (loss) earnings per common share (Note 8)				
Basic	\$ (0.02)	\$ 0.05	\$ (0.05)	\$ 0.08
Diluted	\$ (0.02)	\$ 0.04	\$ (0.05)	\$ 0.07

(See accompanying Notes to the Condensed Interim Consolidated Financial Statements)

SOUTHERN ENERGY CORP.



Condensed Interim Consolidated Statement of Changes in Shareholders' Equity (unaudited)

(in thousands of U.S. Dollars, except share amounts)	Common Shares	Shareholders' Capital	Equity Component of Convertible Debentures	Warrants	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, December 31, 2021	78,121,858	\$ 41,018	\$ 497	\$ 2,723	\$ 4,144	\$(23,894)	\$ (675)	\$ 23,813
Shares issued, net	57,786,927	33,435	(234)	(460)	-	-	-	32,741
Share-based compensation	-	-	-	-	745	-	-	745
Net earnings	-	-	-	-	-	7,550	-	7,550
Other comprehensive income	-	-	-	-	-	-	(152)	(152)
Balance, September 30, 2022	135,908,785	\$ 74,453	\$ 263	\$ 2,263	\$ 4,889	\$(16,344)	\$ (827)	\$ 64,697
Balance, December 31, 2022	138,056,910	\$ 75,271	\$ 245	\$ 2,154	\$ 5,117	\$(14,595)	\$ (790)	\$ 67,402
Shares issued, net (Note 7)	1,031,250	309	-	(65)	-	-	-	244
Share-based compensation	-	-	-	-	644	-	-	644
Net loss	-	-	-	-	-	(7,254)	-	(7,254)
Other comprehensive income	-	-	-	-	-	-	(12)	(12)
Balance, September 30, 2023	139,088,160	\$ 75,580	\$ 245	\$ 2,089	\$ 5,761	\$(21,849)	\$ (802)	\$ 61,024

(See accompanying Notes to the Condensed Interim Consolidated Financial Statements)

SOUTHERN ENERGY CORP.



Condensed Interim Consolidated Statement of Cash Flows (unaudited)

(in thousands of U.S. Dollars)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Operating activities				
Total net (loss) earnings for the period	\$ (2,367)	\$ 6,567	\$ (7,254)	7,550
Changes in non-cash items:				
Depletion, depreciation and amortization (Note 3)	2,536	1,818	7,221	4,095
Gain on dispositions (Note 3)	-	-	-	(398)
Financing expense	824	423	1,843	1,259
Unrealized (gain) loss on derivatives (Note 9)	(82)	(885)	(183)	1,260
Unrealized (gain) loss on foreign exchange	(119)	(354)	10	(451)
Share-based compensation (Note 7)	279	704	813	782
Decommissioning provisions liabilities settled (Note 4)	(35)	(4)	(43)	(27)
Changes in non-cash working capital	(553)	2,567	1,366	271
Net cash provided by operating activities	483	10,836	3,773	14,341
Investing activities				
Capital expenditures	(1,719)	(3,240)	(38,616)	(20,216)
Acquisitions	(15)	-	(3,302)	-
Proceeds from dispositions	-	-	-	759
Changes in non-cash working capital	1,022	(2,827)	1,044	1,661
Net cash used by investing activities	(712)	(6,067)	(40,874)	(17,796)
Financing activities				
Proceeds from share issuances, net	11	28,286	244	29,952
Paydown of long-term debt (Note 5)	(1,356)	(1,669)	(2,690)	(3,409)
Draw on credit facility (Note 5)	2,000	-	15,500	4,000
Payment of interest	(688)	(209)	(1,845)	(848)
Finance lease payments	(38)	(26)	(103)	(111)
Transaction costs on debt refinance	(80)	(18)	(91)	(21)
Changes in non-cash working capital	5	45	(400)	(79)
Net cash (used) provided by financing activities	(146)	26,409	10,615	29,484
Net (decrease) increase in cash and cash equivalents	(375)	31,178	(26,486)	26,029
Effect of foreign exchange rate changes	(2)	(70)	8	(78)
Cash and cash equivalents, beginning of period	2,249	4,465	28,350	9,622
Cash and cash equivalents, end of period	\$ 1,872	\$ 35,573	\$ 1,872	\$ 35,573

(See accompanying Notes to the Condensed Interim Consolidated Financial Statements)

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Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Amounts in thousands of U.S. Dollars, except for per share amounts

1. Reporting Entity and Nature of Operations

Southern Energy Corp. (“Southern” or the “Company”) is an oil and natural gas exploration and production company. Southern has a primary focus on acquiring and developing conventional natural gas and light oil resources in the Southeast Gulf States of Mississippi, Louisiana, and East Texas.

Southern’s head office is located in Calgary, Alberta, Canada. Southern trades on the TSX Venture Exchange (“TSXV”) under the trading symbol “SOU” and on the AIM market of the London Stock Exchange (“AIM”) under the trading symbol “SOUC”. The condensed interim consolidated financial statements were authorized for issue by the Board of Directors on November 29, 2023.

2. Basis of Presentation

a) Principles of Reporting and Consolidation

The condensed interim consolidated financial statements of Southern include the accounts of all domestic and foreign subsidiaries. Wholly-owned subsidiaries included in the Company’s accounts include Southern Energy Corp., Southern Energy Corp (Delaware), Southern Energy Operating, LLC, Southern Energy CMS, LLC, Southern Energy LA, LLC and Southern Energy BWB, LLC. Southern accounts for joint operations by recognizing the Company’s share of assets, liabilities, income and expenses. All intercompany balances and transactions have been eliminated.

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting of the International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The condensed interim consolidated financial statements use the accounting policies which the Company applied in its annual consolidated financial statements for the year ended December 31, 2022. These condensed interim consolidated financial statements should be read in conjunction with Southern’s consolidated financial statements for the year ended December 31, 2022, which are available on SEDAR+ at www.sedarplus.ca or on Southern’s website at www.southernenergycorp.com. These condensed interim consolidated financial statements are presented in United States dollars (“U.S. dollars”). All financial information presented has been rounded to the nearest thousand unless otherwise indicated.

b) Recently Announced Accounting Pronouncements

Amendments to IAS 1 – Presentation of Financial Statements

Southern adopted the amendments to IAS 1, Presentation of Financial Statements effective January 1, 2023. The amendments require entities to disclose their material accounting policy information rather than their significant accounting policies. To support this amendment the IASB also amended IFRS Practice Statement 2 *Making Materiality Judgements*. On adoption of this amendment, there is no material impact to the Company’s condensed interim consolidated financial statements.

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3. Property, Plant and Equipment

The following table presents the reconciliation of the beginning and ending amounts of our PP&E balances including accumulated depletion, depreciation, amortization and impairment:

	Oil and Natural Gas		Total
	Assets	Other	
Net book value as at December 31, 2022	\$ 59,611	\$ 189	\$ 59,800
Additions	38,606	61	38,667
Acquisitions, including decommissioning costs	6,264	-	6,264
Change in decommissioning provision (Note 4)	(1,345)	-	(1,345)
Depletion, depreciation and amortization	(7,083)	(54)	(7,137)
Foreign exchange	5	-	5
Net book value as at September 30, 2023	\$ 96,058	\$ 196	\$ 96,254

Additions

For the three and nine months ended September 30, 2023, Southern incurred \$1.7 million and \$38.7 million of capital additions related to the development of the Central Mississippi Cash Generating Unit ("CMS CGU").

Depletion and depreciation

For the three and nine months ended September 30, 2023, the Company recorded depletion expense of \$2.5 million and \$7.1 million, respectively. In the calculation of depletion expense, an estimated \$142.0 million of future development costs associated with the proven plus probable reserves were included.

Impairment

At the end of each reporting period, the Company performs an assessment to determine whether there are any indications of impairment for the CGUs that comprise oil and natural gas properties. As at September 30, 2023, Southern did not identify any indicators of impairment for any of its CGUs.

Asset Acquisition

On June 1, 2023, Southern closed an acquisition to acquire assets in its core area in the CMS CGU in the State of Mississippi for cash consideration of \$3.2 million. The acquisition resulted in an increase to property, plant and equipment of approximately \$6.2 million and the assumption of \$3.0 million of decommissioning provisions.

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4. Decommissioning Provisions

The Company’s decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The total decommissioning provision is estimated based on the Company’s net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The total estimated, inflated undiscounted risked cash flows required to settle the provision, is approximately \$19.5 million at September 30, 2023 (December 31, 2022 – \$14.8 million). The decommissioning provision was inflated using a rate of 2.4% (December 31, 2022 – 2.4%) and discounted using a risk-free interest rate of 4.6% at September 30, 2023 (December 31, 2022 – 3.9%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 50 years into the future and will be funded from general corporate resources at the time of abandonment.

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of legal obligations associated with the retirement of property, plant and equipment:

		2023
Balance, beginning of year	\$	6,579
Acquisitions		2,962
Liabilities incurred		51
Liabilities settled		(43)
Changes in estimates		(1,345)
Accretion expense		227
Balance, end of period	\$	8,431
Long term liability	\$	8,431

5. Long-term Debt

Southern had the following long-term debt obligations outstanding as at the dates indicated:

	As at Sep 30, 2023	As at Dec 31, 2022
Current portion of senior secured term loan	\$ 4,594	\$ 1,340
Long-term portion of senior secured term loan	13,016	3,460
Unamortized transaction costs	(556)	(623)
Total Long-Term Debt	\$ 17,054	\$ 4,177

Southern Energy Corporation (Delaware), one of the wholly-owned subsidiaries of Southern, held the existing senior secured term loan (“Credit Facility”) at September 30, 2023. The Credit Facility is comprised of Tranche A of \$5.5 million that was advanced at closing on April 30, 2021 and Tranche B of \$31.5 million with an availability until August 31, 2025. Interest on the Credit Facility is 12% per annum on amounts outstanding and includes a 1% per annum standby fee on the unused portion of Tranche B, both paid monthly in arrears on the last day of the month. The Credit Facility is secured against the oil and gas properties of Southern and matures on August 31, 2025. As at September 30, 2023, Southern had \$17.6 million drawn on the Credit Facility and \$11.5 million available from Tranche B.

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Effective September 29, 2023, Southern entered into the fifth amendment to the Credit Facility (the “Fifth Amendment”). The Fifth Amendment includes an increase of \$2.0 million to Tranche B of the Credit Facility, bringing the total Tranche B commitment to \$31.5 million, and an extension of the commitment period for Tranche B until August 31, 2025. The amendment also extends the principal amortization period by an additional twelve months while maintaining the existing 12% per annum coupon, resets the DSCR (as defined below) covenant calculation to an annualized basis beginning in Q4 2023, reduces the DSCR (as defined below) in Q3 2023 to 1.20:1, reverting back to 1.25:1 in Q4 2023 and all future periods, and allows for repayment and reborrowing under the Tranche B facility.

Quarterly positive free cash flow (“FCF”) (as described below) repayments are based on a FCF grid whereby quarterly repayments are X% of the preceding quarter where X is equal to 50% if the ACR (as defined below) is < 3.0x or DSCR (as defined below) is < 1.4x; or X is equal to 0% if the ACR is > 5.0x and DSCR > 1.7x; otherwise is 25%. A standby fee of 1.0% per annum on any undrawn Tranche B amounts.

The Credit Facility includes a monthly repayment of the principal amount outstanding computed as the sum of: (a) outstanding amount multiplied by 1/A, where A equals the number of whole or part months remaining to the maturity date plus 24 months; and (b) on the last day of the second month following each fiscal quarter, the amount determined by the FCF grid (as described above). FCF is calculated as Earnings Before Interest, Taxes, Depreciation, Amortization, and Impairment (“EBITDAX”), less the aggregate of the Credit Facility principal and interest payments.

Below are the financial covenant calculations for the Credit Facility for September 30, 2023 and December 31, 2022:

Financial covenant	Limit	As at Sep 30, 2023	As at Dec 31, 2022
Asset Coverage ratio	Minimum 2.00	3.08	9.77
Debt Service Coverage ratio	Minimum 1.20	1.29	3.87

The asset coverage ratio (“ACR”) of at least 2:1 is calculated as the ratio of the net present value of proved developed producing oil and gas properties as determined by an independent qualified engineer, using a price deck based on the forward commodity prices, discounted at 12% to the principle amount outstanding under the Credit Facility.

The debt service coverage ratio (“DSCR”) of greater than 1.20:1 is the ratio of EBITDAX to scheduled principal payments and interest expense.

As at September 30, 2023, Southern was in compliance with the above covenants.

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6. Convertible Debentures

	Number of Convertible Debentures	Liability Component (\$000s)	Equity Component (\$000s)
Balance at December 31, 2022	4,286	\$ 3,041	\$ 245
Accretion of discount	-	60	-
Effect of foreign exchange rate changes	-	4	-
Balance at September 30, 2023	4,286	\$ 3,105	\$ 245

At September 30, 2023, the convertible debentures were classified as a current liability as they have a maturity date of June 30, 2024.

7. Shareholders' Equity

Share Capital

The authorized share capital of the Company consists of an unlimited number of voting common shares ("Common Shares") and an unlimited number of preferred shares.

The following table reflects the Company's outstanding Common Shares at September 30, 2023 and December 2022:

	Number of Shares	Share Capital (\$000s)
Balance as at December 31, 2022	138,056,910	\$ 75,271
Issuance of common shares to satisfy unit warrant exercise	1,031,250	310
Share issuance costs	-	(1)
Balance as at September 30, 2023	139,088,160	\$ 75,580

Subsequent to September 30, 2023, Southern closed an equity financing on November 9, 2023, raising aggregate gross proceeds of \$5.0 million through the issuance of a total of 26,630,000 new Common Shares (the "Fundraising"). The Fundraising consisted of gross proceeds of \$2.8 million through a placing of 15,853,097 new Common Shares at a price of 15.5 pence per Common Share, \$2.2 million pursuant to a prospectus offering of 10,712,387 Common Shares at a price of CAD\$0.26 per Common Share and the remaining \$0.01 million pursuant to a subscription offering of 64,516 Common Shares at a price of 15.5 pence per Common Share.

Warrants

Southern received approval from the TSX Venture Exchange to extend the expiration date of its Common Share purchase warrants ("Unit Warrant") from April 29, 2023 until December 31, 2023. There are 8,700,000 Unit Warrants remaining with an exercise price of CAD\$0.32.

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In connection with the Fifth Amendment, the Company has agreed to extend the term of the outstanding Common Share purchase warrants (“Bonus Warrants”) previously issued to the lender from April 30, 2024 until August 31, 2025. There are 3,906,250 remaining Bonus Warrants with an exercise price of CAD\$0.40.

As at September 30, 2023, 2,413,333 performance-based Common Share purchase warrants (“Performance Warrants”) had vested as the 20-day volume weighted average trading price (“Market Price”) of the Common Shares had exceeded CAD\$1.20. The Performance Warrants have an exercise price of CAD\$0.80 and expire on December 19, 2023.

Stock Option Plan

Under the Company’s security based compensation arrangement, which includes the stock option plan and share award incentive plan, the Company may grant options or share awards to its directors, officers, employees and consultants up to a maximum of 10% of the issued and outstanding common shares at the time of the grant, with a maximum of 5% of the Company’s issued and outstanding shares reserved for any one person on a yearly basis. The maximum stock option term is 10 years from the grant date with vesting terms set at the discretion of the board of directors.

The following table reflects the Company’s outstanding common stock options at September 30, 2023 and December 31, 2022:

	Number of stock options	Weighted average exercise price (CAD)
Balance at December 31, 2022	7,628,125	\$ 0.87
Granted	60,000	\$ 0.39
Forfeited	(339,375)	\$ 0.89
Balance at September 30, 2023	7,348,750	\$ 0.86

The following table summarizes information regarding stock options outstanding as at September 30, 2023:

Exercise Price (\$CAD/share)	Number of options outstanding (000s)	Weighted average remaining terms (years)	Weighted average exercise price for options outstanding (\$CAD/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable (\$CAD/share)
\$0.39 - \$1.01	7,349	2.9	\$0.86	5,588	\$0.85

Southern recognized \$0.2 million and \$0.6 million of share-based compensation expense relating to stock options during the three and nine months ended September 30, 2023, respectively, compared to \$0.7 million and \$0.7 million for the same periods in 2022.

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Share Award Incentive Plan

The following table reflects the Company's outstanding restricted share awards ("RSAs") at September 30, 2023 and December 31, 2022:

	Number of RSAs
Balance at December 31, 2022	2,495,700
Granted - June 6, 2023	1,345,800
Forfeited	(59,950)
Balance at September 30, 2023	3,781,550

The RSAs vest as to one third on each of the first, second and third anniversaries of the grant date. On the vesting dates of such RSAs, the holder is entitled to receive a cash payment or its equivalent in fully paid Common Shares, at the Company's discretion, equal to the closing market value per Common Share on the TSXV on the business day prior to such payment. For the purpose of calculating share-based compensation, the fair value of the RSAs is based on the market value of Southern's Common Shares at each period end. The fair value is recognized as share-based compensation over the vesting period. Fluctuations in fair values are recognized as share-based compensation in the period they occur. Southern remeasured the fair value of the liability resulting in an increase of \$0.1 million and \$0.2 million relating to the RSAs during the three and nine months ended September 30, 2023 (\$44 thousand – September 30, 2022).

8. (Loss) Earnings Per Share

The following table presents the Company's net loss per share:

	Three months ended September 30, 2023		Nine months ended September 30, 2023	
	2023	2022	2023	2022
Net (loss) earnings	\$ (2,367)	\$ 6,567	\$ (7,254)	\$ 7,550
Dilutive impact of convertible debentures	-	71	-	308
Diluted net (loss) earnings	\$ (2,367)	\$ 6,638	\$ (7,254)	\$ 7,858
Basic - weighted average common shares outstanding	139,085,612	132,822,050	138,907,127	98,292,661
Dilutive effect of warrants and convertible debentures	-	15,818,837	-	10,378,545
Diluted – weighted average common shares outstanding	139,085,612	148,640,887	138,907,127	108,671,206
Net (loss) earnings per share, basic	\$ (0.02)	\$ 0.05	\$ (0.05)	\$ 0.08
Net (loss) earnings per share, diluted	\$ (0.02)	\$ 0.04	\$ (0.05)	\$ 0.07

The calculation of diluted loss per share for the three and nine months ended September 30, 2023 excludes the effect of all outstanding share options, Unit Warrants, Bonus Warrants, Performance Warrants and convertible debentures as they are anti-dilutive.

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9. Financial Instruments and Financial Risk Management

Financial Derivative Contracts

Southern utilizes oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future oil and natural gas production. Typical derivative contracts could consist of options, in the form of price floors, collars or three-way collars and fixed-price swaps. The derivative financial instruments are recorded on the consolidated statement of financial position as either an asset or a liability measured at fair value. Southern does not apply hedge accounting to its commodity derivative contracts; accordingly, changes in the fair value of these instruments are recognized in the consolidated statement of earnings and comprehensive income in the period of change.

Southern had the following commodity derivative contracts in place as at September 30, 2023:

Natural Gas	Volume	Pricing
<i>Fixed Basis Swap</i>		
October 1, 2023 – October 31, 2023	1,000 MMBtu/d	NYMEX – HH + \$0.320/MMBtu
<i>Fixed Price Swap</i>		
October 1, 2023 – December 31, 2023	2,000 MMBtu/d	NYMEX – HH \$3.095/MMBtu
October 1, 2023 – December 31, 2023	1,000 MMBtu/d	NYMEX – HH \$3.050/MMBtu
January 1, 2024 – December 31, 2025	1,000 MMBtu/d	NYMEX – HH \$3.880/MMBtu
April 1, 2024 – October 31, 2024	1,500 MMBtu/d	NYMEX – HH \$3.208/MMBtu
<i>Costless Collar</i>		
October 1, 2023 – March 31, 2024	2,000 MMBtu/d	NYMEX – HH \$3.00 - \$3.98/MMBtu
January 1, 2024 – March 31, 2024	1,000 MMBtu/d	NYMEX – HH \$3.00 - \$4.60/MMBtu
November 1, 2024 – March 31, 2025	1,000 MMBtu/d	NYMEX – HH \$3.50 - \$5.20/MMBtu

Subsequent to September 30, 2023 Southern entered into the following commodity derivative contract:

Natural Gas	Volume	Pricing
<i>Fixed Price Swap</i>		
April 1, 2024 – October 31, 2024	1,500 MMBtu/d	NYMEX – HH \$3.420/MMBtu
April 1, 2025 – October 31, 2025	1,500 MMBtu/d	NYMEX – HH \$3.420/MMBtu

Financial Derivative Contracts Financial Statement Recognition

The Company's financial instruments that were accounted for at fair value as of September 30, 2023 and December 31, 2022 are presented below:

Comprised of:	As at Sep 30, 2023	As at Dec 31, 2022
Current derivative asset	\$ 352	\$ 17
Non-current derivative asset	130	-
Current derivative liability	(127)	-
Non-current derivative liability	(155)	-
Net fair value of contracts, end of period	\$ 200	\$ 17

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Below is a reconciliation of the (gain) loss on derivatives from the condensed interim consolidated statement of loss and comprehensive loss:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Realized (gain) loss on derivatives	\$ (33)	\$ 3,693	\$ (143)	\$ 5,769
Unrealized (gain) loss on derivatives	(82)	(885)	(183)	1,260
(Gain) loss on derivative instruments	\$ (115)	\$ 2,808	\$ (326)	\$ 7,029

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The carrying amount of the Company's cash and cash equivalents and accounts receivable and the positive fair value of any financial derivatives represent the maximum credit exposure.

Cash and cash equivalents

The Company manages the credit exposure related to cash and cash equivalents by selecting financial institutions with high credit ratings and monitors all short-term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

Accounts receivable and other

Substantially all of the Company's accounts receivable are due from purchasers of the Company's petroleum and natural gas production, joint interest partners and government agencies, and are subject to normal industry credit risk.

Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Management of the Company believes the risk is mitigated by the size and reputation of the companies to which they extend credit.

Southern had no provision for doubtful accounts as at September 30, 2023 or December 31, 2022.

Liquidity Risk

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its current and future liquidity requirements. The financial liabilities in the statement of financial position consist of accounts payable, royalties payable, lease liabilities, financial derivative liabilities, convertible debentures and the senior secured credit facility. Strategies to manage liquidity include, having adequate sources of financing available through its Credit Facilities, estimating future cash flows generated from

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operations based on reasonable production and pricing assumptions, adding additional commodity derivative contracts, reducing capital spending and utilizing equity to settle interest payments on convertible debentures. With the November 2023 Fundraising, Southern improved its ability to settle future financial liabilities. The Company believes that it has access to sufficient capital through internally generated cash flows, strategic sale of assets (if required), continued support of current lending group and external sources (convertible debentures and bank credit markets, if required) to meet current spending forecasts. After examining the economic factors that could cause liquidity risk, the Company believes it will have sufficient liquidity to support its operations and meet its financial obligations for at least twelve months.

Market Risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its assets and liabilities. The object of market risk management is to manage and control market risk exposure within acceptable parameters.

To partially mitigate exposure to commodity price risk, Southern entered into various financial derivative instruments. The instruments currently outstanding are described above. As at September 30, 2023, a 10% change in future commodity prices applied against these contracts would have approximately a \$0.5 million impact on net income.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. This risk is mitigated as the Credit Facility has a fixed interest rate.

10. Royalties Payable

As at September 30, 2023, Southern had \$5.6 million (\$5.1 million at December 31, 2022) of non-interest bearing royalty payables related to unresolved title or ownership issues. The royalty payable account is made up of balances due to approximately 6,400 royalty holders with over 95% of the balances outstanding for greater than 120 days. The royalty holders have deficiencies with their accounts that precludes Southern from making payments.

11. Oil and Natural Gas Sales

Southern sells its production pursuant to variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for the quality, location and other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contract, Southern is required to deliver a fixed or variable volume of crude oil, natural gas liquids or natural gas to the contract counterparty. Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed transaction price. Revenues are typically collected in the month following production.

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The following table presents Southern's oil and natural gas sales disaggregated by revenue source:

	Three months ended		Nine months ended	
	September 30,		September 30,	
Commodity sales from production, by product	2023	2022	2023	2022
Crude oil	\$ 1,095	\$ 998	\$ 2,548	\$ 3,181
Natural gas liquids	36	78	139	244
Natural gas	4,154	18,075	11,528	31,962
Total Oil and Natural Gas Sales	\$ 5,285	\$ 19,151	\$ 14,215	\$ 35,387

12. Financing

The following table presents a breakdown of Southern's financing expenses:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Credit facility interest	\$ 553	\$ 209	\$ 1,124	\$ 474
Convertible debentures interest	65	71	191	305
Interest income	(8)	-	(182)	-
Accretion	201	134	510	451
Interest on lease obligations	5	9	18	29
Total Financing Expenses	\$ 816	\$ 423	\$ 1,661	\$ 1,259

13. Capital Risk Management

The Company monitors its capital based on projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by or reviewed with the Company's Board of Directors. The budget results are regularly reviewed and updated as required.

In order to maintain or adjust the capital structure, the Company may issue shares, seek debt financing and adjust its capital spending to manage its current and projected capital structure. The Company's ability to raise additional debt or equity financing is impacted by external conditions, including future commodity prices and global economic conditions. The Company continually monitors business conditions including changes in economic conditions, the risk of its drilling programs, forecasted commodity prices, and potential corporate or asset acquisitions.