

Vital Energy Inc.

Financial Statements

December 31, 2019 and 2018

(Expressed in Canadian Dollars)

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, 2019 and December 31, 2018 and the statements of net and comprehensive income (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, 2019 and December 31, 2018, 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.

Independent Auditor's Report (continued)

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.

Independent Auditor's Report (continued)

- 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
June 8, 2020**

**(Signed) "Crowe MacKay LLP"
Chartered Professional Accountants**

Vital Energy Inc.

Balance Sheets

(Expressed in Canadian Dollars)

As at December 31,	Note	2019	2018
Assets			
Current			
Cash and cash equivalents		\$ 413,663	\$ 1,034,365
Trade and other receivables		999,755	221,807
Prepaid expenses		66,199	30,418
		1,479,617	1,286,590
Deposits	8	556,027	545,026
Property and equipment	5	13,467,104	12,190,105
		\$ 15,502,748	\$ 14,021,721
Liabilities			
Current			
Accounts payable and accrued liabilities		\$ 1,110,015	\$ 1,304,993
Contract liabilities	6	1,979,677	1,823,246
Current portion of decommissioning liabilities	8	262,432	-
		3,352,124	3,128,239
Decommissioning liabilities	8	1,395,148	990,151
		4,747,272	4,118,390
Shareholders' Equity			
Share capital	9	31,740,885	31,740,885
Contributed surplus		1,406,451	1,406,451
Deficit		(22,391,860)	(23,244,005)
		10,755,476	9,903,331
		\$ 15,502,748	\$ 14,021,721
General information and going concern	1		
Commitment	15		
Subsequent events	19		

Approved by the Board:

(Signed) "Ngai Ho", Director

(Signed) "Yingchuan Wu", Director

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

Year ended December 31,	Note	2019	2018
Revenue			
Oil and gas sales	10	\$ 7,590,494	\$ 4,331,747
Less: Crown royalties		(1,417,345)	(724,233)
Net revenue		6,173,149	3,607,514
Other income			
Interest		13,626	15,494
		6,186,775	3,623,008
Expenses			
Operating expenses		2,224,472	1,562,932
General and administrative	11	1,015,790	1,241,126
Finance charges	11,14	-	167,325
Accretion of decommissioning liabilities	8	66,477	33,202
Revision to decommissioning liabilities	8	82,652	-
Depletion and depreciation	5	1,945,239	1,488,563
		5,334,630	4,493,148
Income (loss) before income taxes		852,145	(870,140)
Provision for income taxes:			
Current	12	226,000	-
Deferred income tax recovery	12	(226,000)	-
		-	-
Net and comprehensive income (loss) for the year		\$ 852,145	\$ (870,140)
Basic income (loss) per share	9	\$ 0.01	\$ (0.01)

Vital Energy Inc.**Statements of Changes in Shareholders' Equity***(Expressed in Canadian Dollars)*

	Notes	Share capital	Contributed surplus	(Deficit)	Total equity
Balance, December 31, 2018		\$ 31,740,885	\$ 1,406,451	\$ (23,244,005)	\$ 9,903,331
Net and comprehensive income		-	-	852,145	852,145
Balance, December 31, 2019		\$ 31,740,885	\$ 1,406,451	\$ (22,391,860)	\$ 10,755,476
Balance, December 31, 2017		\$ 29,565,885	\$ 1,406,451	\$ (22,373,865)	\$ 8,598,471
Conversion of debentures payable	7	2,175,000	-	-	2,175,000
Net and comprehensive loss		-	-	(870,140)	(870,140)
Balance, December 31, 2018		\$ 31,740,885	\$ 1,406,451	\$ (23,244,005)	\$ 9,903,331

Vital Energy Inc.

Statements of Cash Flows

(Expressed in Canadian Dollars)

Year ended December 31,	2019	2018
Operating activities		
Net and comprehensive income (loss) for the year	\$ 852,145	\$ (870,140)
Decommissioning liabilities settled	(28,453)	-
Non-cash items:		
Current income taxes	226,000	-
Deferred income tax recovery	(226,000)	-
Depletion and depreciation	1,945,239	1,488,563
Bad debt (note 18)	-	175,285
Revision to decommissioning liabilities (note 8)	82,652	-
Accretion of decommissioning liabilities (note 8)	66,477	33,202
	2,918,060	826,910
Changes in non-cash working capital		
Trade and other receivables	(777,948)	82,867
Prepaid expenses	(35,781)	(512)
Accounts payable and accrued liabilities	(1,218)	169,465
	2,103,113	1,078,730
Investing activities		
Deposits paid	(11,001)	(8,589)
Expenditures on property and equipment	(2,675,484)	(3,376,572)
Changes in accounts payable and accrued liabilities	(193,761)	720,190
Changes in contract liabilities	156,431	1,823,246
	(2,723,815)	(841,725)
Financing activities		
Carried interest funds received (note 18)	-	135,000
Carried interest expenditures paid (note 18)	-	(1,406,001)
	-	(1,271,001)
Decrease in cash and cash equivalents	(620,702)	(1,033,996)
Cash and cash equivalents, beginning of year	1,034,365	2,068,361
Cash and cash equivalents, end of year	\$ 413,663	\$ 1,034,365
Cash and cash equivalents:		
Cash at bank and on hand	\$ 299,026	\$ 919,728
Cashable guaranteed investment certificate	114,637	114,637
	\$ 413,663	\$ 1,034,365
Supplemental cash flow information:		
Interest paid (note 14)	-	167,325

Non-cash transactions – (notes 5 and 8)

See accompanying notes

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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 - 6th 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 has a working capital deficiency of \$1,872,507 (December 31, 2018 - \$1,841,649) and an accumulated deficit of \$22,391,860 (2018 - \$23,244,005). There can be no assurance that in the future the Company will be able to generate profits and cash flow from operations in order to eliminate the working capital deficiency. 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 in conjunction with maintaining profitable operations in the near future. In addition, subsequent to December 31, 2019, there was a world-wide outbreak of a novel coronavirus known as Covid-19 which has impacted the global economy and there has been extreme volatility in global oil commodity prices (notes 19a and 19b). These factors give rise to a material uncertainty that may cast significant doubt on the Company’s ability to continue as a going concern.

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, 2019. The financial statements were authorized for issue by the Board of Directors on June 8, 2020.

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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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

Use of 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 ("NI 51-101") 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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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

Use of 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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

Carried working interest arrangement

The Company had entered into a carried working interest arrangement on one of its properties whereby the Carried Working Interest Partner (“Partner”) paid 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.

Property and equipment

Property and equipment consist of oil and gas assets, computer equipment, office equipment, furniture and vehicles. 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 groups of assets that generates cash flows that are largely independent of the cash flows of other assets or groups 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

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

Property and equipment (continue)

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.

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 obligations 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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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 and contract liabilities. 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

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.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

Financial instruments (continued)

a. Financial assets (continued)

Impairment of Financial Assets

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.

b. Financial liabilities

Financial liabilities include accounts payable and accrued liabilities and contract liabilities. 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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

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.

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 25th day of the month following production.

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 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 recognizes the impact of the revision of original estimates, if any, in the statement of net and comprehensive income (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.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

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.

Leases

Policy applicable from January 1, 2019

The Company assesses whether a contract is a lease based on whether the contract conveys the right to control the use of an underlying asset for a period of time in exchange for consideration. The Company allocates the consideration in the contract to each lease component based on their relative stand-alone prices.

Leases are recognized as a Right-of Use ("ROU") asset and a corresponding lease liability at the date on which the leased asset is available for use by the Company. Assets and liabilities arising from a lease are initially measured on a present value basis. These payments are discounted using the Company's incremental borrowing rate when the rate implicit in the lease is not readily available. The Company uses a single discount rate for a portfolio of leases with reasonably similar characteristics. Lease payments are allocated between the liability and finance costs. The finance cost is charged to net earnings over the lease term. The lease liability is measured at amortized cost using the effective interest method. It is re-measured when there is a change in the future lease payments arising from a change in an index or rate, if there is a change in the amount expected to be payable under a residual value guarantee or if there is a change in the assessment of whether the Company will exercise a purchase, extension or termination option that is within the control of the Company.

When the lease liability is re-measured, a corresponding adjustment is made to the carrying amount of the ROU asset or is recorded in the Statements of Net and Comprehensive Income (Loss) if the carrying amount of the ROU asset has been reduced to zero.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

3. Significant and changes in accounting policies (continued)

Leases (continued)

The ROU asset is initially measured at cost, which comprises the initial amount of the lease liability, any initial direct costs incurred, and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or site on which it is located less any lease payments made at or before the commencement date. The ROU asset is depreciated, on a straight-line basis, over the shorter of the estimated useful life of the asset or the lease term. The ROU asset may be adjusted for certain re-measurements of the lease liability and impairment losses. Leases that have terms of less than twelve months or leases on which the underlying asset is of low value are recognized as an expense in the Statements of Operations and Comprehensive Loss on a straight-line basis over the lease term. A lease modification will be accounted for as a separate lease if the modification increases the scope of the lease and if the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope. For a modification that is not a separate lease or where the increase in consideration is not commensurate, at the effective date of the lease modification, the Company will re-measure the lease liability using the Company's incremental borrowing rate, when the rate implicit to the lease is not readily available, with a corresponding adjustment to the ROU asset. A modification that decreases the scope of the lease will be accounted for by decreasing the carrying amount of the ROU asset, and recognizing a gain or loss in net loss that reflects the proportionate decrease in scope.

ROU assets are assessed for impairment on initial recognition and subsequently on an annual basis, at a minimum. ROU assets subject to leases that have become onerous in nature are adjusted by the amount of any provision for onerous leases.

During the year ended December 31, 2019, the Company expensed and paid \$61,809 for short-term leases including operating costs.

Policy applicable before January 1, 2019

Leases in which substantially all of the risks and rewards of ownership are retained by the counterparty are classified as operating leases. Operating lease payments are recognized as an expense in the period in which they are incurred.

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases.

4. Newly adopted accounting standards and pronouncements

IFRS 16 Leases

The Company has adopted the new accounting standard, on a modified retroactive basis, effective January 1, 2019. On initial adoption, the Company elected to use the practical expedients permitted under the standard by accounting for leases with a remaining term of less than twelve months, as of January 1, 2019, as short term lease payments, and accounting for lease payments as an expense and not recognize a ROU asset if the underlying asset is of low dollar value. There were no transitional or subsequent adjustments required in the financial statements as the Company's leases are all short-term or low value in nature.

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.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

4. Newly adopted accounting standards and pronouncements (continued)

The following accounting standard is effective for reporting periods beginning on or after January 1, 2020:

Amendments to IFRS 3 Business Combinations

Amendments to IFRS 3, Business Combinations assist in determining whether a transaction should be accounted for as a business combination or an asset acquisition. It amends the definition of a business to include an input and a substantive process that together significantly contribute to the ability to create goods and services provided to customers, generating investment and other income, and it excludes returns in the form of lower costs and other economic benefits.

These amendments are effective for reporting periods beginning on or after January 1, 2020. This amendment is not expected to have any impact on the financial statements when adopted.

5. Property and equipment

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

	2019	2018
Cost, beginning of year	\$ 24,076,562	\$ 24,881,547
Additions	2,786,025	3,478,068
Decommissioning liability revisions (note 8)	436,213	(259,982)
Expired PNG leases	-	(4,023,071)
Cost, end of year	27,298,800	24,076,562
Accumulated depletion and impairment, beginning of year	11,886,457	14,420,965
Depreciation and depletion	1,945,239	1,488,563
Expired PNG leases	-	(4,023,071)
Accumulated depletion and impairment, end of year	13,831,696	11,886,457
Carrying value, end of year	\$ 13,467,104	\$ 12,190,105

During 2018, 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, 2019, future development costs of \$6,040,800 (2018 - \$5,893,400) 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, 2019. The prices are referenced for medium crude oil based on Western Canadian Select ("WCS") Crude Oil at Hardisty:

	2020	2021	2022	2023	2024	2025	2026
Cdn\$/bbl	\$60.00	\$63.00	\$65.00	\$67.00	\$69.00	\$71.00	+2%/yr thereafter

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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 (amended in 2019 for a further two 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.

As at December 31, 2019, all seven wells were drilled (2018 – 3 wells).

7. Debentures payable

In December 2017, the Company extended the maturity date of the \$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 in 2018, all of the convertible debentures were converted and 21,750,00 common shares were issued (note 9). 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 \$1,612,500 (December 31, 2018 - \$1,423,400) which will be settled over the operating lives of the underlying assets, estimated to occur between 2020 and 2041. A risk-free interest rate of 1.7% (2018 - 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, 2019, \$556,027 (December 31, 2018 - \$545,026) has been paid as deposits to the applicable regulatory bodies for settlement of these obligations.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

8. Decommissioning liabilities (continued)

	2019	2018
Balance, beginning of year	\$ 990,151	\$ 1,115,435
Additions	110,540	101,496
Settlement of obligations	(28,453)	-
Revisions (note 5)	518,865	(259,982)
Accretion	66,477	33,202
	1,657,580	990,151
Less: current portion	262,432	-
Balance, end of year	\$ 1,395,148	\$ 990,151

There was a revision to the decommissioning liabilities of \$518,865 as a result of changes in estimates. Property and Equipment was increased \$436,213 (2018 – decreased \$259,982) and \$82,652 (2018 - \$nil) was charged to the Statement of Net and Comprehensive Income (Loss) representing the impact of the revisions on previously impaired properties.

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
Balance, December 31, 2017	60,499,971	\$ 29,565,885
Conversion of debentures in 2018 (note 7)	21,750,000	2,175,000
Balance, December 31, 2018 and 2019	82,249,971	\$ 31,740,885

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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

9. Share capital (continued)

c. Share-based compensation (continued)

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

			2019		2018
	#		Weighted average exercise price	#	Weighted average exercise price
Outstanding, beginning of year	4,200,000	\$	0.25	4,200,000	\$ 0.25
Forfeited	(3,000,000)	\$	0.25	-	-
Outstanding, end of year	1,200,000	\$	0.25	4,200,000	\$ 0.25
Exercisable, end of year	1,200,000	\$	0.25	4,200,000	\$ 0.25

d. Share-based compensation

The details of the options outstanding at December 31, 2019 are as follows:

Options outstanding	Weighted average exercise price	Options exercisable	Weighted average years to expiry
1,200,000	0.25	1,200,000	4.5

e. 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.

	2019	2018
Weighted average number of common shares		
Issued and outstanding at beginning of period	82,249,971	60,499,971
Effect of share issuance	-	834,247
Weighted average number of common shares –basic and diluted	82,249,971	61,334,218

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, diluted income (loss) per share and the impact of these instruments on the weighted average number of shares outstanding is not presented in the financial statements.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

10. Revenue

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.

	2019	2018
Oil	\$ 7,525,757	\$ 4,236,704
Natural gas	64,737	95,043
	\$ 7,590,494	\$ 4,331,747

11. Expenses by nature

	2019	2018
Wages and employee benefits	\$ 454,616	\$ 443,716
Professional fees	103,962	81,713
Consulting fees	283,968	354,951
User fees	69,588	54,871
Rent	61,809	62,128
Office	41,847	68,462
Bad debt (note 18)	-	175,285
Total general and administration costs	\$ 1,015,790	\$ 1,241,126

Finance costs were \$nil for the year ended December 31, 2019 (2018 - \$167,325).

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 23% (2018 - 27%).

	2019	2018
Temporary differences related to:		
Property and equipment	\$ 6,357,000	\$ 7,085,000
Decommissioning liabilities	381,000	267,000
Tax loss carry forwards	3,147,000	4,472,000
Other	12,000	25,000
Deferred tax assets not recognized, net	(9,897,000)	(11,849,000)
Deferred income tax asset	\$ -	\$ -

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

12. Deferred income taxes (continued)

At December 31, 2019, the Company has tax pools and non-capital losses as described below totaling approximately \$54,841,000 (2018 - \$55,086,000) that are available to shelter future taxable income. The Company's non-capital losses expire between the years 2028 and 2039.

Non-capital losses	\$	13,682,000
Undepreciated capital cost		5,866,000
Canadian exploration expenses		12,810,000
Canadian development expenses		11,335,000
Canadian oil and gas property expenses		11,096,000
Financing costs		52,000
		<hr/>
		\$ 54,841,000

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:

	2019	2018
Income (loss) before income taxes	\$ 852,145	\$ (870,140)
Statutory rate	26.5%	27.0%
Anticipated income tax recovery at the combined basic federal and provincial tax rate	\$ 226,000	\$ (235,000)
Increase (decrease) in taxes resulting from:		
Change in substantively enacted tax rates	1,725,000	-
Other	1,000	-
Change in deferred tax assets not recognized	(1,952,000)	235,000
Tax expense	\$ -	\$ -

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 services is shown below:

	2019	2018
Salaries and other short-term employee benefits	\$ 358,667	\$ 320,000
Consulting fees	78,048	146,500
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	\$ 436,715	\$ 466,500

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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, 2019, the Company incurred \$267,243 (2018 - \$317,929) in consulting fees billed from an officer and companies controlled by officers and directors.

In 2018, the debentures were payable to directors. Interest expense of \$nil (2018 - \$167,325) is included in finance charges in the Statements of Net and Comprehensive Income (Loss) related to this debt.

15. Commitment

The Company is committed under an office lease that expires on July 31, 2021. The minimum annual payments are \$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 and contract liabilities.

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.

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

16. Financial instruments (continued)

a. Credit risk (continued)

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, 2019 and 2018, the majority of the Company's trade receivable are all current. No default on outstanding receivables is anticipated and, as such, no provision for expected credit losses 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
2019	\$ 999,755	\$ 208,328	\$ 791,427	\$ -	\$ -
2018	\$ 221,807	\$ 157,313	\$ 54,867	\$ 9,124	\$ 503

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, 2019.

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

2019	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable and accrued liabilities	\$ 1,110,015	\$ 1,110,015	\$ -
Contract liabilities	1,979,677	1,979,677	-
	\$ 3,089,692	\$ 3,089,692	\$ -
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	-
	\$ 3,128,239	\$ 3,128,239	\$ -

Vital Energy Inc.

Notes to the Financial Statements

(Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

16. Financial instruments (continued)

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 (note 19). The Company has no commodity hedges in place as at December 31, 2019 and 2018.

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, 2019 and 2018.

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, 2019 and 2018.

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 expenditures 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.

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

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 in the amount of \$175,285 which was not collected, deemed unrecoverable, and has been recognized as a bad debt expense. There have been no further wells drilled nor plans to continue with the carried working interest arrangement.

At December 31, 2019, the net cash call liability position was \$nil (2018 - \$nil) and trade payables of \$nil (2018 - \$nil) were included in accounts payable and accrued liabilities in these financial statements.

There have been no operating profits earned to date on the well drilled under this arrangement.

19. Subsequent events

a. Covid-19

Subsequent to December 31, 2019, there was a global outbreak of a novel coronavirus identified as "COVID-19". On March 11, 2020, the World Health Organization declared a global pandemic. In order to combat the spread of COVID-19 governments worldwide have enacted emergency measures including travel bans, legally enforced or self-imposed quarantine periods, social distancing and business and organization closures. These measures have caused material disruptions to businesses, governments and other organizations resulting in an economic slowdown and increased volatility in national and global equity and commodity markets.

Central banks and governments, including Canadian federal and provincial governments, have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the efficacy of any interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company and its operations in future periods.

The outbreak and subsequent measures intended to limit the pandemic contributed to significant declines and volatility in financial markets. The pandemic adversely impacted global commercial activity, including significantly reducing worldwide demand for crude oil. The outbreak and market conditions increase the complexity of estimates and assumptions used to prepare financial statements for future periods, particularly related to the following key sources of estimation uncertainty:

Vital Energy Inc.

Notes to the Financial Statements (Expressed in Canadian Dollars)

For the years ended December 31, 2019 and 2018

19. Subsequent events (continued)

a. Covid-19 (continued)

i) Reserve estimates, impairment indicators and discount rates

Determining the recoverable amount of a cash-generating unit (“CGU”) or an individual asset requires the use of estimates and assumptions, which are subject to change as new information becomes available. The severe drop in commodity prices, due to reasons noted above, have increased the risk of measurement uncertainty in determining the recoverable amounts, especially in the estimation of economic crude oil and natural gas reserves and forward commodity prices.

ii) Decommissioning Costs

Provisions are recorded for the future decommissioning and restoration of the Company’s properties and facilities at the end of their economic lives. Management uses judgment to assess the existence and to estimate the future liability. Market conditions have increased the measurement uncertainty inherent in determining the estimation of decommissioning liabilities, especially estimating the expected timing of settlement.

iii) Measurement of share-based compensation

The measurement of the fair value of stock options requires the use of assumptions, which include the estimated volatility of the Company’s stock price over the life of the options, forfeiture rates, future interest rates and the estimated life of the option. Financial market volatility as a result of the events noted above increases the measurement uncertainty inherent in the inputs used to estimate the fair values.

b. Commodity prices

Crude oil prices have also been severely impacted by increased global supply due to disagreements over production restrictions between the Organization of Petroleum Exporting Countries (“OPEC”) and non-OPEC members, primarily Saudi Arabia and Russia.

c. Loan agreement

In May 2020, the Company entered into a Loan Agreement (“Agreement”) with a director for a principal amount not to exceed \$4,000,000. The advances under this loan facility will bear interest at 12% per annum with interest payable annually and are unsecured. The advances under this Agreement are at the sole discretion of the lender and are repayable on demand with the loan facility expiring two years from the date of the first advance.

On June 1, 2020, the Corporation received \$2,000,000 as the first advance under this Loan Agreement.