

**Vital Energy Inc.**

**Financial Statements**

**December 31, 2018 and 2017**

*(Expressed in Canadian Dollars)*



**Crowe MacKay LLP**

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## **Independent Auditor's Report**

To the Shareholders of Vital Energy Inc.

### **Opinion**

We have audited the financial statements of Vital Energy Inc. ("the Company"), which comprise the balance sheets as at December 31, 2018 and December 31, 2017 and the statements of net and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and December 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

### **Basis for Opinion**

We conducted our audits in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audits of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Material Uncertainty Related to Going Concern**

We draw attention to Note 1 to the financial statements which describes the material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

### **Other Information**

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis

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

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

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

## **Responsibilities of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation and fair presentation of the 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.

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

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

## **Auditor's Responsibilities for the Audit of the Financial Statements**

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Todd Freer.

**Calgary, Canada**  
**April 30, 2019**

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

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## Vital Energy Inc.

### Balance Sheets

(Expressed in Canadian Dollars)

	Notes	December 31, 2018	December 31, 2017
<b>Assets</b>			
<b>Current</b>			
Cash and cash equivalents		\$ 1,034,365	\$ 2,068,361
Trade and other receivables		221,807	493,725
Prepaid expenses		30,418	29,906
		1,286,590	2,591,992
<b>Deposits</b>	<b>8</b>	<b>545,026</b>	536,437
<b>Property and equipment</b>	<b>5</b>	<b>12,190,105</b>	10,460,582
		\$ 14,021,721	\$ 13,589,011
<b>Liabilities</b>			
<b>Current</b>			
Accounts payable and accrued liabilities		\$ 1,304,993	\$ 1,700,105
Contract liabilities	6	1,823,246	-
Current portion of debentures payable	7	-	2,175,000
		3,128,239	3,875,105
<b>Decommissioning liabilities</b>	<b>8</b>	<b>990,151</b>	1,115,435
		4,118,390	4,990,540
<b>Shareholders' Equity</b>			
Share capital	9	31,740,885	29,565,885
Contributed surplus		1,406,451	1,406,451
Deficit		(23,244,005)	(22,373,865)
		9,903,331	8,598,471
		\$ 14,021,721	\$ 13,589,011

General information and going concern (note 1)  
Commitment (note 15)

Approved by the Board:

(Signed) "Ngai Ho", Director

(Signed) "Yingchuan Wu", Director

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

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<b>Years ended December 31,</b>	<b>Note</b>	<b>2018</b>	<b>2017</b>
<b>Revenue</b>			
Oil and gas sales	10	\$ 4,331,747	\$ 3,236,022
Less: Crown royalties		(724,233)	(350,409)
<b>Net revenue</b>		<b>3,607,514</b>	<b>2,885,613</b>
<b>Other income</b>			
Interest		15,494	5,344
		<b>3,623,008</b>	<b>2,890,957</b>
<b>Expenses</b>			
Operating expenses		1,562,932	1,508,618
General and administrative	11	1,241,126	830,951
Share-based payments	9	-	5,250
Finance charges	11,14	167,325	231,127
Accretion of decommissioning liabilities	8	33,202	27,399
Depletion and depreciation	5	1,488,563	1,156,416
		<b>4,493,148</b>	<b>3,759,761</b>
<b>Net and comprehensive loss for the year</b>		<b>\$ (870,140)</b>	<b>\$ (868,804)</b>
<b>Basic loss per share</b>	9	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>

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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, 2017</b>		<b>\$ 29,565,885</b>	<b>\$ 1,406,451</b>	<b>\$ (22,373,865)</b>	<b>\$ 8,598,471</b>
Conversion of debentures payable	7	2,175,000	-	-	2,175,000
Net and comprehensive loss		-	-	(870,140)	(870,140)
<b>Balance, December 31, 2018</b>		<b>\$ 31,740,885</b>	<b>\$ 1,406,451</b>	<b>\$ (23,244,005)</b>	<b>\$ 9,903,331</b>
<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>
Share-based compensation	9	-	5,250	-	5,250
Net and comprehensive loss		-	-	(868,804)	(868,804)
<b>Balance, December 31, 2017</b>		<b>\$ 29,565,885</b>	<b>\$ 1,406,451</b>	<b>\$ (22,373,865)</b>	<b>\$ 8,598,471</b>

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## Vital Energy Inc.

### Statements of Cash Flows

(Expressed in Canadian Dollars)

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Years ended December 31,	2018	2017
<b>Operating activities</b>		
Net and comprehensive loss for the year	\$ (870,140)	\$ (868,804)
Non-cash items:		
Depletion and depreciation	1,488,563	1,156,416
Bad debt	175,285	-
Accretion of decommissioning liabilities	33,202	27,399
Share-based payments	-	5,250
	<b>826,910</b>	<b>320,261</b>
Changes in non-cash working capital		
Trade and other receivables	82,867	(216,366)
Prepaid expenses	(512)	(11,191)
Accounts payable and accrued liabilities	169,465	77,434
	<b>1,078,730</b>	<b>170,138</b>
<b>Investing activities</b>		
Deposits paid	(8,589)	(4,830)
Expenditures on property and equipment	(3,376,572)	(231,825)
Changes in accounts payable and accrued liabilities	720,190	(15,387)
Changes in contract liabilities	1,823,246	-
	<b>(841,725)</b>	<b>(252,042)</b>
<b>Financing activities</b>		
Carried interest funds received (note 18)	135,000	1,565,840
Carried interest expenditures paid (note 18)	(1,406,001)	(294,839)
Repayment of note payable and debenture	-	(75,000)
Debenture proceeds	-	100,000
	<b>(1,271,001)</b>	<b>1,296,001</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1,033,996)</b>	<b>1,214,097</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>2,068,361</b>	<b>854,264</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 1,034,365</b>	<b>\$ 2,068,361</b>
<b>Cash and cash equivalents:</b>		
Cash at bank and on hand	\$ 919,728	\$ 1,955,578
Cashable guaranteed investment certificate	114,637	112,783
	<b>\$ 1,034,365</b>	<b>\$ 2,068,361</b>
<b>Supplemental cash flow information:</b>		
Interest paid	167,325	171,868
Increase in accounts payable related to carried interest (note 18)	-	1,271,001
<b>Non-cash transactions – (notes 5 and 7)</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, 2018 and 2017

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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 888, 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 \$1,841,649 (December 31, 2017 - \$1,283,113).

There can be no assurance that in the future the Company will be able to generate profits and cash flow from operations. If that were not 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. The Company will require the continued support from its key creditors, officers and directors in conjunction with achieving profitable operations in the near future.

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, 2018. The financial statements were authorized for issue by the Board of Directors on April 30, 2019.

The financial statements have been prepared on the historical cost basis except where otherwise noted.

The financial statements are presented in Canadian dollars which is also the Company’s functional currency.

##### 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’s 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, 2018 and 2017

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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 proven 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 ("CGU's"), based on separately identifiable and largely independent cash flows. The determination of the Company's CGU's is subject to judgment.

The recoverable amounts of CGU's 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 a before-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, 2018 and 2017

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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 costs will be incurred by the Company. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. These assumptions can be impacted by changes outside of the Company's control, such as technological advancements, legal and regulatory requirements and environmental laws and regulations. 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 stock options requires the use of assumptions, which include the estimated volatility of the issuer's stock price over the life of the options, future interest rates, dividend yield, 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.

### 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 and changes in accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements except as otherwise noted.

### 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.

### Carried working interest arrangement

The Company has entered into a carried working interest arrangement on one of its properties whereby the Carried Working Interest Partner ("Partner") pays the cost of drilling, completing and equipping the well in return for a share of the net operating profits of that particular well. The Partner has no ownership interest in any of the petroleum and natural gas leases or the well and is only entitled to their predetermined share of the operating profits. As such, the Company records a liability for the decommissioning costs of the well and records as an operating expense, the share of net operating profits earned by the Partner.

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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, 2018 and 2017

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### 3. Significant and changes in accounting policies (continued)

#### Property and equipment

Property and equipment consist 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 into account 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 the 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, 2018 and 2017**

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### 3. Significant and changes in 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.

Exploration and evaluation assets are subject to a separate impairment test at least annually or when facts and circumstances indicate that an impairment has occurred.

Once technical feasibility and commercial viability are confirmed, the E&E asset is then reclassified to property and equipment and tested for impairment.

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 discount rate. When the liability is initially recognized, an amount equivalent to the provision is capitalized to the 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 to the statement of net and comprehensive loss 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 that can be readily converted to cash without penalty.

#### 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, 2018 and 2017

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### 3. Significant and changes in accounting policies (continued)

#### Financial instruments

Financial instruments are comprised of cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities, contract liabilities and debentures 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

##### Classification and Measurement of Financial Assets

##### Policy Applicable from January 1, 2018

The initial classification of a financial asset depends upon the Company's business model for managing its financial assets and the contractual terms of the cash flows. There are three measurement categories into which the Company classified its financial assets:

- Amortized Cost: Includes assets that are held within a business model whose objective is to hold assets to collect contractual cash flows and its contractual terms give rise on specified dates to cash flows that represent solely payments of principal and interest;
- Fair value through other comprehensive income ("FVOCI"): Includes assets that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets, where its contractual terms give rise on specified dates to cash flows that represent solely payments of principal and interest; or
- Fair Value through Profit and Loss ("FVTPL"): Includes assets that do not meet the criteria for amortized cost or FVOCI and are measured at fair value through profit or loss.

This includes all derivative financial assets. On initial recognition, the Company may irrevocably designate a financial asset that meets the amortized cost or FVOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch. On initial recognition of an equity investment that is not held-for-trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in OCI. There is no subsequent reclassification of fair value changes to earnings following the derecognition of the investment. However, dividends that reflect a return on investment continue to be recognized in net earnings. This election is made on an investment-by-investment basis. At initial recognition, the Company measures a financial asset at its fair value and, in the case of a financial asset not at FVTPL, including transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are recorded as an expense in net earnings. Financial assets are reclassified subsequent to their initial recognition only if the business model for managing those financial assets changes. The affected financial assets will be reclassified on the first day of the first reporting period following the change in the business model. A financial asset is derecognized when the rights to receive cash flows from the asset have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

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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, 2018 and 2017

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### 3. Significant and changes in accounting policies (continued)

#### Financial instruments (continued)

##### a. Financial assets (continued)

Policy Applicable before January 1, 2018

Prior to the adoption of IFRS 9, "Financial Instruments" ("IFRS 9") on January 1, 2018, the Company classified and measured financial assets under IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). There were three measurement categories into which the Company classified its financial assets:

- FVTPL: Assets were either 'held-for-trading' or had been 'designated at fair value through profit or loss. The assets were measured at fair value with changes in fair value recognized in net earnings;
- Loans and Receivables: Included assets with fixed or determinable payments that are not quoted in an active market. After initial measurements, these assets were measured at amortized cost at the settlement date using the effective interest rate method of amortization; and
- Available for Sale Financial Assets: Included investments in the equity of private companies that the Company did not have control or had significant influence over.

These assets were measured at fair value, with changes in fair value recognized in OCI. When an active market was non-existent, fair value was determined using valuation techniques. When the fair value could not be reliably measured, such assets were carried at cost.

#### Impairment of Financial Assets

Policy Applicable from January 1, 2018

The Company recognizes loss allowances for expected credit losses ("ECLs") on its financial assets measured at amortized cost. Due to the nature of its financial assets, The Company measures loss allowances at an amount equal to lifetime ECLs. Lifetime ECLs are the anticipated ECLs that result from all possible default events over the expected life of a financial asset. ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the related financial asset. The Company does not have any financial assets that contain a financing component.

Policy Applicable before January 1, 2018

At each reporting date, the Company assesses whether there are any indicators that its financial assets are impaired. An impairment loss is only recognized if there is objective evidence of impairment, the loss event has an impact on future cash flows and the loss can be reliably estimated. Evidence of impairment may include default or delinquency by a debtor or indicators that the debtor may enter bankruptcy. For equity securities, a significant or prolonged decline in the fair value of the security below cost is evidence that the assets are impaired. An impairment loss on a financial asset carried at amortized cost is calculated as the difference between the amortized cost and the present value of the future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account. Impairment losses on financial assets carried at amortized cost are reversed through net earnings in subsequent periods if the amount of the loss decreases.

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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, 2018 and 2017

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### 3. Significant and changes in accounting policies (continued)

#### Financial instruments (continued)

##### b. Financial liabilities

Financial liabilities include accounts payable and accrued liabilities, contract liabilities and debentures payable. Financial liabilities are classified as current liabilities if payment is due within twelve months; otherwise, they are presented as non-current liabilities.

##### Classification and Measurement of Financial Liabilities

A financial liability is initially classified as measured at amortized cost or FVTPL. A financial liability is classified as measured at FVTPL if it is held-for-trading, a derivative, or designated as FVTPL on initial recognition. The classification of a financial liability is irrevocable. Financial liabilities at FVTPL (other than financial liabilities designated at FVTPL) are measured at fair value with changes in fair value, along with any interest expense, recognized in net earnings. Other financial liabilities are initially measured at fair value less directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in net earnings. Any gain or loss on derecognition is also recognized in net earnings. A financial liability is derecognized when the obligation is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same counterparty with substantially different terms, or the terms of an existing liability are substantially modified, it is treated as a derecognition of the original liability and the recognition of a new liability. When the terms of an existing financial liability are altered, but the changes are considered non-substantial, it is accounted for as a modification to the existing financial liability. Where a liability is substantially modified it is considered to be extinguished and a gain or loss is recognized in net earnings based on the difference between the carrying amount of the liability derecognized and the fair value of the revised liability. Where a liability is modified in a non-substantial way, the amortized cost of the liability is remeasured based on the new cash flows and a gain or loss is recorded in net earnings.

##### Finance charges

Included in finance charges is interest on the debentures payable and costs incurred in sourcing additional capital.

##### Revenue recognition

Revenue associated with the sale of the Company's crude oil and natural gas is recognized when control passes from the Company to its customer. This generally occurs when product is physically transferred into a vessel, pipe or other delivery mechanism and it is probable that the economic benefits will flow to the Company.

Interest income is recognized when earned.

##### Policy Applicable Before January 1, 2018

Revenues associated with the sales are recognized when the significant risks and rewards of ownership have been transferred to the customer, the sales price and costs can be measured reliably and it is probable that the economic benefits will flow to the Company. This is generally met when title passes from the Company to its customer. Net revenues from the production of crude oil and natural gas represent the Company's share, net of royalty payments to governments and other mineral interest owners.

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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, 2018 and 2017

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### 3. Significant accounting and changes in policies (continued)

#### 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 fair value of the associated share-based compensation is reclassified from contributed surplus to share capital.

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 statement of net and comprehensive loss, 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 within a separate component of 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.

#### Earnings (loss) per share

Earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is 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 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.

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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, 2018 and 2017

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#### 4. Newly adopted accounting standards and pronouncements

The Company has adopted these accounting standards effective January 1, 2018. The adoption of the standards and amendments had no material impact on the financial statements:

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

Effective January 1, 2018, the Company adopted IFRS 9, which replaced IAS39. The Company applied the new standard retrospectively and, in accordance with the transitional provisions, comparative figures have not been restated. The adoption of IFRS 9 did not have a material impact on the Company's Financial Statements. The nature and effects of the key changes to the Company's accounting policies resulting from the adoption of IFRS 9 are summarized below.

##### Classification of Financial Assets and Financial Liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, FVOCI, and FVTPL. The previous IAS 39 categories of held to maturity, loans and receivables and available for sale are eliminated. IFRS 9 bases the classification of financial assets on the contractual cash flow characteristics and the Company's business model for managing the financial asset. Additionally, embedded derivatives are not separated if the host contract is a financial asset within the scope of IFRS 9. Instead, the entire hybrid contract is assessed for classification and measurement. IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. The differences between the two standards did not impact the Company at the time of transition.

##### Impairment of Financial Assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an ECL model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments measured at FVOCI. Under IFRS 9, credit losses will be recognized earlier than under IAS 39.

##### Transition

On January 1, 2018, the Company:

- Identified the business model used to manage its financial assets and classified its financial instruments into the appropriate IFRS 9 category; and
- Applied the ECL model to financial assets classified as measured at amortized cost.

The classification and measurement of financial instruments under IFRS 9 did not have a material impact on the Company's opening retained earnings as at January 1, 2018. In addition, the application of the ECL model to financial assets classified as measured at amortized cost did not result in a material adjustment on transition. The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 as at January 1, 2018 for each class of the Company's financial assets and financial liabilities. The Company has no contract assets or debt investments measured at FVOCI.

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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, 2018 and 2017

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#### 4. Newly adopted accounting standards and pronouncements (continued)

Below is a summary indicating the classification and measurement basis of the Company's financial instruments as at January 1, 2018, as a result of adopting IFRS 9 along with a comparison to IAS 39.

Financial Instrument	IAS 39		IFRS 9	
	Classification	Measurement	Classification	Measurement
Asset				
Cash and cash equivalents	Loans and receivables	Amortized cost	Amortized cost	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost	Amortized cost	Amortized cost
Liabilities				
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost	Amortized cost	Amortized cost
Debentures payable < 1 year	Other financial liabilities	Amortized cost	Amortized cost	Amortized cost

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

This standard provides a single model that applies to contracts with customers as well as two revenue recognition approaches: at a point in time or over time. The model features a contract-based, five-step analysis of transactions to determine whether, when and the amount of revenue is recognized. The new standard applies to contracts with customers. The new revenue standard permits a full retrospective method of adoption with restatement of all prior periods presented, or a modified retrospective method with the cumulative effect of applying the new standard recognized as an adjustment to opening retained earnings in the period of adoption.

The Company reviewed its revenue streams and major contracts with customers under IFRS 15 and determined there were no material changes to net loss or timing of oil and natural gas revenue recognized.

Under IFRS 15, revenue from the sale of commodities is calculated by reference to consideration specified in contracts with customers and recognized when control of the product is transferred to the buyer. The nature of each of its performance obligations, including roles of their parties and partners, are evaluated to determine if the Company acts as a principal and therefore recognizes revenues on a gross basis or as an agent and therefore recognizes revenue on a net basis. The Company would act as a principal when it controls the product delivered before the control passes to the customer.

Revenue from the sale of crude oil and natural gas is recognized based on the consideration specified in contracts with customers. The Company recognizes revenue when control of the product transfers to the buyer and collection is reasonably assured. This is generally at the point in time when the customer obtains legal title to the product which is when it is physically transferred to the pipeline or battery.

When allocating the transaction price realized in contracts with multiple performance obligations, the Company is required to make estimates of the prices at which the product would sell separately to customers. The company does not currently have any contracts with multiple performance obligations.

See note 10 for additional disclosures required by IFRS 15.

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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, 2018 and 2017

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#### 4. Newly adopted accounting standards and pronouncements (continued)

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

##### 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. The Company does not believe this new standard will have a material impact when adopted.

This standard is effective for reporting periods beginning on or after January 1, 2019.

#### 5. Property and equipment

Petroleum and natural gas ("PNG") properties are as follows:

	2018	2017
Cost, beginning of year	\$ 24,881,547	\$ 24,613,193
Additions	3,478,068	268,354
Revisions (note 8)	(259,982)	-
Expired PNG leases	(4,023,071)	-
Cost, end of year	24,076,562	24,881,547
Accumulated depletion and impairment, beginning of year	14,420,965	13,264,549
Depreciation and depletion	1,488,563	1,156,416
Expired PNG leases	(4,023,071)	-
Accumulated depletion and impairment, end of year	11,886,457	14,420,965
<b>Carrying value, end of year</b>	<b>\$ 12,190,105</b>	<b>\$ 10,460,582</b>

During the year, the Company reviewed the PNG leases that had expired. All the expired leases had previously been depleted and/or impaired and were removed from the Company's books.

At December 31, 2018, future development costs of \$5,893,400 (2017 - \$7,537,000) 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, 2018. The prices are referenced for medium crude oil based on Western Canadian Select ("WCS") Crude Oil at Hardisty:

	2019	2020	2021	2022	2023	2024	2025
Cdn\$/bbl	\$55.00	\$60.00	\$65.00	\$68.00	\$69.00	\$72.00	+2%/yr thereafter

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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, 2018 and 2017

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##### 6. Contract liabilities

During 2018, the Company entered into an agreement with an exploration drilling contractor whereby the contractor agreed to drill and complete up to five wells and finance the expenditures over a twelve (12) month period from date of invoice. In consideration of the financing terms, the Company is charged a 12% fee based on contract invoices. The invoices shall be paid by the Company within twelve months of issuance in equal monthly payments starting the month following the invoice date. The balance owing is non-interest bearing if all payments are made on schedule. Interest accrues at a rate of 18% per annum on all invoiced amounts not paid by the Company pursuant to the above terms.

The Company is not obligated to drill all five wells. As at December 31, 2018, three wells were drilled and a further two wells are planned to be drilled in 2019 under this agreement.

##### 7. Debentures payable

In December 2017, the Company extended \$2,075,000 of debentures originally issued on December 23, 2015 to December 23, 2018 and repaid one debenture in the amount of \$50,000. The extended debentures had the same terms as the original debentures, being interest at 8% per annum payable quarterly and secured by a general security agreement. The debentures were convertible at the holder's option into common shares of the Company at a conversion price of \$0.10 per common share.

On December 28, 2017, the Company issued an 8% per annum secured convertible debenture in the principal amount of \$100,000 to a director. The debenture had a one year maturity from the date of issuance, was secured by a general security agreement and required quarterly interest payments. The debenture was convertible at the holder's option into common shares of the Company at a conversion price of \$0.10 per common share.

At maturity, all of the convertible debentures were converted and 21,750,00 common shares were issued. There was no gain or loss on conversion.

##### 8. 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 \$1,423,400 (December 31, 2017 - \$1,259,700) which will be settled over the operating lives of the underlying assets, estimated to occur between 2020 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, 2018, \$545,026 (December 31, 2017 - \$536,437) has been paid as deposits to the applicable regulatory bodies for settlement of these obligations.

	2018	2017
<b>Balance, beginning of year</b>	<b>\$ 1,115,435</b>	\$ 1,051,507
Additions	<b>101,496</b>	36,529
Revisions (note 5)	<b>(259,982)</b>	-
Accretion	<b>33,202</b>	27,399
<b>Balance, end of year</b>	<b>\$ 990,151</b>	\$ 1,115,435

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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, 2018 and 2017

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#### 9. 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, 2016 and 2017</b>	60,499,971	\$ 29,565,885
Conversion of debentures (note 7)	21,750,000	2,175,000
<b>Balance, December 31, 2018</b>	<b>82,249,971</b>	<b>\$ 31,740,885</b>

##### c. 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 period is presented below:

	2018		2017	
	#	Weighted average exercise price	#	Weighted average exercise price
<b>Outstanding, beginning of year</b>	<b>4,200,000</b>	<b>\$ 0.25</b>	4,650,000	\$ 0.25
Forfeited	-	-	(450,000)	0.25
<b>Outstanding, end of year</b>	<b>4,200,000</b>	<b>\$ 0.25</b>	4,200,000	\$ 0.25
<b>Exercisable, end of year</b>	<b>4,200,000</b>	<b>\$ 0.25</b>	4,200,000	\$ 0.25

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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, 2018 and 2017

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#### 9. Share capital (continued)

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

The details of the options outstanding at December 31, 2018 are as follows:

Options outstanding	Weighted average exercise price	Options exercisable	Weighted average years to expiry
4,200,000	0.25	4,200,000	5.75

Share-based compensation expense was \$nil in 2018 (2017 - \$5,250).

##### d. 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.

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	2018	2017
Weighted average number of common shares		
Issued and outstanding at beginning of period	60,499,971	60,499,971
Effect of share issuance	834,247	-
Weighted average number of common shares –basic and diluted	61,334,218	60,499,971

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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.

#### 10. Revenue

On January 1, 2018, the Company adopted *IFRS 15, "Revenue from Contracts with Customers"* as detailed in note 3. There was no impact to oil and natural gas revenues as a result of adopting IFRS 15.

The Company sells its production pursuant to variable price contracts. The transaction price for variable price contracts is based on the commodity price and then adjusted for quality, location or other factors whereby each component of the pricing formula can be either fixed or variable depending on the contract terms. Revenue is recognized when a unit of production is delivered to the counterparty. The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

Crude oil and natural gas are sold under contracts of varying price and volume terms of up to one year. Revenues are typically collected on the 25<sup>th</sup> day of the month following production.

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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, 2018 and 2017

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#### 10. Revenue (continued)

The following table presents the Company's oil and gas revenues disaggregated by revenue source. All of the Company's revenues are earned in Canada.

	2018	2017
Oil	\$ 4,236,704	\$ 3,027,804
Natural gas	95,043	208,218
	<b>\$ 4,331,747</b>	<b>\$ 3,236,022</b>

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#### 11. Expenses by nature

	2018	2017
Wages and employee benefits	\$ 443,716	\$ 307,979
Professional fees	81,713	124,485
Consulting fees	354,951	195,324
User fees	54,871	54,879
Rental	62,128	73,625
Office	65,389	67,255
Bad debt (note 16)	175,285	-
Travel and entertainment	3,073	7,404
<b>Total general and administration costs</b>	<b>\$ 1,241,126</b>	<b>\$ 830,951</b>

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Finance costs were \$167,325 for the year ended December 31, 2018 (2017 - \$231,127). The 2017 finance costs include \$59,258 paid as a finder's fee for attempting to source new capital.

#### 12. Deferred income taxes

Deferred income taxes are based on the differences between the accounting amounts and the related tax bases of the Company's assets and liabilities. The income tax rate used to calculate deferred income taxes is 27% (2017 - 27%).

	2018	2017
Temporary differences related to:		
Property and equipment	\$ 7,085,000	\$ 6,641,000
Decommissioning liabilities	267,000	301,000
Tax loss carry forwards	4,472,000	4,637,000
Other	25,000	35,000
Deferred tax assets not recognized, net	(11,849,000)	(11,614,000)
<b>Deferred income tax asset</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, 2018 and 2017

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#### 12. Deferred income taxes (continued)

At December 31, 2018, the Company has tax pools and non-capital losses as described below totaling approximately \$55,086,000 (2017 - \$52,363,000) that are available to shelter future taxable income. The Company's non-capital losses expire between the years 2026 and 2038.

Non-capital losses	\$	16,563,000
Undepreciated capital cost		4,823,000
Canadian exploration expenses		12,810,000
Canadian development expenses		9,730,000
Canadian oil and gas property expenses		11,068,000
Financing costs		92,000
		<hr/>
		\$ 55,086,000

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:

	2018	2017
Loss before income taxes	\$ (870,140)	\$ (868,804)
Statutory rate	27.0%	27.0%
Anticipated income tax recovery at the combined basic federal and provincial tax rate	\$ (235,000)	\$ (235,000)
Increase resulting from:		
Share-based compensation	-	1,000
Change in deferred tax assets not recognized	235,000	234,000
<b>Tax expense</b>	<b>\$ -</b>	<b>\$ -</b>

#### 13. 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:

	2018	2017
Salaries and other short-term employee benefits	\$ 320,000	\$ 240,000
Share-based compensation	-	5,250
Consulting fees	317,929	145,000
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	\$ 637,929	\$ 390,250

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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, 2018 and 2017

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#### 14. 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.

For the year ended December 31, 2018, the Company incurred \$317,929 (2017 - \$145,000) in consulting fees to an officer and companies controlled by officers and directors.

The debentures were payable to directors. Interest expense of \$167,325 (2017 - \$171,868) is included in finance costs in the Statements of Net and Comprehensive Loss related to this debt.

#### 15. Commitment

The Company is committed under an office lease that commenced August 1, 2017 and expires on July 31, 2021. The minimum annual payments are \$11,665 during the first two years of the lease and then increase to \$14,245 per year for the remainder of the lease.

#### 16. Financial instruments

The Company's financial instruments recognized on the balance sheet includes cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities, contract liabilities and debentures payable.

##### Fair value

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

##### 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, 2018 and 2017, the majority of the Company's trade receivable are all current. No default on outstanding receivables is anticipated and, as such, no provision for loss allowances has been recorded. The aging of the

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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, 2018 and 2017

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#### 16. Financial instruments (continued)

##### a. Credit risk (continued)

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
2018	\$	221,807	\$ 157,313	\$ 54,867	\$ 9,124	\$ 503
2017	\$	493,725	\$ 426,578	\$ 65,969	\$ 1,178	\$ -

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##### 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 and contract liabilities 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, 2018.

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

2018	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable and accrued liabilities	\$ 1,304,993	\$ 1,304,993	\$ -
Contract liabilities	1,823,246	1,823,246	-
	<b>\$ 3,128,239</b>	<b>\$ 3,128,239</b>	<b>\$ -</b>
2017	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable and accrued liabilities	\$ 1,700,105	\$ 1,700,105	\$ -
Debenture payable	2,349,000	2,349,000	-
	<b>\$ 4,049,105</b>	<b>\$ 4,049,105</b>	<b>\$ -</b>

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##### 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.

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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, 2018 and 2017

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#### 16. Financial instruments (continued)

##### 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, 2018 and 2017.

##### 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, 2018 and 2017.

##### 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, 2018 and 2017. The contract liabilities and debentures 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 debentures payable. In order to maintain or adjust its capital structure, the Company may from time to time issue new shares or debentures 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.

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.

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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, 2018 and 2017

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##### 18. Carried working interest arrangement

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") would advance by December 31, 2017 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 would advance up to \$500,000 for the acquisition of petroleum and natural gas leases.

In exchange, the Company would 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 would convert to a 5% gross overriding royalty.

As at December 30, 2018, the Partner had advanced \$1,700,840 (December 31, 2017 - \$1,565,840) for the drilling, completion and equipping of the first well which was drilled in December 2017. The partner failed to drill all seven wells or to advance \$10,500,000 before December 2017, therefore the partner is in default under the terms of the amended carried working interest agreement.

As at December 31, 2018, the Company had cash called the Partner \$175,285 which has not been paid and has been recognized as a bad debt expense in these financial statements. As of the date of these financial statements, there have been no further wells drilled and there are no further plans to continue with the carried working interest arrangement.

At December 31, 2018, the net cash call liability position was \$nil (2017 - \$25,298) and trade payables of \$nil (2017 - \$1,245,703) were included in accounts payable and accrued liabilities in these financial statements.

There have been no operating profits earned to December 31, 2018 on the well drilled under this arrangement.