

**Vital Energy Inc.**

**Financial Statements**

**December 31, 2016 and 2015**

*(Expressed in Canadian Dollars)*



**Crowe MacKay LLP**  
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## **Independent Auditors' Report**

### **To the Shareholders of Vital Energy Inc.**

We have audited the accompanying financial statements of Vital Energy Inc., which comprise the balance sheets as at December 31, 2016 and December 31, 2015, and the statements of comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

#### **Management's Responsibility for the Financial Statements**

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

#### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Vital Energy Inc. as at December 31, 2016 and December 31, 2015 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

#### **Emphasis of matter**

Without modifying our opinion, we draw attention to Note 1 to the financial statements which describes the material uncertainty that may cast significant doubt about the ability of Vital Energy Inc. to continue as a going concern.

**Calgary, Alberta  
April 28, 2017**

*Crowe MacKay LLP*  
**Chartered Professional Accountants**

## Vital Energy Inc.

### Balance Sheets

(Expressed in Canadian Dollars)

December 31,	Notes	2016	2015
<b>Assets</b>			
<b>Current</b>			
Cash and cash equivalents	5	\$ 854,264	\$ 1,999,716
Cash held in trust		-	238,839
Trade and other receivables	6	277,359	322,337
Goods and services tax receivable		-	14,220
Prepaid expenses		18,715	27,844
		1,150,338	2,602,956
Deposits	12	531,607	630,625
Property and equipment	7	11,348,644	12,650,047
Exploration and evaluation assets	8	-	421,125
		\$ 13,030,589	\$ 16,304,753
<b>Liabilities</b>			
<b>Current</b>			
Accounts payable and accrued liabilities		\$ 353,214	\$ 1,051,445
Goods and services tax payable		13,843	-
Abandonment deposit payable		-	238,839
Current portion of note payable and debentures payable	9,10	2,150,000	
		2,517,057	1,290,284
Debentures payable	9	-	2,125,000
Note payable	10	-	25,000
Decommissioning liabilities	12	1,051,507	1,078,107
		3,568,564	4,518,391
<b>Shareholders' Equity</b>			
Share capital	13	29,565,885	29,565,885
Contributed surplus		1,401,201	1,383,701
Deficit		(21,505,061)	(19,163,224)
		9,462,025	11,786,362
		\$ 13,030,589	\$ 16,304,753

General information and going concern (note 1)

Commitments (note 21)

Subsequent event (note 22)

Approved by the Board:

(Signed) "Jeffrey L. Standen", Director

(Signed) "Zhouliang (Nick) Zhang", Director

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**Vital Energy Inc.****Statements of Comprehensive Loss***(Expressed in Canadian Dollars)*

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<b>Years ended December 31,</b>	<b>Note</b>	<b>2016</b>	<b>2015</b>
<b>Revenue</b>			
Oil and gas sales		\$ 2,886,166	\$ 2,174,090
Less: Crown royalties		(269,547)	(179,506)
		<b>2,616,619</b>	1,994,584
<b>Other income</b>			
Interest		5,231	35,096
		<b>2,621,850</b>	2,029,680
<b>Expenses</b>			
Operating expenses		1,470,872	1,131,961
General and administrative	18	1,241,221	1,337,532
Share-based payments	14	17,500	36,500
Finance charges	18	310,707	4,190
Accretion of decommissioning liabilities	12	43,581	28,699
Depletion and depreciation	7	1,458,681	1,640,903
Impairments	7,8	421,125	4,260,539
		<b>4,963,687</b>	8,440,324
<b>Net loss and comprehensive loss for the year</b>		\$ (2,341,837)	\$ (6,410,644)
<b>Basic loss per share</b>		15 \$ (0.04)	\$ (0.12)

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## Vital Energy Inc.

### Statements of Changes in Shareholders' Equity

(Expressed in Canadian Dollars)

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	Notes	Share capital	Contributed surplus	(Deficit)	Total equity
<b>Balance, December 31, 2015</b>		<b>\$ 29,565,885</b>	<b>\$ 1,383,701</b>	<b>\$ (19,163,224)</b>	<b>\$ 11,786,362</b>
Share-based payments	14	-	17,500	-	17,500
Net and comprehensive loss		-	-	(2,341,837)	(2,341,837)
<b>Balance, December 31, 2016</b>		<b>\$ 29,565,885</b>	<b>\$ 1,401,201</b>	<b>\$ (21,505,061)</b>	<b>\$ 9,462,025</b>
Balance, December 31, 2014		\$ 28,515,885	\$ 1,347,201	\$ (12,752,580)	\$ 17,110,506
Issued for cash	13	1,050,000	-	-	1,050,000
Share-based payments	14	-	36,500	-	36,500
Net and comprehensive loss		-	-	(6,410,644)	(6,410,644)
Balance, December 31, 2015		\$ 29,565,885	\$ 1,383,701	\$ (19,163,224)	\$ 11,786,362

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## Vital Energy Inc.

### Statements of Cash Flows

(Expressed in Canadian Dollars)

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Years ended December 31,	2016	2015
<b>Operating activities</b>		
Net and comprehensive loss for the year	\$ (2,341,837)	\$ (6,410,644)
Non-cash items:		
Depletion and depreciation	1,458,681	1,640,903
Impairments	421,125	4,260,539
Accretion of decommissioning liabilities	43,581	28,699
Share-based payments	17,500	36,500
	(400,950)	(444,003)
Changes in non-cash working capital		
Trade and other receivables	44,978	131,686
Goods and services tax	28,063	118,848
Prepaid expenses	9,129	(4,352)
Accounts payable and accrued liabilities	(195,783)	225,566
	(514,563)	27,745
<b>Investing activities</b>		
Deposits (paid) refunded	99,018	(389,461)
Expenditures on property and equipment	(227,459)	(8,679,492)
Changes in accounts payable and accrued liabilities	(502,448)	(239,536)
	(630,889)	(9,308,489)
<b>Financing activities</b>		
Proceeds from share issuances	-	1,050,000
Debt proceeds	-	2,095,000
	-	3,145,000
<b>Decrease in cash</b>	<b>(1,145,452)</b>	<b>(6,135,744)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>1,999,716</b>	<b>8,135,460</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 854,264</b>	<b>\$ 1,999,716</b>
<b>Non-cash items:</b>		
Proceeds from debenture and note payable from an officer and a director not yet received	\$ -	\$ 55,000
<b>Cash and cash equivalents consist of:</b>		
Cash at bank	\$ 741,993	\$ 1,888,103
Cashable guaranteed investment certificate	112,271	111,613
	\$ 854,264	\$ 1,999,716

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# Vital Energy Inc.

## Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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### For the years ended December 31, 2016 and 2015

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#### 1. General information and going concern

Vital Energy Inc. (“the Company”) is an oil and gas exploration and development company incorporated in the province of Alberta on November 14, 2006 with its head and registered office at Suite 500, 940 - 6<sup>th</sup> Avenue SW, Calgary, Alberta, T2P 3T1. The Company is engaged in the acquisition of, exploration for and development of crude oil and natural gas in Western Canada.

The Company continues to incur losses from operations and has a working capital deficiency of \$1,366,719 (2015 - working capital surplus of \$1,312,672) and which includes \$2,150,000 owing to directors pursuant to debentures and a note payable which mature in December 2017. These amounts are classified as current liabilities in the 2016 financial statements. If the Company is unable to repay the debentures and note payable at maturity, it will need to re-negotiate the terms of the debt which will require the continued support and forbearance from the directors.

There can be no assurance that the Company will be able to repay or re-negotiate the debentures and notes payable when they become due. If that were to occur, the Company may not be able to continue its operations, and the amounts realizable for the assets could be less than the amounts reflected in these financial statements.

These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported amounts of revenues and expenses and the classification of the statement of financial position items if the going concern assumption is inappropriate and these adjustments could be material.

#### 2. Basis of preparation, significant estimates and judgments

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board as of December 31, 2016. The financial statements were authorized for issue by the Board of Directors on April 26, 2017.

The financial statements have been prepared on the historical cost basis except any derivative financial instruments, which are measured at fair value.

The financial statements are presented in Canadian dollars. At the present time and development of the Company, the functional currency is the Canadian dollar.

##### **Use of estimates and judgments**

The preparation of the financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, shareholder’ equity, income and expenses. Actual amounts may differ from these estimates. Estimates and underlying assumptions are continually reviewed. Changes to accounting estimates are recognized in the period in which the estimates are revised.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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#### 2. Basis of preparation, significant estimates and judgments (continued)

Information about critical judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements are outlined below:

a. Reserve estimate

Petroleum and natural gas assets are depleted on a unit-of-production basis at a rate calculated by reference to proved and probable reserves determined in accordance with National Instrument 51-101, Standards of disclosure for Oil and Gas Activities ("NI51-101") and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reservoir engineering reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Reserves estimates, although not reported as part of the Company's financial statements, can have a significant effect on net income (loss), assets and liabilities as a result of their impact on depreciation and depletion, decommissioning liabilities, deferred taxes and asset impairments. Independent reservoir engineers perform evaluations of the Company's oil and gas reserves on an annual basis. The estimation of reserves is an inherently complex process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based upon a number of variables and assumptions such as geoscientific interpretation, production forecast, commodity prices and costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available or as economic conditions change.

b. Impairment indicators and discount rate

For purposes of impairment testing, petroleum and natural gas assets are grouped into cash generating units ("CGUs"), based on separately identifiable and largely independent cash flows. The determination of the Company's CGU is subject to judgment.

The recoverable amounts of CGUs and individual assets are based on the higher of their value-in-use and fair values less costs to sell. These calculations require the use of estimates and assumptions. Unless indicated otherwise, the recoverable amount used in assessing impairment charges is fair value less costs to sell. The Company generally estimates fair value less costs to sell using a discounted cash flow model which has a significant number of assumptions. The model uses expected cash flows from proved plus probable reserves. These estimates are subject to measurement uncertainty as discussed above and subject to variability to changes in forecasted commodity prices. The discount rate applied to the cash flows is also subject to management's judgment and will affect the recoverable amount calculated.

It is reasonably possible that the commodity price assumptions may change which may then impact the estimated life of the field and may then require a material adjustment to the carrying value of its tangible and intangible assets. The Company monitors internal and external indicators of impairment relating to its tangible assets. These indicators include changes in (a) commodity prices, (b) reserve volumes and (c) discount rates.

The future cash flows are adjusted for risks specific to the asset and discounted using an after-tax discount rate of 10%. As a result, changes in commodity prices, a reduction to reserve volumes or an increase in the discount rate may potentially lead to impairments.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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## 2. Basis of preparation, significant estimates and judgments (continued)

### c. Decommissioning costs

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 cost will be incurred by the Company. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. The liability, the related assets and the expenses are impacted by estimates with respect to the costs and timing of decommissioning.

### d. Measurement of share-based compensation

The estimation of the fair value of the options required input of several variables including estimated volatility of the issuer's stock price over the life of the options, future interest rates, forfeiture rates and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the valuation model.

The use of net asset value per share as determination for the compensation shares issued is subject to several variables primarily being the financial performance of the Company. The use of differing valuation techniques can significantly alter the amount recorded as share-based payment expense.

### e. Income taxes

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

## 3. Significant accounting policies

### Business combinations

The acquisition method of accounting is used to account for acquisitions of subsidiaries. The cost of an acquisition is measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of comprehensive loss.

Transaction costs incurred in a business combination, other than those associated with the issuance of debt or equity securities, are expensed as incurred.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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### 3. Significant accounting policies (continued)

#### Jointly controlled operations and jointly controlled assets

Some of the Company's petroleum and natural gas properties are jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

#### Property and equipment

Property and equipment comprise of oil and gas assets, computer equipment, office equipment, furniture and vehicle. Oil and gas properties are stated at cost, less any accumulated depletion, depreciation and accumulated impairment losses. These properties and equipment include oil and natural gas development and production assets, which represent costs incurred in developing oil and natural gas reserves and maintaining or enhancing production from such reserves. Future decommissioning liabilities related to producing assets are also capitalized to property and equipment.

Oil and gas properties are not depreciated until commercial production commences. The net carrying value of oil and gas assets is depleted using the unit-of-production method based on estimated proven and probable oil and gas reserves. The depletion calculation takes account of the estimated future development costs of the recognized proved plus probable reserves.

Proven and probable reserves are determined by independent engineers in accordance with Canadian National Instrument 51-101. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil. Changes in estimates of proved and probable reserves used in prior periods that affect the unit-of-production calculations do not give rise to prior year adjustments and are dealt with on a prospective basis.

Values of oil and gas properties are reviewed for impairment at the end of each reporting period for any indication that the carrying value of asset may not be recoverable. If any such indication of impairment exists, an estimate of the recoverable amount is calculated. Individual assets are grouped, for the purposes of impairment testing, together into the smallest group of assets or group of assets that generates cash flows that are largely independent of the cash flows of other assets or group of assets (the cash generating unit or CGU). A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written-down to its recoverable amount.

The recoverable amount is the greater of the value in use or fair value less costs to sell. Fair value is the amount the asset could be sold for in an arm's length transaction. The value in use is the present value of the estimated future cash flows of the asset from its continued use. The fair value less costs to sell considers the continued development of a property and market transactions in a valuation model. The Company uses the present value of the cash generating unit's estimated future cash flows from both proved and probable reserves in its fair value model. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded entities or other available fair value indicators.

Computer equipment, office equipment, furniture and vehicles are recorded at cost. The declining balance method of depreciation is used to depreciate the cost of these assets over their estimated useful lives. Computer equipment is depreciated at 100% per annum, office equipment and furniture is depreciated at 20% per annum and vehicles are depreciated at 30% per annum.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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### 3. Significant accounting policies (continued)

#### Exploration and evaluation

Exploration and evaluation (“E&E”) costs are capitalized for projects after the Company has acquired the legal right to explore but prior to their technical feasibility and commercial viability being confirmed, generally determined as the establishment of proved or probable reserves. These costs may include costs of license acquisition, technical services and studies, seismic acquisition, exploration drilling and testing, directly attributable overhead and administration expenses, including remuneration of production personnel and supervisory management, the projected costs of retiring the assets, and any activities in relation to evaluating the technical feasibility and commercial viability of extracting mineral resources.

Once technical feasibility and commercial viability are confirmed, the E&E asset is then reclassified to property, plant and equipment and tested for impairment. For purposes of impairment testing, E&E assets are allocated to the appropriate cash-generating units based on geographic proximity.

Expired lease costs are expensed as part of impairment expense as they occur and costs incurred prior to the legal right to explore are charged to net income (loss).

#### Decommissioning liabilities

The Company provides for future decommissioning liabilities related to its oil and gas operating activities based on current legislation, constructive obligation and industry operating practices. Decommissioning liabilities are recognized as a liability in the period in which they are incurred. Decommissioning liabilities are measured as the present value of management’s best estimate of the expenditure required to settle the asset retirement liability at the reporting date using a credit adjusted discount rate. When the liability is initially recognized, an amount equivalent to the provision is capitalized as a cost of the related oil and gas asset. This cost is amortized to expense through depletion and depreciation over the life of the related asset on a unit-of-production basis. Subsequent to initial measurement, the liability is adjusted at the end of each period to reflect the passage of time and changes in the estimated future costs underlying the liability. The increase in the balance due to the passage of time is charged as a finance costs whereas increases or decreases due to changes in the estimated future costs are capitalized. Actual costs incurred upon settlement of the decommissioning liability are charged against the liability or expense if greater than the liability.

#### Cash and cash equivalents

Cash and cash equivalents include balances with banks and other short-term highly liquid investments with a maturity of less than three months.

#### Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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### 3. Significant accounting policies (continued)

#### Financial instruments

Financial instruments are comprised of cash and cash equivalents, trade and other receivables, deposits, cash held in trust, accounts payable and accrued liabilities, abandonment deposit payable, debentures and note payable. Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or when the Company has transferred all risks and rewards of ownership.

#### a. Financial assets

Financial assets are measured at fair value on initial recognition of the instrument. Financial assets are classified as "available-for-sale-investments", "fair value through profit or loss" or "loans and receivables".

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company has no assets in this category.

Fair value through profit or loss are financial assets and liabilities which are acquired for resale prior to maturity or are designated as such by the Company. The Company has no assets in this category.

Loan and receivables are non-derivate financial assets with fixed or determinable payments that are not quoted in the active market. The Company's loan and receivables comprise cash and cash equivalents, trade and other receivables and cash held in trust.

Loans and receivables are recognized initially at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value.

Financial assets are assessed for indicators of impairment at each financial reporting date and are impaired when there is objective evidence that the estimated future cash flow has been impacted.

#### b. Financial liabilities

Financial liabilities include accounts payable and accrued liabilities, debentures payable, note payable and abandonment deposit payable. Financial liabilities are recognized on an accrual basis and are stated initially at fair value and subsequently measured at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

#### Finance costs

Included in finance costs is interest on the debentures and note payable, the unwinding of the present value discount on decommissioning liabilities which is recognized as accretion on decommissioning liabilities and costs incurred in sourcing additional capital.

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## **Vital Energy Inc.**

### **Notes to the Financial Statements**

*(Expressed in Canadian Dollars)*

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**For the years ended December 31, 2016 and 2015**

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### **3. Significant accounting policies (continued)**

#### **Revenue recognition**

Revenue associated with the sales of the Company's crude oil owned by the Company is recognized when title passes from the Company to its customer. This generally occurs when product is physically transferred into a vessel, pipe or other delivery mechanism.

Interest income is recognized when earned.

#### **Share-based compensation plan**

The Company has issued options to acquire common shares to directors, officers and employees of the Company. These options are accounted for using the fair-value method which estimates the value of the options at the date of the grant using the Black Scholes option pricing model. The fair value thus established is recognized as compensation expense over the vesting period of the options using the graded method of amortization, with an equivalent increase to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest. At the time the stock options are exercised, the issuance of common shares is recorded as an increase to shareholders' capital and a corresponding decrease to contributed surplus.

At each reporting date, the Company revises its estimates of the number of options expected to vest. It recognized the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

#### **Convertible debentures**

The proceeds received on the issuance of convertible debt are allocated into their liability and equity components. The amount initially attributed to the debt component equals the discounted cash flows using a market rate of interest that would be payable on a similar debt instrument that does not include an option to convert. The remainder of the proceeds is allocated to the conversion option and is recognized accordingly in Contributed Surplus component within shareholders' equity, net of income tax effects. Subsequently, the debt component is accounted for as a financial liability measured at amortized cost until extinguished on conversion or maturity of the instrument.

#### **Income taxes**

Deferred income tax is determined on a non-discounted basis using the liability method and tax rates and laws that have been enacted or substantially enacted at the reporting date. Provision is made for temporary differences at the reporting date between the tax basis of the assets and liabilities and their carrying amounts for financial reporting purposes.

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

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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### 3. Significant accounting policies (continued)

#### Earnings per share

Earnings per share are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments using the treasury stock method. The Company's potentially dilutive common shares include convertible debentures convertible into common shares and stock options granted to employees and directors. It is assumed that any proceeds obtained on the exercise of any options or warrants would be used to purchase common shares at the average price during the period.

### 4. New accounting standards

#### Change in accounting policies

The Company has adopted these accounting standards effective January 1, 2016. The adoption of the standards and amendments had no material impact on the financial statements:

#### Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

These amendments clarify circumstances in which an entity reclassifies an asset (or disposal group) from held for sale to held for distribution (or vice versa), and in circumstances which an entity no longer meets the criteria for held for distribution.

#### Amendments to IFRS 7 Financial Instruments

These amendments clarify the applicability of the amendments to IFRS 7 Disclosure-Offsetting Financial Assets and Financial Liabilities to condensed interim financial statements.

#### Amendments to IAS 19 Employee Benefits

These amendments clarify the application of the requirements of IAS 19 Employee Benefits (2011) on determination of the discount rate to a regional market consisting of multiple countries sharing the same currency.

#### Amendments to IAS 34 Interim Financial Reporting

These amendments clarify the meaning of disclosure of information 'elsewhere in the interim financial report' and require a cross reference.

#### Amendments to IFRS 11 Joint Arrangements

These amendments require an acquirer of an interest in a joint operation in which the activity constitutes a business (as defined in IFRS 3) to: (a) apply all of the business combinations accounting principles in IFRS 3 and other IFRS standards, except for those principles that conflict with the guidance in IFRS 11; and (b) disclose the information required by IFRS 3 and other IFRS standards for business combinations. The amendments apply both to the initial acquisition of an interest in joint operation, and the acquisition of an additional interest in a joint operation (in the latter case, previously held interests are not re-measured).

#### Amendments to IAS 27 Separate Financial Statements

These amendments permit investments in subsidiaries, joint ventures and associates to be optionally accounted for using the equity method in separate financial statements.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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#### 4. New accounting standards (continued)

##### **Amendments to IAS 1 Presentation of Financial Statements**

These amendments clarify existing IAS 1 requirements resulting from the Disclosure Initiative. It is designed to further encourage companies to apply professional judgment in determining what information to disclose in their financial statements.

##### **Amendments to IAS 16 Property, Plant and Equipment**

These amendments clarify the acceptable methods of depreciation and amortization.

##### **Amendments to IFRS 10, IFRS 12, and IAS 28**

These amendments (Investment Entities: Applying the Consolidation Exception) clarify and confirm that: (1) the exemption from preparing consolidated financial statements for an intermediate parent entity is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all of its subsidiaries at fair value; (2) a subsidiary that provides services related to the parent's investment activities should not be consolidated if the subsidiary itself is an investment entity; (3) when applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries; and (4) an investment entity measuring all of its subsidiaries at fair value provides the disclosures relating to investment entities required by IFRS 12.

##### **Amendments to IAS 38 Intangible Assets**

These amendments clarify the acceptable methods of depreciation and amortization.

##### **Accounting pronouncements not yet adopted**

The following accounting standards and amendments are effective for future periods.

##### **Amendments to IAS 7 Statement of Cash Flows**

These amendments (Disclosure Initiative) require that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. One way to fulfil the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Finally, the amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities. This standard is effective for reporting periods beginning on or after January 1, 2017.

##### **Amendments to IAS 12 Income Taxes**

These amendments, Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), clarify how to account for deferred tax assets related to debt instruments measured at fair value. These amendments are effective for reporting periods beginning on or after January 1, 2017.

##### **Amendments to IFRS 12 Disclosure of Interests in Other Entities**

These amendments clarify the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10 - B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. These amendments are effective for reporting periods beginning on or after January 1, 2017.

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## Vital Energy Inc.

### Notes to the Financial Statements

*(Expressed in Canadian Dollars)*

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#### For the years ended December 31, 2016 and 2015

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#### 4. New accounting standards (continued)

##### **Amendments to IFRS 2 Share-based Payment**

These amendments added guidance that introduces accounting requirements for cash-settled share-based payments that follow the same approach as used for equity-settled share-based payments. They introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety, provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature. Finally, they clarify the accounting treatment in situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. These amendments are effective for reporting periods beginning on or after January 1, 2018.

##### **IFRS 9 Financial Instruments**

This standard introduces new classification and measurement models for financial assets, using a single approach to determine whether a financial asset is measured at amortised cost or fair value. To be classified and measured at amortised cost, assets must satisfy the business model test for managing the financial assets and have certain contractual cash flow characteristics. All other financial instrument assets are to be classified and measured at fair value. This standard allows an irrevocable election on initial recognition to present gains and losses on equity instruments (that are not held-for-trading) in other comprehensive income, with dividends as a return on these investments being recognised in profit or loss. In addition, those equity instruments measured at fair value through other comprehensive income would no longer have to apply any impairment requirements nor would there be any 'recycling' of gains or losses through profit or loss on disposal. The accounting for financial liabilities continues to be classified and measured in accordance with IAS 39, with one exception, being that the portion of a change of fair value relating to the entity's own credit risk is to be presented in other comprehensive income unless it would create an accounting mismatch. This standard is effective for reporting periods beginning on or after January 1, 2018.

##### **IFRS 15 Revenue from Contracts with Customers**

The IASB issued IFRS 15, Revenue from Contracts with Customers, which provides a single principle-based framework to be applied to all contracts with customers. IFRS 15 replaces the previous revenue standard IAS 18, Revenue, and the related Interpretations on revenue recognition. The standard scopes out contracts that are considered to be lease contracts, insurance contracts and financial instruments. The new standard is a control-based model as compared to the existing revenue standard which is primarily focused on risks and rewards. Under the new standard, revenue is recognized when a customer obtains control of a good or service. Transfer of control occurs when the customer has the ability to direct the use of and obtain the benefits of the good or service. This standard is effective for reporting periods beginning on or after January 1, 2018.

##### **Amendments to IAS 40 Investment Property**

These amendments specify that a transfer into, or out of investment property should be made only when there has been a change in use of the property; and such a change in use would involve an assessment of whether the property qualifies as an investment property. That change in use should be supported by evidence. These amendments are effective for reporting periods beginning on or after January 1, 2018.

##### **Amendments to IAS 28 Investments in Associates and Joint Ventures**

These amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organisation, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition. These amendments are effective for reporting periods beginning on or after January 1, 2018.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 4. New accounting standards (continued)

##### **IFRIC 22 Foreign Currency Transactions and Advance Consideration**

This interpretation clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. It covers foreign currency transactions when an entity recognizes a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income. It does not apply when an entity measures the related asset, expense or income on initial recognition at fair value or at the fair value of the consideration received or paid at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability. Also, the Interpretation need not be applied to income taxes, insurance contracts or reinsurance contracts. This interpretation is effective for reporting periods beginning on or after January 1, 2018.

##### **IFRS 16 Leases**

IFRS 16 was issued in January 2016 and specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. This standard is effective for reporting periods beginning on or after January 1, 2019.

#### 5. Cash and cash equivalents

	2016	2015
Cash at bank and on hand	\$ 741,993	\$ 1,888,103
Cashable guaranteed investment certificate	112,271	111,613
<b>Cash and cash equivalents</b>	<b>\$ 854,264</b>	<b>\$ 1,999,716</b>

#### 6. Trade and other receivables

	2016	2015
Trade receivables	\$ 277,359	\$ 267,337
Due from an officer and a director	-	55,000
<b>Trade and other receivables</b>	<b>\$ 277,359</b>	<b>\$ 322,337</b>

The trade receivables have been reviewed for collectability and no allowance for doubtful accounts is considered necessary.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 7. Property and equipment

Petroleum and natural gas properties are as follows at December 31:

	2016	2015
Cost, beginning of year	\$ 24,455,915	\$ 15,669,398
Additions	227,459	8,786,517
Revisions to decommissioning liabilities	(70,181)	-
Cost, end of year	<b>24,613,193</b>	24,455,915
Accumulated depletion, beginning of year	11,805,868	6,871,699
Impairment	-	3,293,266
Depreciation and depletion	1,458,681	1,640,903
Accumulated depletion, end of year	<b>13,264,549</b>	11,805,868
<b>Carrying value, end of year</b>	<b>\$ 11,348,644</b>	<b>\$ 12,650,047</b>

As at December 31, 2016, the Company recorded an impairment charge of \$nil (2015 - \$3,293,266) related to various properties and equipment. Recoverable amounts have been determined using the fair value less costs to sell method and based on internally generated cash flow projections. In determining fair value less costs to sell, the Company considered recent transactions within the industry, long-term views of oil prices, externally evaluated reserve volumes, and discount rates specific to the asset. The estimated future cash flows were estimated as the proved plus probable reserve value for the property in each CGU discounted at 10% per annum and were based on the Company's independent engineering report.

At December 31, 2016, future development costs of \$6,978,000 (2015 - \$7,270,000) associated with proved and probable reserves are included in costs subject to depletion.

The benchmark prices used by the independent reserve evaluators in preparing the Company's reserve report are outlined below and were also used in determining whether impairment of the carrying value of the CGU's existed at December 31, 2016. The prices are referenced for medium crude oil based on Heavy Crude Oil at Hardisty:

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Cdn\$/bbl	\$46.69	\$50.40	\$55.03	\$56.96	\$59.95	\$63.43	\$66.99	\$70.48	\$73.63	\$77.54	+2%/yr

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 8. Exploration and evaluation assets

Exploration and evaluation expenditures consist of the Company's exploration projects which are pending the determination of proven or probable reserves.

	2016	2015
<b>Cost, beginning of year</b>	<b>\$ 421,125</b>	\$ 1,389,345
Impairment	<b>(421,125)</b>	(967,273)
Other	-	(947)
<b>Cost, end of year</b>	<b>\$ -</b>	\$ 421,125

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As at December 31, 2016, the Company reviewed the Exploration and Evaluation Expenditures for recoverability and impairment and determined that an impairment charge of \$421,125 (2015 - \$967,273) be recorded. The Company performed this review after considering capital market conditions for raising funds for exploration and production activities and near term drilling plans. The recoverable amount has been determined to be the assets' fair value less cost of disposals.

Impairments were in the following areas:

	2016	2015
Kidney	\$ -	\$ 333,159
Red Willow	<b>106,125</b>	-
Panny	<b>315,000</b>	631,626
Other	-	2,488
	<b>\$ 421,125</b>	\$ 967,273

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#### 9. Debenture payable

On December 23, 2015, the Company issued 8% secured convertible debentures in the principal amount of \$2,125,000 to directors. The debentures mature two years from the date of issuance, are secured against the property of the Company and interest is paid quarterly. The debentures are convertible at the holder's option into common shares of the Company at a conversion price of \$0.10 per common share.

The fair value of the convertible debenture was allocated solely to the liability based on the fair value of the liability component, which was determined to be its face value \$2,125,000 using future cash flows discounted at a rate of 8% estimated as the interest rate for a comparable financial instrument.

#### 10. Note payable

On December 29, 2015, the Company issued an 8% unsecured promissory note in the principal amount of \$25,000 to an officer. The promissory note matures two years from the date of issuance and interest is paid quarterly.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 11. Deferred income taxes

Deferred income taxes are based on the differences between the accounting amounts and the related tax bases of the Company's property and equipment, decommissioning liability. The future income tax rate in determining the temporary differences was 27% (2015 - 27%).

	2016	2015
Temporary differences related to:		
Property and equipment	\$ 6,611,000	\$ 6,069,000
Decommissioning liabilities	(284,000)	(291,000)
Tax loss carry forwards	4,730,000	4,649,000
Other	140,000	143,000
Deferred tax assets not recognized, net	(11,197,000)	(10,570,000)
<b>Deferred income tax asset</b>	<b>\$ -</b>	<b>\$ -</b>

At December 31, 2016, the Company has tax pools and non-capital losses as described below totaling approximately \$52,470,000 (2015 - \$51,700,000) that are available to shelter future taxable income. The Company's non-capital losses expire between the year 2026 and 2036.

Non- capital losses	\$ 17,517,000
Undepreciated capital cost	4,540,000
Canadian exploration expenses	11,868,000
Canadian development expenses	7,388,000
Canadian oil and gas property expenses	11,008,000
Cumulative eligible capital	149,000
	<b>\$ 52,470,000</b>

The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate to the income for the year and is reconciled as follows:

	2016	2015
Loss before income taxes	\$ (2,341,837)	\$ (6,410,644)
Statutory rate	27.0%	26.0%
Anticipated income tax recovery at the combined basic federal and provincial tax rate	\$ (632,000)	\$ (1,667,000)
Increase (decrease) resulting from:		
Share-based compensation	5,000	10,000
Effect of change in tax rates	-	(669,000)
Change in deferred tax assets not recognized	627,000	2,326,000
<b>Effective tax expense</b>	<b>\$ -</b>	<b>\$ -</b>

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 12. Decommissioning liabilities

The Company's total decommissioning liability is estimated based on the Company's net ownership in wells and facilities and management's estimate of costs to abandon and reclaim those wells and facilities, as well as an estimate of the future timing of the costs to be incurred.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements could be significant. The total undiscounted amount of the estimated cash flows required to settle its decommissioning liabilities are approximately \$1,200,700 (2015 - \$1,200,700) which will be settled over the operating lives of the underlying assets, estimated to occur between 2018 and 2041. A credit adjusted interest rate of 7% and an inflation rate of 2% were used to calculate the decommissioning liability. Settlement of the liability will be funded from general corporate funds at the time of retirement or removal. As at December 31, 2016, \$531,607 (2015- \$630,625) has been paid as deposits to the applicable regulatory bodies for settlement of these obligation. Changes to the liabilities were as follows:

	2016	2015
<b>Balance, beginning of year</b>	<b>\$ 1,078,107</b>	\$ 893,866
Additions	-	155,542
Revisions	<b>(70,181)</b>	-
Accretion	<b>43,581</b>	28,699
<b>Balance, end of year</b>	<b>\$ 1,051,507</b>	\$ 1,078,107

#### 13. Share capital

##### a. Authorized

- Unlimited number of voting Class A, B and C common shares
- Unlimited number of non-voting Class D, E and F common shares
- Unlimited number of non-voting, non-cumulative, redeemable Class A preferred shares
- Unlimited number of non-voting, cumulative, redeemable Class B preferred shares

##### b. Issued and outstanding - Class A common shares

	# of shares	Amount
<b>Balance, December 31, 2014</b>	<b>49,999,971</b>	\$ 28,515,885
Issued for cash	<b>10,500,000</b>	1,050,000
<b>Balance, December 31, 2015 and 2016</b>	<b>60,499,971</b>	\$ 29,565,885

On November 3, 2015, the Company issued to a director, 10,500,000 common shares at \$0.10 per common share for gross proceeds of \$1,050,000. The common shares were subject to a four month hold period which expired on March 3, 2016.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 14. Share-based compensation

The Company has established a stock option plan (the "Plan") which is administered by the Board of Directors, allowing the Board of Directors to grant stock options. The Company adopted a 10% Rolling Stock Option Plan, which allows for the granting of stock options for the purchase of up to 10% of the outstanding shares of the Company.

Additionally, options may not be granted to any one person, any one consultant or any persons performing investor relations duties in any twelve month period which could, when exercised, result in the issuance of shares exceeding 5%, 2% or 2%, respectively, of the issued and outstanding shares of the Company. All options granted under the Plan shall expire no later than the tenth anniversary of the date the options were granted.

The exercise price of the options is to be determined by the Board of Directors, subject to any applicable Exchange approval, at the time any option is granted. In no event shall such exercise price be lower than the exercise price permitted by any applicable Exchange. Vesting of the options is at the discretion of the Board of Directors.

A summary of the status of the stock option plan and changes during the year is presented below:

	December 31, 2016		December 31, 2015	
	#	Weighted average exercise price	#	Weighted average exercise price
<b>Outstanding, beginning of year</b>	<b>4,750,000</b>	<b>\$ 0.25</b>	4,650,000	\$ 0.25
Forfeited	(100,000)	0.25	(450,000)	0.25
Issued	-	-	550,000	0.25
<b>Outstanding, end of year</b>	<b>4,650,000</b>	<b>\$ 0.25</b>	4,750,000	\$ 0.25
<b>Exercisable, end of year</b>	<b>4,500,000</b>	<b>\$ 0.25</b>	4,400,000	\$ 0.25

The details of the options outstanding at December 31, 2016 are as follows:

Options outstanding	Weighted average exercise price	Options exercisable	Weighted average years to expiry
4,200,000	0.25	4,200,000	7.50
450,000	0.25	300,000	3.25
<b>4,650,000</b>	<b>0.25</b>	<b>4,500,000</b>	<b>7.00</b>

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 14. Share-based compensation (continued)

The Company accounts for its share-based compensation using the fair value method for all stock options. In April 2015, the Company issued 550,000 stock options to an employee and a director. Of the 2015 issuance, 450,000 options vest equally as to one-third annually commencing from the date of grant. The remaining 100,000 options vest 50% at date of grant and 25% annually commencing one and two years from the date of grant. Total share consideration recognized in 2016 in respect of these options was \$17,500 (2015 - \$36,500). The fair value of the stock options issued in the period has been estimated at the date of grant using the Black-Scholes option pricing model based on the following assumptions:

Dividend yield	-
Expected volatility	130%
Risk-free interest rate	0.98%
Expected life	5 years
Forfeiture	0%

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#### 15. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares issued during the year excluding ordinary shares purchased by the Company and held as treasury shares. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

	2016	2015
Loss attributable to equity holders of the Company	\$ (2,341,837)	\$ (6,410,644)
Weighted average number of common shares outstanding - basic and diluted	60,499,971	51,668,464

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The Company has dilutive instruments outstanding, which consist of stock options. The dilutive impact of these instruments using the treasury stock method results in anti-dilution as a result of the Company incurring losses during the years presented. As a result, diluted loss per share and the impact of these instruments on the weighted average number of shares outstanding is not presented in the financial statements.

#### 16. Financial instruments

The Company's financial instruments recognized on the balance sheet includes cash and cash equivalents, trade and other receivables, cash held in trust, accounts payable and accrued liabilities, debentures payable, note payable and abandonment deposit payable.

##### Fair value

The fair value of these financial instruments approximates their carrying value due to their short-term nature.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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For the years ended December 31, 2016 and 2015

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#### 16. Financial instruments (continued)

##### Risks associated with financial assets and liabilities

The Company's activities are exposed to a variety of financial risks such as credit risk, market risk and liquidity risk that arise as a result of its exploration, development and production activities. Management has primary responsibility for monitoring and managing financial instrument risks under the direction of the Board of Directors, which has overall responsibility for establishing the Company's risk management framework.

##### a. Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company limits its exposure to credit risk related to cash and cash equivalents by only investing in liquid securities and only with counterparties that have an acceptable credit rating. Given these factors, management does not expect any counterparty to fail to meet its obligations.

Credit risk is primarily related to the Company's trade receivables from petroleum and natural gas marketers and the risk of financial loss if a marketer fails to meet its contractual obligation. The Company's policy to mitigate credit risk associated with these receivables is to establish marketing relationships with large, credit worthy purchasers. The Company has not experienced any collection issues with its petroleum and natural gas marketers. As at December 31, 2016 and 2015, the majority of the Company's trade accounts receivable are all current. No default on outstanding receivables is anticipated and, as such, no provision for doubtful accounts has been recorded. The aging of the Company's trade and other receivables at December 31 is as follows:

		Total	0 - 30 days	31 - 60 days	61 - 90 days	Over 90 days
2016	\$	277,359	\$ 239,919	\$ 37,440	\$ -	\$ -
2015	\$	322,337	\$ 280,554	\$ 36	\$ 1,090	\$ 40,657

##### b. Liquidity risk

Liquidity risk relates to the risk the Company will encounter should it have difficulty in meeting obligations associated with the financial liabilities which are due within one year. The financial liabilities on its balance sheet consist of accounts payable and accrued liabilities, note payable and debentures payable, which are due within one year. The Company manages its liquidity through continuously monitoring its cash flows from operating activities and review of its actual capital expenditure program against budget. Liquidity difficulties would emerge if the Company was unable to establish a profitable production base to generate sufficient cash flow to cover both operating and capital requirements and service debt financing arrangements. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and issuance of debt or equity instruments. The Company has no bank debt as at December 31, 2016.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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For the years ended December 31, 2016 and 2015

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#### 16. Financial instruments (continued)

##### b. Liquidity risk (continued)

The following are the contractual maturities of financial liabilities including expected interest payments at December 31:

2016	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable, accrued liabilities and goods and services tax payable	\$ 367,057	\$ 367,057	\$ -
Debenture payable	2,295,000	2,295,000	-
Note payable	27,000	27,000	-
	<b>\$ 2,689,057</b>	<b>\$ 2,689,057</b>	<b>\$ -</b>

  

2015	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable and accrued liabilities	\$ 1,051,445	\$ 1,051,445	\$ -
Abandonment deposit payable	238,839	238,839	-
Debenture payable	2,465,000	170,000	2,295,000
Note payable	29,000	2,000	27,000
	<b>\$ 3,784,284</b>	<b>\$ 1,462,284</b>	<b>\$ 2,322,000</b>

##### c. Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

##### d. Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world and continental/regional economic and other events that dictate the level of supply and demand. The Company has no commodity hedges in place as at December 31, 2016 and 2015.

##### e. Foreign currency risk

Foreign currency risk is the risk that future cash flow will fluctuate as a result of changes in foreign exchange rates. Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market price in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian dollar and the United States dollar. The Company has no forward exchange rate contracts in place as at December 31, 2016 and 2015.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 16. Financial instruments (continued)

##### f. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent the changes in market interest rates will impact the Company's cash and cash equivalents that are at a floating or short-term rate of interest. The Company does not have any floating interest rate contracts in place as at December 31, 2016 and 2015. The debentures and note payable are at a fixed interest rate and therefore not exposed to interest rate risk.

#### 17. Capital risk management

The Company's policy is to maintain a strong capital base for the objectives of maintaining financial flexibility in order to preserve its ability to meet financial obligations, to execute on strategic acquisitions, and to provide an appropriate return on investment to its shareholders.

The Company manages its capital structure and makes adjustments to respond to changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholders' equity and working capital. In order to maintain or adjust its capital structure, the Company may from time to time issue new shares and adjust its capital spending.

In order to facilitate the management of capital expenditures, the Company prepares annual budgets which are updated as necessary depending upon varying factors including current and forecast crude oil and natural gas prices, capital expenditure and general industry conditions.

At December 31, 2016 and 2015, the Company had the following capital structure:

	<b>2016</b>	2015
Shareholders' equity	\$ 9,462,025	\$ 11,786,362
Working capital (deficiency)	<b>(1,366,719)</b>	1,312,672
<b>Capital</b>	<b>\$ 8,095,306</b>	<b>\$ 13,099,034</b>

The Company's share capital is not subject to external restrictions. The Company has not declared or paid any dividends since inception and does not contemplate doing so in the foreseeable future. During the prior year, the Company issued debentures and a note payable in order to balance its capital structure.

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## Vital Energy Inc.

### Notes to the Financial Statements

(Expressed in Canadian Dollars)

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#### For the years ended December 31, 2016 and 2015

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#### 18. Expenses by nature

	2016	2015
Wages and employee benefits	\$ 427,786	\$ 502,758
Professional fees	87,251	119,004
Consulting fees	438,926	468,215
User fees	66,840	84,514
Rental	89,487	91,589
Office	115,277	64,534
Travel and entertainment	15,654	6,918
<b>Total general and administration costs</b>	<b>\$ 1,241,221</b>	<b>\$ 1,337,532</b>

Finance costs were \$310,707 for the year ended December 31, 2016 (2015 - \$4,190) and are comprised of \$139,680 (2015 - \$nil) paid as a finder's fee for attempting to source new capital and \$171,027 (2015 - \$4,190) in interest expense related to the debentures and note payable.

#### 19. Key management compensation

Key management includes directors involved with the daily operations of the Company. The compensation paid or payable to key management for employee services is shown below:

	2016	2015
Salaries and other short-term employee benefits	\$ 288,000	\$ 312,000
Directors fees	108,000	57,000
Share-based compensation	17,500	36,500
Consulting fees	231,500	283,000
	<b>\$ 645,000</b>	<b>\$ 688,500</b>

#### 20. Related party transactions

Transactions with related parties are incurred in the normal course of business and are measured at the exchange amount which is the amount of consideration established and approved by the related parties. Related party transactions are disclosed below, unless they have been disclosed elsewhere in the financial statements.

During the year ended December 31, 2016, the Company incurred \$231,500 (2015 - \$283,000) in consulting fees to officers or companies controlled by officers.

During the year, \$108,000 (2015 - \$57,000) was paid to directors as consulting fees.

In April 2015, the Company issued 450,000 stock options to a director at an exercise price of \$0.25 per common share. The stock options had a fair value of \$54,000 at the date of grant and \$15,000 was recorded in 2016 as share-based compensation (2015 - \$27,250).

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## **Vital Energy Inc.**

### **Notes to the Financial Statements**

*(Expressed in Canadian Dollars)*

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**For the years ended December 31, 2016 and 2015**

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#### **21. Commitments**

The Company is committed under an office lease that expires on July 1, 2017. The 2017 payments are approximately \$36,000.

#### **22. Subsequent event**

On March 20, 2017, the Company entered into a Carried Working Interest Agreement regarding the development of lands in the Pennant area. Under the Agreement, the Carried Working Interest partner ("Partner") will advance up to \$10,500,000 for the drilling, completion, equipping and all testing facilities for seven (7) horizontal wellbores, construction of five (5) lease pads and associated road works. In addition, the Partner will advance up to \$500,000 for the acquisition of petroleum and natural gas leases.

In exchange, the Company will pay 80% of the net profits from the seven (7) horizontal wells to the Partner until such time as the Partner has recovered 180% of their investment. At that time, the carried working interest will convert to a 5% gross overriding royalty.

On April 17, 2017, the Partner made its initial advance to fund the acquisition of petroleum and natural gas leases.