AUDITED CONSOLIDATED FINANCIAL STATEMENTS

RESPONSIBLY GROWING THE **EXCEPTIONAL** PIPESTONE MONTNEY PLAY

FOR THE YEAR ENDED DECEMBER 31, 2021

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Pipestone Energy Corp.

Opinion

We have audited the consolidated financial statements of Pipestone Energy Corp. and its subsidiaries (collectively, "Pipestone"), which comprise the consolidated statements of financial position as at December 31, 2021 and 2020, and the consolidated statements of income (loss) and comprehensive income (loss), consolidated statements of changes in equity and consolidated statements of cash flows for the years ended December 31, 2021 and 2020, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of Pipestone as at December 31, 2021 and 2020, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2021 and 2020 in accordance with International Financial Reporting Standards (IFRSs)

Basis for Opinion

We conducted our audit 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 Consolidated Financial Statements* section of our report. We are independent of Pipestone in accordance with the ethical requirements that are relevant to our audit of the consolidated 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.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the consolidated financial statements of the current period. These matters were addressed in the context of the audit of the consolidated financial statements as a whole, and in forming the auditor's opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Assessment of Indicators of impairment for the cash generating units

As at December 31, 2021 the carrying value of property, plant and equipment was $724 million. Refer to note 3 of the consolidated financial statements for a description of Pipestone's impairment accounting policy. At each reporting date, property, plant and equipment in the cash generating unit (CGU) is assessed by management for indicators of impairment or impairment reversal. Pipestone determined that there were no internal or external indicators of impairment at December 31, 2021 for its single CGU. Significant management judgment is required analyzing internal and external indicators of impairment or historical impairment reversal with the estimate of cash flows from proved and probable oil and gas reserves being significant to the assessment.

The estimate of cash flows from proved and probable oil and gas reserves includes significant assumptions

We evaluated Pipestone's assessment of internal and external indicators of impairment by considering whether quantitative and qualitative information in the analysis was consistent with external market and industry data, Pipestone's press releases and certain minutes of the meetings of the Board of Directors.

To test the estimate of cash flows from proved and probable oil and gas reserves, we performed the following procedures, among others:

- We evaluated the competence, capabilities and objectivity of the independent third-party reserve evaluators engaged by Pipestone.
- We compared forecasted oil and gas commodity prices to those published by other independent third- party reserve evaluators.

related to forecasted oil and gas commodity prices; forecasted production volumes; forecasted operating costs; forecasted royalty costs; and forecasted future development costs.

Pipestone engaged independent third-party reserve evaluators to estimate the cash flows from proved and probable oil and gas reserves as at December 31, 2021.

Auditing the assessment of internal and external indicators of impairment or reversal of impairment of the CGU was complex given the inherent subjective nature of the significant assumptions used in calculating the estimated cash flows from proved and probable oil and gas reserves.

Significant auditor judgment was required in evaluating the results of our audit procedures with respect to the internal and external indicators of impairment including the estimate of cash flows from proved and probable oil and gas reserves.

- We compared the 2021 actual production volumes, operating costs, royalty costs and development costs of Pipestone to those estimates used in the prior year's estimate of proved cash flows from oil and gas reserves to assess Pipestone's ability to accurately forecast.
- We evaluated the appropriateness of forecasted production volumes and forecasted operating costs, royalty costs and future development costs assumptions by comparing to 2021 historical results.

Other Information

Management is responsible for the other information. The other information comprises the Management's Discussion & Analysis.

Our opinion on the consolidated 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 consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

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

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

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

In preparing the consolidated financial statements, management is responsible for assessing Pipestone'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 Pipestone or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 Pipestone'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 Pipestone'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 consolidated 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 Pipestone to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Robert Troy Jubenvill.

Chartered Professional Accountants

Calgary, Alberta
March 8, 2022

Pipestone Energy Corp.
Consolidated Statements of Financial Position

(amounts in thousands of Canadian dollars)

	Note	**December 31, 2021**	December 31, 2020
		$	$
Assets			
Current assets			
Accounts receivable	4(c)	**45,832**	17,003
Risk management contracts	4(e)	**197**	-
Prepaid expenses and deposits		**3,743**	5,201
Total current assets		**49,772**	22,204
Non-current assets			
Exploration and evaluation assets	5	**29,752**	34,225
Property and equipment	5	**723,952**	582,406
Right-of-use assets	6	**82,692**	55,164
Risk management contracts	4(e)	**-**	472
Total assets		**886,168**	694,471
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	7	**82,127**	59,367
Risk management contracts	4(e)	**6,016**	6,775
Lease liabilities	9	**6,144**	4,665
Total current liabilities		**94,287**	70,807
Non-current liabilities			
Bank debt	8	**171,866**	133,466
Lease liabilities	9	**82,074**	53,560
Decommissioning provisions	10	**15,283**	9,239
Risk management contracts	4(e)	**118**	1,228
Convertible preferred share obligation	11	**73,396**	68,132
Deferred tax liabilities	16(b)	**25,505**	2,981
Total liabilities		**462,529**	339,413
Shareholders' Equity			
Share capital	12	**394,159**	380,367
Contributed surplus	13	**4,789**	2,613
Warrants	12(c)	**-**	15,307
Retained earnings (deficit)		**24,691**	(43,229)
Total shareholders' equity		**423,639**	355,058
Total liabilities and shareholders' equity		**886,168**	694,471

Commitments, contingencies and insurance proceeds (note 19)
Subsequent events (note 20)

Approved by the Board of Directors.

(Signed) "GR", Director

(Signed) "KA", Director

See accompanying notes to the consolidated financial statements.

Pipestone Energy Corp.

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

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

	Note	Years ended December 31, 2021	2020
		$	$
Revenue			
Sales of liquids and natural gas	14	**391,295**	135,950
Royalties		**(14,366)**	(4,185)
Liquids and natural gas revenue		**376,929**	131,765
Realized (loss) gain on commodity risk management contracts	4(e)	**(56,881)**	14,030
Unrealized loss on commodity risk management contracts	4(e)	**(84)**	(4,523)
Total revenue		**319,964**	141,272
Expenses			
Operating		**103,400**	63,732
Transportation		**24,869**	19,708
General and administrative		**7,897**	6,302
Share-based compensation	13	**3,506**	2,022
Exploration and evaluation	5	**1,658**	414
Depletion and depreciation	5,6	**66,014**	53,145
Total expenses		**207,344**	145,323
Operating Income (Loss)		**112,620**	(4,051)
Realized loss on interest rate risk management contracts	4(e)	**(1,038)**	(1,361)
Unrealized gain (loss) on interest rate risk management contracts	4(e)	**1,677**	(678)
Financing expense	15	**(22,815)**	(16,440)
Income (Loss) Before Income Taxes		**90,444**	(22,530)
Deferred income tax (expense) recovery	16(a)	**(22,524)**	5,253
Income (Loss) and Comprehensive Income (Loss) for the Year		**67,920**	(17,277)
Income (Loss) per Share			
Basic	12(b)	**0.35**	(0.09)
Diluted	12(b)	**0.24**	(0.09)

See accompanying notes to the consolidated financial statements.

Pipestone Energy Corp.
Consolidated Statements of Changes in Equity

(amounts in thousands of Canadian dollars)

	Note	Common shares	Share capital	Contributed surplus	Warrants	Retained earnings (deficit)	Total
		(000s)	**$**	**$**	**$**	**$**	**$**
Balance at January 1, 2020		189,783	379,469	1,251	15,307	(25,952)	370,075
Conversion of restricted share units	13(c)	302	427	(427)	-	-	-
Exercise of stock options	13(a)	16	10	(3)	-	-	7
Share-based compensation	13	-	230	1,792	-	-	2,022
Employee share purchase plan	13(d)	698	231	-	-	-	231
Loss for the year		-	-	-	-	(17,277)	(17,277)
Balance at December 31, 2020		190,799	380,367	2,613	15,307	(43,229)	355,058
Conversion of restricted share units	13(c)	838	737	(737)	-	-	-
Conversion of performance share units	13(b)	180	172	(172)	-	-	-
Exercise of stock options and warrants	13(a)	268	395	(114)	-	-	281
Share-based compensation	13	-	307	3,199	-	-	3,506
Employee share purchase plan	13(d)	310	308	-	-	-	308
Purchase of common shares under NCIB	12(d)	(949)	(3,434)	-	-	-	(3,434)
Expiry of warrants	12(c)	-	15,307	-	(15,307)	-	-
Income for the year		-	-	-	-	67,920	67,920
Balance at December 31, 2021		**191,446**	**394,159**	**4,789**	**-**	**24,691**	**423,639**

See accompanying notes to the consolidated financial statements.

Pipestone Energy Corp.
Consolidated Statements of Cash Flows

(amounts in thousands of Canadian dollars)

	Note	Years ended December 31, 2021	2020
		$	$
Cash flows related to:			
Operating Activities			
Income (Loss)		**67,920**	(17,277)
Add (deduct) items not involving cash:			
Unrealized (gain) loss on interest rate risk management contracts	4(e)	**(1,677)**	678
Unrealized loss on commodity risk management contracts	4(e)	**84**	4,523
Share-based compensation	13	**3,506**	2,022
Exploration and evaluation	5	**1,658**	414
Depletion and depreciation	5, 6	**66,014**	53,145
Deferred income tax expense (recovery)	16(a)	**22,524**	(5,253)
Non-cash financing expense	15	**6,329**	2,246
Decommissioning provision costs incurred	10	**(153)**	(18)
Change in non-cash working capital	17	**(8,341)**	1,158
Cash from operating activities		**157,864**	41,638
Investing Activities			
Exploration and evaluation asset expenditures	5	**(383)**	(605)
Property and equipment expenditures	5	**(190,659)**	(103,988)
Property and equipment acquisitions	5	**(318)**	-
Change in non-cash working capital	17	**3,730**	1,379
Cash used in investing activities		**(187,630)**	(103,214)
Financing Activities			
Advances (repayments) of bank debt	8	**38,236**	(28,996)
Bank debt issuance costs	8	**(729)**	(1,271)
Principal portion of lease payments	9	**(4,896)**	(3,706)
Exercise of stock options and warrants	13(a)	**281**	7
Proceeds from issuance of common shares under employee purchase plan	13(d)	**308**	231
Purchase of common shares under NCIB	12(d)	**(3,434)**	-
Proceeds from issuance of preferred shares	11	**-**	67,900
Preferred share issuance costs	11	**-**	(1,236)
Cash from financing activities		**29,766**	32,929
Decrease in cash and cash equivalents		**-**	(28,647)
Cash and cash equivalents, beginning of year		**-**	28,647
Cash and cash equivalents, end of year		**-**	-

Supplemental cash flow information (note 17)

See accompanying notes to the consolidated financial statements.

1. Reporting entity and description of the business

Pipestone Energy Corp. ("Pipestone Energy" or the "Company") is engaged in the responsible exploration for, and development and production of, oil and natural gas liquids (including condensate, butane and propane) herein collectively referenced as "liquids" and natural gas in Western Canada, with substantially all of its activities and assets focused in the Montney resource play in Alberta. Pipestone Energy is committed to building long-term value for its shareholders and values the partnerships that it is developing within its operating community. The Company is incorporated under the Business Corporations Act (Alberta) and its common shares are listed on the Toronto Stock Exchange ("TSX") under the ticker symbol PIPE. The address and principal place of business of the Company is Suite 3700, 888 – 3rd Street S.W., Calgary, Alberta, T2P 5C5.

2. Basis of preparation

Principles of consolidation

The consolidated financial statements include the accounts of Pipestone Energy and its wholly owned subsidiary, Pennant Energy Inc. All intercompany transactions, balances, and unrealized gains and losses from intercompany transactions are eliminated on consolidation. The Company conducts some of its liquids and natural gas production activities through jointly owned assets and these consolidated financial statements reflect only the Company's proportionate interest in such revenues, expenses, assets and liabilities.

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"), and Canadian generally accepted accounting principles ("GAAP") as set out in Part 1 of the Chartered Professional Accountants Canada Handbook – Accounting.

The consolidated financial statements were approved and authorized for issuance by Pipestone Energy's Board of Directors (the "Board") on March 8, 2022.

Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments, which are measured at fair value.

The consolidated financial statements are presented in Canadian dollars, the Company's functional currency.

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. These estimates are reviewed periodically and, as adjustments become necessary, are reported in the period in which they become known. By their nature, these estimates and related future cash flows are subject to measurement uncertainty, and the impact on future consolidated financial statements could be material.

Significant estimates and judgments made by management in the preparation of the consolidated financial statements are outlined below:

a) Reserves

Reserve estimates, although not reported as part of the Company's consolidated financial statements, can have a significant effect on profit or loss, assets and liabilities because of their impact on depletion and depreciation, decommissioning provisions, deferred tax, asset impairments and business combinations. Independent petroleum reservoir engineers evaluate the Company's liquids and natural gas reserves annually. The estimation of reserves is a complex and inherently uncertain process requiring significant judgment. Estimates of economically recoverable liquids and natural gas reserves are based on several variables and assumptions, such as geo-scientific interpretation, production forecasts, current and estimated future commodity prices, 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

The valuation of the Company's liquids and natural gas properties is based on management's best estimate of the future recoverability of these assets. Various estimates are required in assessing the potential impairment of costs capitalized. Consideration of impairment includes estimates relating to reserve quantities, overall costs, future cash flows, regulatory approval, timing, commodity prices, the general economic environment and the ability to finance future activities.

Forecasted reserve cash flows are prepared by the Company's independent reserve evaluator and are utilized by the Company in determining its recoverable amount of non-current assets. Based on an asset's individual characteristics, other economic and operating factors are also considered, which may increase or decrease the implied discount rate. Changes in economic conditions could significantly change the estimated recoverable amount.

c) Exploration and evaluation (E&E) assets

The application of the Company's accounting policy for E&E expenditures requires judgment in determining whether future economic benefits are likely before activities have reached a stage at which technical feasibility and commercial viability can be reasonably determined. Factors such as drilling results, future capital programs, future commodity prices, future operating costs, as well as estimated economically recoverable reserves are considered.

d) Identification of cash-generating units (CGUs)

The Company's assets are grouped into CGUs, defined as the lowest level of assets for which there is separately identifiable independent cash inflow. Pipestone Energy has a single CGU. The classification and allocation of assets into CGUs requires significant judgment and interpretation. Factors considered in the classification include the integration among assets, shared infrastructure, the existence of common sales points, geography, geological structure and the manner in which management monitors and makes decisions about Pipestone Energy's operations. The recoverability of the Company's assets is assessed at the CGU level and, therefore, the particular classification of the CGUs could have a significant impact on impairment losses and reversals.

e) Decommissioning provisions

The decommissioning provision utilizes assumptions to estimate the future liability based on experience and current economic factors which management believes are reasonable. The actual cost of decommissioning, however, is uncertain and cost estimates may change in response to numerous factors including changes in environmental and regulatory requirements, technological advances, inflation and the timing of expected decommissioning and restoration. In addition, management determines the appropriate discount rate at the end of each reporting period. This discount rate, which is estimated by management as risk-free, determines the present value of the estimated future cash outflows required to settle the obligation and may change in response to numerous market and Pipestone Energy-specific factors.

f) Financial derivative instruments

The amounts recorded for the fair value of financial derivative instruments are based on estimates of future commodity prices, interest rates and the volatility in those variables.

g) Income tax

Tax interpretations, regulations and legislation in the jurisdiction in which the Company operates are subject to interpretations and changes. As such, income taxes are subject to measurement uncertainty. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates relating to the expectations of future cash flows from operations, and the application of existing tax laws. To the extent that future cash flows and taxable income differ significantly from estimates, the Company's ability to realize the deferred tax assets or liabilities recorded at the balance sheet date could be affected. Additionally, changes in tax laws could limit the Company's ability to obtain future tax deductions.

h) Business combinations

Business combinations are accounted for using the acquisition method of accounting, in which the identifiable assets acquired, liabilities assumed and non-controlling interest, if any, are recognized and measured at their fair values estimated based on information available at the date of acquisition. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of property and equipment and E&E assets acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning provisions associated with the acquired assets. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could affect the amounts assigned to assets and liabilities. Future net profit or loss can be affected as a result of changes in future depletion and depreciation, or asset impairment.

i) Share-based compensation

The Company's share-based compensation expense relates to equity awards which may be granted to employees, officers, directors and consultants. Awards are measured at fair value on the date of grant. The fair value of equity awards is recognized as share-based compensation expense over their vesting period with a corresponding increase to contributed surplus. All share-based compensation plans are currently accounted for as equity-settled share-based compensation arrangements. Upon exercise, share-based compensation plans allow the holder of an award to purchase or receive common shares.

The fair value of stock options is determined using the Black-Scholes option pricing model. It employs estimates of future volatility in the Company's share price, expected lives of awards, the risk-free interest rate, and other relevant assumptions. Volatility is estimated to be the average price volatility of the Company's common shares over the preceding period equaling the expected lives of Pipestone Energy options. The fair value of all other equity awards is based on the preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from their grant date. The primary vesting condition for the Company's share-based compensation plans is continuous employment, with limited exceptions in the case of qualified retirement.

Performance-based awards may be granted with certain time and performance-based vesting conditions and potentially a performance multiplier that is determined by the Company's Board on the date of grant. If the Company satisfies these performance criteria, a pre-determined adjustment factor is applied to the vested awards at the end of the performance period, which is based on, among other things, the Company's relative total return to shareholders performance compared to a selected peer group. The fair value of the performance-based awards at the date of grant is adjusted to reflect the probability of possible outcomes. If the estimated performance multiple required to settle the awards changes, the expense attributable to the original fair value estimate is adjusted accordingly in the current period and recognized over the remaining term of the awards.

An estimated forfeiture rate is applied to the valuation of applicable equity awards over the vesting period and is subsequently adjusted to reflect the actual number of equity awards that ultimately vest. When equity compensation units are exercised or released, the consideration received, if any, together with the expense previously recognized in contributed surplus, is recorded as an increase to share capital.

3. Significant accounting policies

The following significant accounting policies are presented to assist the reader in evaluating the consolidated financial statements:

a) New or amended standards adopted by the Company

There have been no new or amended IFRS adopted in 2021.

b) Cash and cash equivalents

Cash and cash equivalents consist of deposits held with banks, term deposits and other similar short-term money market instruments with original maturities of three months or less.

c) Exploration and evaluation (E&E) assets

All costs directly associated with the exploration and evaluation of liquids and natural gas reserves are initially capitalized. E&E costs are those expenditures for an area where technical feasibility and commercial viability have not yet been determined. These costs include licence acquisition, exploration, geological and geophysical activities, E&E drilling, sampling, appraisals, directly attributable overhead and administration expenses, and the decommissioning provision. Costs incurred prior to acquiring the legal rights to explore an area are charged directly to profit or loss as E&E expense.

E&E costs are subject to regular technical, commercial and management review to confirm the continued intent to develop the resources. When an area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to property and equipment. When an area is determined not to be technically feasible and commercially viable, the Company decides not to continue with its activity or the rights to explore and develop expire, the unrecoverable costs are charged to profit or loss as E&E expense. E&E assets are not amortized.

Exchanges or swaps that involve only E&E assets are accounted for at cost. Any gains or losses from the divestiture of E&E assets are recognized in profit or loss.

d) Property and equipment (P&E)

P&E are carried at cost less accumulated depreciation, depletion, and impairment.

Included in cost are the purchase price and the costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the Company's management. For liquids and natural gas properties, cost includes land acquisition costs, geological and geophysical expenditures, drilling, completion, infrastructure and the estimated costs of provisions for restoring and abandoning sites located on the asset in question. Costs incurred subsequent to the determination of technical feasibility and commercial viability are added to the cost base of the respective item of P&E when they increase the future economic benefits of that asset. The costs of regular service and maintenance are expensed in profit or loss in the period in which they occur.

Costs associated with office furniture and fixtures, leasehold improvements, office equipment, computer hardware and computer software are carried at cost and depreciated on a straight-line basis, at rates approximating the estimated service lives of the assets, between 20 percent and 55 percent per year.

Depletion and depreciation

Depletion of liquids and natural gas properties within Pipestone Energy's single CGU is recognized using the unit-of-production method based on the Company's share of total proved plus probable liquids and natural gas reserves before royalties as determined by independent reservoir engineers. The reserve evaluation is based on an estimated remaining reserve life. Future development costs are included in costs subject to depletion. For purposes of the depletion calculation, proved plus probable liquids and natural gas reserves are converted to a common unit of measurement based on their relative energy content, with 6,000 standard cubic feet of natural gas equalling 1 barrel of liquids. Costs of major development projects are excluded from the costs subject to depletion until they are available for use.

Well equipment will be depreciated using the unit-of-production method along with the related reserves when the assets are designed to have a life similar to the reserves of the related wells. When well equipment, including major components, have useful lives differing from those of the related wells, they are depreciated separately, on a straight-line basis over their estimated respective useful lives.

e) Leases

Leases are recognised as a right-of-use ("ROU") asset with a corresponding liability at the date on which the leased asset is made available for use by the Company. Each lease payment is allocated between the liability and financing expense. The financing expense is charged to profit or loss over the lease period and results in a constant periodic rate of interest on the remaining balance of the liability for each period. The ROU asset is depreciated with the expense recognized over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments, less any lease incentives receivable;
- variable lease payments that are based on an index or rate;
- amounts expected to be payable under residual value guarantees;
- the exercise price of a purchase option if the Company is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the Company exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the Company's incremental borrowing rate is used, being the rate that the Company would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

ROU assets are measured at cost, comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

The lease liability is subsequently increased by the interest expense on the lease liability and decreased by the lease payment made. It is re-measured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee or, as appropriate, changes in the assessment of whether a purchase or extension is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Company has applied judgment to determine the lease term for lease contracts which include renewal options. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of ROU assets and lease liabilities recognized.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

Cash flows relating to leases are presented as follows:

- cash payments for the principal portion of the lease liabilities is included under financing activities;
- cash payments for the interest portion of the lease liabilities is included under operating activities, consistent with the presentation of other interest payments; and
- short-term lease payments, payments for leases of low-value assets and variable lease payments that are not included in the measurement of the lease liabilities are included under operating activities.

f) Impairment of assets

Financial assets

The Company recognizes loss allowances for expected credit losses (ECL) on its financial assets measured at amortized cost. Due to the nature of its financial assets, Pipestone Energy measures loss allowances at an amount equal to expected 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.

Non-financial assets

Non-financial assets are reviewed at the end of each reporting period for any indication that an asset may be impaired and, if so, the Company determines whether the asset is impaired by comparing the carrying amount to the estimated recoverable amount. E&E assets are also assessed for impairment when they are reclassified to P&E.

For the purpose of the impairment test, non-financial assets are grouped into the Company's single CGU, which is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of a CGU is the higher of its fair value less costs of disposal (FVLCOD) and its value in use (VIU). For the purposes of testing for impairment, E&E assets are tested at the CGU level.

The Company determines VIU and FVLCOD by estimating the future cash flows expected from the CGU, discounted at a rate which reflects the current market assessment of the time value of money and the risks specific to the CGU. FVLCOD is determined as the amount obtainable from the sale of the CGU in an arm's-length transaction between knowledgeable,

willing parties, less the costs of disposal. The Company considers recent transactions for similar assets within the same industry as indicators of fair value.

An impairment loss is recognized when the carrying amount of the CGU exceeds its recoverable amount. Impairment losses for a CGU are allocated first to goodwill allocated to the CGU, if any exists, and then to the other assets of the group pro rata on the basis of the carrying amount of each of the group's assets. The reductions in carrying amounts are recognized in profit or loss in the period in which they occur.

At the end of each reporting period, the Company assesses whether there is evidence that any impairment loss recognized in prior periods should be reduced because the asset's expected recoverable amount has increased since the impairment loss was recorded. If circumstances have changed since the recognition of an impairment loss such that the loss has been reduced, the carrying amount of the CGU is increased to the revised estimate of its recoverable amount but never beyond the previous value, net of depletion and depreciation, if no impairment loss had been recognized for the asset in prior periods.

g) Decommissioning provisions

The Company recognizes provisions for legal, contractual or constructive liabilities relating to the dismantling and reclamation of E&E assets and P&E in the period in which the liability is incurred. The amount recognized is the best estimate of the decommissioning cost, discounted to its present value using a risk-free discount rate, and is added to the carrying amount of the related asset and depreciated or depleted on a unit-of-production or straight-line basis, depending on the asset. The decommissioning provision is increased over time, with the accretion recognized as a financing expense. The Company reviews the appropriateness of the provision at the end of each reporting period. Changes in the estimated timing, cost of decommissioning, or discount rate are recognized on a prospective basis with an adjustment to the provision and corresponding adjustment to the related asset. When incurred, the actual costs of decommissioning are charged against the accumulated liability.

h) Income taxes

Income tax expense consists of current and deferred taxes. The expense is recognized in profit or loss, except for income tax related to the components of equity, which in such cases is recognized in equity. Income taxes are provided for on a non-discounted basis at amounts expected to be paid using the tax rates and laws that have been enacted or substantively enacted at the end of the reporting period.

Income taxes payable and receivable are obligations or claims for the current and prior periods to be paid to (or recovered from) taxation authorities that are outstanding at the end of the reporting period. Current tax is computed on the basis of taxable profit, which differs from net profit.

The Company uses the liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on the difference between the carrying value and the tax basis of the assets and liabilities. Any changes in the net amount of deferred income tax assets and liabilities are determined using enacted or substantively enacted tax rates and laws that will be in effect when differences are expected to be reversed. Deferred income tax assets and unused tax losses are recognized to the extent that it is probable that the assets can be utilized. Deferred income tax assets and liabilities are only offset when they arise within the same entity and tax jurisdiction.

i) Revenue

The Company recognizes revenue from the sale of commodities, which include liquids and natural gas. Revenue is measured based on the consideration specified in a contract with a customer. Pipestone Energy recognizes revenue when it transfers control of the commodity to a customer, which is when title passes from the Company to its customer, the risks and rewards of ownership of the commodity pass to the customer and Pipestone Energy has the right to payment.

Purchases and sales of products entered in contemplation of each other with the same counterparty are recorded on a net basis, when the Company has a legal right to offset.

The Company satisfies its performance obligations in contracts with customers upon the delivery of liquids and natural gas, which is generally at a point in time. Revenue represents the Company's share of commodity sales, net of royalty obligations to governments and other mineral interest owners. Pipestone Energy sells its production of liquids and natural gas pursuant to variable and short-term fixed price contracts. The transaction price for contracts is based on the commodity price, adjusted for differentials, quality, location and other factors. The amount of revenue recognized is based on the agreed upon transaction price, whereby any variability in revenue is related specifically to the Company's efforts to deliver production. The resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the Company's variable revenue is considered to be constrained.

The Company's revenue transactions do not contain significant financing components and payments are typically due within 25 days of the month that revenue is recognized in. The Company does not adjust transaction prices for the effects of a significant financing component when the period between the transfer of the promised goods to the customer and payment by the customer is less than one year. The Company does not disclose or quantify information about remaining performance obligations that have an original expected duration of one year or less and it does not have any long-term contracts with unfulfilled performance obligations.

j) Financing expense

Financing expense comprises interest expense on borrowing and leases, other financing costs, accretion of the discount on decommissioning provisions and non-cash expenses related to the Company's convertible preferred shares.

Any borrowing costs incurred for the acquisition or construction of qualifying assets are capitalized during the period required to complete and prepare the assets for their intended use or sale. A qualifying asset is one that takes substantial time to get ready for use or sale.

When funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs. When the funds used to finance a project form part of general borrowing, the amount capitalized is calculated using the weighted average of rates applicable to the Company's relevant general borrowing during the period.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred, using the effective interest rate method.

k) Income (loss) per share

Basic per share amounts are computed by dividing the profit or loss by the weighted-average number of common shares outstanding during the period. The Company utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted-average number of shares is calculated assuming that proceeds arising from the exercise of stock options, warrants and other dilutive instruments where the market price exceeds the exercise price are used to purchase, for cancellation, common shares of the Company at their average market price for the period. The weighted-average number of shares is then adjusted by the net change.

l) Financial instruments

Pipestone Energy's financial assets include cash and cash equivalents, accounts receivable and financial derivative instruments. The Company's financial liabilities include accounts payable and accrued liabilities, bank debt, financial derivative instruments and the convertible preferred share obligation.

Financial instruments are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets and liabilities are not offset unless the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously.

The Company characterizes its fair value measurements into a three-level hierarchy depending on the degree to which the inputs are observable, as follows:

- Level 1 inputs are quoted prices in active markets for identical assets and liabilities;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability – the Company has no level 3 financial instruments.

Classification and measurement of financial assets and financial liabilities

The initial classification of a financial asset depends on 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 or 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 after 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.

Derivative financial instruments

Derivative financial instruments are used to manage economic exposure to market risks relating to commodity prices and interest rates. Derivative financial instruments are not used for speculative purposes. Policies and procedures are in place with respect to required documentation and approvals for the use of derivative financial instruments. Where specific financial instruments are executed, the Company assesses, both at the time of purchase and on an ongoing basis, whether the financial instrument used in the particular transaction is effective in offsetting changes in fair values or cash flows of the transaction.

Risk management contract assets and liabilities are derivative financial instruments classified as measured at FVTPL unless designated for hedge accounting. Derivative instruments that do not qualify as hedges, or are not designated as hedges,

are recorded using mark-to-market accounting whereby instruments are recorded in the balance sheet as either an asset or liability with changes in fair value recognized in profit or loss as a gain or loss on risk management. The estimated fair value of all derivative instruments is based on quoted market prices or, in their absence, third-party market indications and forecasts.

m) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a reduction to equity, net of any tax effects.

n) Government subsidies

Government subsidies are recognized when there is reasonable assurance that the Company will comply with the conditions attached to them and the subsidies will be received. If a subsidy is received before it is certain whether compliance with all conditions will be achieved, the subsidy is recognized as a deferred liability until such conditions are fulfilled. When the conditions of a subsidy relate to income or expense, it is recognized in the statements of income or loss. When the conditions of a subsidy relate to an underlying asset, it is recognized as a reduction to the carrying amount of the related asset. During the year ended December 31, 2020, Pipestone Energy applied for eligibility under, and met the conditions associated with, the Federal Government’s Canada Emergency Wage Subsidy (“CEWS”) program and received $0.5 million in wage subsidies which have been offset directly against gross general and administrative expenses for the year. In 2021 the Company did not qualify for or receive any subsidies under CEWS.

o) New or revised IFRS not yet adopted

Pipestone Energy plans to adopt the following amendments to accounting standards, issued by the IASB, that are effective for annual periods beginning on or after January 1, 2022. The pronouncements will be adopted on their respective effective dates; however, each is not expected to have a material impact on the consolidated financial statements.

Amendments to IAS 12 Income Taxes

In May 2021, the IASB issued an amendment to IAS 12 Income Taxes to clarify the accounting for deferred tax on transactions such as leases and decommissioning obligations. The scope of the recognition exemption in IAS 12 no longer applies to transaction that, on initial recognition, give rise to equal taxable and deductible temporary differences. The amendments are effective for annual periods beginning on or after January 1, 2023, with early adoption permitted.

Amendments to IFRS 9 Financial Instruments

In May 2020, the IASB issued an amendment to IFRS 9 Financial Instruments clarifying which fees to include in the test in assessing whether to derecognize a financial liability. Only those fees paid or received between the borrower and the lender, including fees paid or received by either the entity or the lender on the other’s behalf are included. The amendment is effective for annual periods beginning on or after January 1, 2022, with early adoption permitted.

Amendments to IAS 16 Property, Plant and Equipment

In May 2020, the IASB issued Property, Plant and Equipment - Proceeds before Intended Use, which made amendments to IAS 16 Property, Plant and Equipment. Effective January 1, 2022, the amendments prohibit a company from deducting from the cost of PP&E amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognize such sales proceeds and related cost in profit or loss.

Amendments to IAS 37 Provisions Contingent Liabilities and Contingent Assets

In May 2020, the IASB issued Onerous Contracts - Cost of Fulfilling a Contract, which made amendments to IAS 37 Provisions Contingent Liabilities and Contingent Assets. Effective January 1, 2022, the amendments specify which costs an entity includes in determining the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous.

Amendments to IAS 1 Presentation of Financial Statements

In January 2020, the IASB issued amendments to IAS 1 Presentation of Financial Statements, to clarify its requirements for the presentation of liabilities as current or non-current in the statement of financial position. This will be effective on January 1, 2023.

4. Financial instruments and risk management

a) Risk management overview

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. This note presents information about changes to the Company's exposure to each of these risks, its objectives, policies and processes for measuring and managing risk, and its management of capital during the year. Further quantitative disclosure is included throughout these consolidated financial statements. Pipestone Energy employs risk management strategies and policies to ensure its risk exposure is consistent with its business objectives and risk tolerance. While the Board has overall responsibility for Pipestone Energy's risk management framework, Pipestone Energy's management monitors the risks and administers the risk management measures.

b) Fair value of financial instruments

The significance of inputs used in making fair-value measurements is examined and the inputs are classified according to a fair-value hierarchy with three levels.

Cash and cash equivalents are measured at fair value based on their Level 1 designation. Derivative financial instruments, including risk management contracts, are measured at fair value based on a Level 2 designation. Bank debt is carried at amortized cost.

c) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk with respect to accounts receivable and risk management contracts that are in an unrealized asset position.

The Company believes that the credit risk associated with its risk management contracts is low given that the contracts are all held with Canadian financial institutions that have high credit ratings. Given these credit ratings, management does not expect any financial institution counterparty to fail to meet its obligations.

Substantially all of the Company's accounts receivable are due from purchasers of Pipestone Energy's liquids and natural gas production, joint interest partners and government agencies, and are subject to normal industry credit risk. Receivables from liquids and natural gas marketers are normally collected on the 25th day of the month following production. The Company mitigates the credit risk associated with the marketing of its liquids and natural gas production by establishing marketing relationships with a variety of large, credit-worthy purchasers. The Company has not experienced any collection issues with its marketers to date.

Joint interest receivables are typically collected within one to three months following production. A decrease in commodity prices can potentially increase the credit risk associated with the Company's customers and joint arrangement partners. Pipestone Energy's management believes the risk is mitigated by the size and reputation of the companies to which the Company extends credit.

The Company's accounts receivable was comprised of:

As at December 31,	**2021**	2020
	$	$
Liquids and natural gas sales	**45,026**	15,969
Joint interest billings and other	**806**	1,034
Accounts receivable	**45,832**	17,003

As at December 31, 2021, approximately 77 percent of the Company's accruals, joint operations and trade receivables were with investment grade counterparties. The Company considers all accounts receivable greater than 90 days to be past due. At December 31, 2021, $Nil is past due (December 31, 2020 – $Nil) and the Company's expected credit losses are nominal. Subsequent to December 31, 2021, the Company collected all receivables owing related to its liquids and natural gas sales balance. The Company continues to monitor the creditworthiness of customers and joint operations to limit exposure to this risk and considers all accounts receivable and risk management contract balances to be collectible at December 31, 2021.

d) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company expects to repay its financial liabilities in the normal course of operations and to fund future operational, capital and other obligations through future operating cash flow, as well as future equity and debt financing. Refer to note 8 for further details on available amounts under existing banking arrangements.

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

The timing of undiscounted cash flows relating to the financial liabilities outstanding at December 31, 2021 is outlined below:

	Within 1 year	**Year 2**	**Thereafter**	**Total**
	$	**$**	**$**	**$**
Accounts payable and accrued liabilities	82,127	-	-	82,127
Interest rate risk management contracts	333	106	-	439
Commodity risk management contracts	5,683	12	-	5,695
Bank debt [1]	-	171,866	-	171,866

[1] Excludes future interest payable on amounts drawn on the bank debt.

In addition to the above, the Company is also subject to lease liabilities as disclosed in note 9 and commitments as disclosed in note 19.

e) Market risk

Market risk is the risk that changes in market conditions, such as commodity prices, interest rates and foreign exchange rates, will reduce the Company's net income or the value of financial instruments. These risks are largely outside the Company's control. The Company's objective is to manage and mitigate market risk exposure within acceptable limits, while maximizing returns. The Company has elected not to use hedge accounting for any of its risk management contracts. Market risks are as follows:

Foreign currency risk

Crude oil and natural gas liquids (including condensate, butane and propane) prices are determined in global markets and generally denominated in United States dollars. Natural gas prices obtained by the Company are influenced by U.S. and Canadian supply and demand and, to a much lesser degree, the international market for liquefied natural gas. The impact of such exchange rate fluctuations cannot be predicted. At December 31, 2021 and 2020, the Company had no forward exchange rate contracts nor any working capital denominated in foreign currencies.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate because of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears variable rates of interest. The Company has a floating-to-fixed interest rate swap in place with one of its lenders.

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

Years ended December 31,	**2021**	2020
	$	$
Fair value of contracts, beginning of year	**(2,117)**	(1,439)
Change in the fair value of contracts	**640**	(2,039)
Fair value of contracts realized	**1,038**	1,361
Fair value of contracts, end of year	**(439)**	(2,117)
Current liability	**(333)**	(889)
Long-term liability	**(106)**	(1,228)

At December 31, 2021, a 1 percent fluctuation in interest rates would impact the fair value of the interest rate risk management contract as well as profit or loss for the year ended December 31, 2021, through unrealized gains or losses, by $2.5 million (year ended December 31, 2020 – $1.5 million).

Commodity price risk

The Company's operations expose it to fluctuations in commodity prices. Commodity prices for liquids and natural gas are affected by both global economic events and North American specific factors that influence supply and demand.

Pipestone Energy's commodity price risk management program is designed to reduce cash flow volatility, enhance certainty on funding available for the Company's capital expenditure program and service debt. Mitigation of cash flow volatility is an integral component of the Company's business strategy. Business conditions are monitored regularly and reviewed with the Board to establish risk management guidelines, such as target prices and volumes, which are then used by management in carrying out the Company's strategic risk management program while also meeting minimum hedging requirements, if any, imposed by the Company's external lenders.

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

As at December 31,	**2021**	2020
	$	$
Crude oil	**(3,973)**	(6,040)
Natural gas	**(1,542)**	712
Condensate	**17**	(86)
Net commodity risk management contract liability	**(5,498)**	(5,414)

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

As at December 31,	**2021**			2020		
	$	**$**	**$**	$	$	$
	Asset	**Liability**	**Net**	Asset	Liability	Net
Current asset	**1,187**	**(990)**	**197**	-	-	-
Long-term asset	**-**	**-**	**-**	774	(302)	472
Current liability	**1,391**	**(7,074)**	**(5,683)**	1,269	(7,155)	(5,886)
Long-term liability	**-**	**(12)**	**(12)**	-	-	-
Net position	**2,578**	**(8,076)**	**(5,498)**	2,043	(7,457)	(5,414)

At December 31, 2021, Pipestone Energy had the following commodity risk management contracts in place:

	C$ WTI swaps		**EdCon basis swaps**		**AECO 5A swaps**	
Term	**bbls/d**	**C$/bbl**	**bbls/d**	**US$/bbl**	**GJ/d**	**C$/GJ**
Jan. – Mar. '22	2,500	82.92	500	0.95	32,500	3.24
Apr. – Jun. '22	3,000	87.62	500	0.95	25,000	3.01
Jul. – Sept. '22	2,000	89.82	-	-	25,000	3.01
Oct. – Dec. '22	1,250	89.10	-	-	15,055	2.72

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

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

See note 20 for details of commodity risk management contracts that were entered subsequent to December 31, 2021.

Reconciliation of changes of fair value in Pipestone Energy's risk management contracts:

Years ended December 31,	**2021**	2020
	$	$
Fair value of contracts, beginning of year	**(5,414)**	(891)
Change in the fair value of contracts	**(56,965)**	9,507
Fair value of contracts realized	**56,881**	(14,030)
Fair value of contracts, end of year	**(5,498)**	(5,414)

Commodity price sensitivities – risk management positions

The following summarizes the sensitivity of the fair value of Pipestone Energy's risk management contracts to fluctuations in commodity prices, with all other variables held constant. Management believes the price fluctuations identified below are a reasonable measure of volatility. Fluctuating commodity prices could have resulted in unrealized gains or losses on the Company's risk management contracts at December 31, 2021, affecting profit or loss for the year as follows:

Commodity	Sensitivity range	Increase	Decrease
		$	$
Crude oil	± Cdn$1 per bbl – WTI NYMEX	(718)	718
Natural gas	± Cdn$0.10 per GJ – AECO 5A	(764)	764
Condensate	± Cdn$1 per bbl – Edmonton Condensate	(7)	7

f) Capital management

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

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

The Company strives for a proportion of debt to future cashflow which appropriately balances the level of risk being incurred by its capital investments. At December 31, 2021, the Company's net debt to adjusted funds flow from operations ratio was 1.2 times (December 31, 2020 – 4.2 times). Pipestone Energy's long-term strategy is to achieve and maintain a net debt to adjusted funds flow from operations ratio of less than 1.0 times. The actual ratio may fluctuate due to several factors including commodity prices, production levels and timing of expenditures.

The Company has no externally imposed formal capital requirements. The Company has not paid or declared any dividends. In 2021 the Company began buying back its common shares, see note 12 (d) for details.

Adjusted funds flow from operations

Pipestone Energy uses adjusted funds flow from operations to provide an understanding of the Company's ability to generate cash flow necessary for financing its capital expenditures, expenditures on decommissioning provisions, financial obligations and shareholder distributions. The Company calculates adjusted funds flow from operations based on cash from operating activities before the change in non-cash working capital and decommissioning provision costs incurred. Because the timing of collections and payments from operations is variable, management believes that excluding them from this calculation provides a more meaningful performance measure of Pipestone Energy's operations on an ongoing basis. Decommissioning provision costs incurred also vary depending upon the Company's planned capital program and the maturity of operating areas requiring environmental remediation. The settlement of decommissioning provisions is managed through Pipestone Energy's capital budgeting process.

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

Years ended December 31,	**2021**	2020
	$	$
Cash from operating activities	**157,864**	41,638
Change in non-cash working capital	**8,341**	(1,158)
Decommissioning provision costs incurred	**153**	18
Adjusted funds flow from operations [1]	**166,358**	40,498

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

Net debt

Pipestone Energy considers net debt to be a useful measure in understanding the Company's capital structure and, when considered with adjusted funds flow from operations, an indicator of leverage and overall financial strength. Pipestone Energy calculates net debt as accounts payable and accrued liabilities less accounts receivable and prepaid expenses and deposits plus bank debt. The Company does not consider its convertible preferred share obligation to be part of net debt as this represents a non-cash obligation that will ultimately be settled by conversion into Pipestone Energy common shares and reclassified from a liability to share capital on the Company's statement of financial position.

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

As at December 31,	**2021**	2020
	$	$
Current assets	**49,772**	22,204
Current liabilities	**(94,287)**	(70,807)
Working capital deficit	**(44,515)**	(48,603)
Less: current asset risk management contracts	**(197)**	-
Plus: current liability risk management contracts	**6,016**	6,775
Plus: current lease liabilities	**6,144**	4,665
Adjusted working capital deficit [1]	**(32,552)**	(37,163)
Bank debt	**(171,866)**	(133,466)
Net debt [2]	**(204,418)**	(170,629)
Net debt to adjusted funds flow from operations	**1.2**	4.2

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

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

The net debt to adjusted funds flow from operations ratio represents the time period in years that it would take Pipestone Energy to pay off net debt if no further capital expenditures or decommissioning provision costs were incurred and if adjusted funds flow from operations remained constant.

5. Exploration and evaluation ("E&E") assets and property and equipment ("P&E")

	E&E assets	Liquids and natural gas interests	Corporate	Total P&E
Cost	$	$	$	$
Balance, January 1, 2020	38,881	534,514	741	535,255
Additions	605	103,876[1]	112	103,988
Transfers	(4,847)	4,847	-	4,847
Decommissioning provisions (note 10)	-	2,442	-	2,442
Expiries	(414)	-	-	-
Balance, December 31, 2020	34,225	645,679	853	646,532
Additions	383	190,540[1]	119	190,659
Property acquisitions	-	318	-	318
Transfers	(3,198)	3,198	-	3,198
Decommissioning provisions (note 10)	-	6,024	-	6,024
Expiries	(1,658)	-	-	-
Balance, December 31, 2021	29,752	845,759	972	846,731
Accumulated depletion and depreciation				
Balance, January 1, 2020	-	16,961	95	17,056
Depletion and depreciation	-	46,986	84	47,070
Balance, December 31, 2020	-	63,947	179	64,126
Depletion and depreciation	-	58,574	79	58,653
Balance, December 31, 2021	-	122,521	258	122,779
Carrying amount				
Balance, December 31, 2020	34,225	581,732	674	582,406
Balance, December 31, 2021	29,752	723,238	714	723,952

(1) Pipestone Energy capitalized direct general and administrative expenses of $3.2 million to P&E during the year ended December 31, 2021 (year ended December 31, 2020 - $2.6 million).

Pipestone Energy has a single CGU.

At December 31, 2021, the Company assessed its transfers of E&E assets to P&E for impairment and determined there was none (December 31, 2020 – no impairment).

Future capital costs required to develop proved plus probable reserves in the amount of $988.7 million (December 31, 2020 – $935.4 million) are included in the depletion calculation for liquids and natural gas interests at December 31, 2021.

At December 31, 2021, the Company did not identify any indicators of impairment (December 31, 2020 – indicator of impairment identified but concluded there was no impairment based on test performed).

P&E additions for the year ended December 31, 2021 included $4.2 million of infrastructure equipment that was financed and transferred from prepaid expenses and deposits upon receiving ownership of the items. As such, this addition represents a non-cash transfer to the P&E balance.

6. Right-of-use ("ROU") assets

The Company's ROU assets are comprised of the following:

	Offices	Field equipment	Compressors	Pipeline	Total ROU assets
	$	$	$	$	$
Cost					
Balance, January 1, 2020	1,536	1,630	51,590	-	54,756
Additions	43	-	7,971	-	8,014
Balance, December 31, 2020	1,579	1,630	59,561	-	62,770
Additions	354	-	1,193	33,342	34,889
Balance, December 31, 2021	**1,933**	**1,630**	**60,754**	**33,342**	**97,659**
Accumulated depreciation					
Balance, January 1, 2020	187	483	861	-	1,531
Depreciation	322	527	5,226	-	6,075
Balance, December 31, 2020	509	1,010	6,087	-	7,606
Depreciation	268	517	6,085	491	7,361
Balance, December 31, 2021	**777**	**1,527**	**12,172**	**491**	**14,967**
Carrying amount					
Balance, December 31, 2020	1,070	620	53,474	-	55,164
Balance, December 31, 2021	**1,156**	**103**	**48,582**	**32,851**	**82,692**

Pipestone Energy has obtained the right to use, and in some cases operate, its leased assets but they remain under third-party ownership.

In 2021 a midstream partner funded the construction of a pipeline for use by Pipestone Energy. In exchange the Company entered into a long-term fixed capital fee commitment. The asset became available for use in the fourth quarter of 2021.

In 2019 a midstream partner funded the construction of a compressor station for use by Pipestone Energy. In exchange the Company entered into a long-term fixed capital fee commitment. The asset became available for use in late 2019. During the fourth quarter of 2020, an additional compressor was added by the third-party to increase the capacity of the compressor station. In 2021 the capital fee was adjusted resulting in an addition to the compressor balance.

7. Accounts payable and accrued liabilities

As at December 31,	**2021**	2020
	$	$
Accruals	**45,234**	30,675
Trade	**35,643**	28,411
GST and other	**1,250**	281
Total accounts payable and accrued liabilities	**82,127**	59,367

8. Bank debt

a) Reserve-based loan

Years ended December 31,	**2021**	2020
	$	$
Balance, beginning of year	**133,466**	163,048
Increase (decrease) in borrowing	**38,236**	(28,996)
Debt issuance costs	**(729)**	(1,271)
Amortization of bank debt issuance costs	**893**	685
Balance, end of year	**171,866**	133,466
Current portion	**-**	-
Long-term portion	**171,866**	133,466

On April 30, 2021, Pipestone Energy renewed its reserve-based loan (the "RBL") and maintained its borrowing capacity at $225.0 million. Upon renewal, the Company's previous $70.0 million additional facility (the "Additional Facility"), established in 2020, was converted back into fully conforming capacity available under the senior facility (the "Senior Facility"). At that time, the RBL was comprised of a $195.0 million Senior Facility and a $30.0 million operating facility (the "Operating Line"). The elimination of the Additional Facility reduced Pipestone Energy's annual borrowing cost by 2.0 percent on the amounts previously drawn on the Additional Facility. In addition, the Senior Facility and Operating Line pricing was reduced by 0.25 percent across the pricing grid, which further reduced the Company's borrowing cost on all amounts drawn post April 30, 2021.

On October 29, 2021, the Company redetermined and upsized its RBL. The total borrowing capacity of the RBL was increased from $225.0 million to $280.0 million, with the Senior Facility capacity being increased by $55.0 million to $250.0 million currently, and the Operating Line remaining unchanged at $30.0 million. The covenants of the credit facility were also amended to allow for permitted distributions which provides the Company with flexibility under certain circumstances to return capital to shareholders. The next redetermination of the borrowing base is scheduled for May 2022. The revolving period of the RBL is May 31, 2022, with an additional one-year term out period thereafter.

At December 31, 2021, the Company had $171.0 million drawn against the Senior Facility (December 31, 2020 - $125.0 million) and $1.3 million drawn on the Operating Line (December 31, 2020 - $9.1 million), for an aggregate draw on the RBL of $172.3 million (December 31, 2020 - $134.1 million).

As at December 31,	**2021**	2020
	$	$
RBL – portion drawn	**172,288**	134,052
Unamortized debt issuance costs	**(422)**	(586)
Balance, end of year	**171,866**	133,466

The borrowing base on the facility is scheduled to be redetermined in May 2022 and, subject to any further amendments, is based on the lenders' assessment of the Company's reserves and future commodity prices. If not extended by any or all lenders, the commitments of such non-extending lenders under the RBL will cease to revolve, and all outstanding advances thereunder owing to such non-extending lenders will become repayable in one year from the term date and the margins owing on such outstanding advances will increase by 0.5 percent. In the event the borrowing base is reduced below amounts outstanding, any excess will become due and payable 60 days subsequently. Borrowing base redetermination will also be required if the Company's Liability Management Rating or equivalent measurement falls below 2.0 in any material jurisdiction where Pipestone Energy operates. The Company's most recent Alberta Liability Management Rating was 40.8 which is well in excess of this minimum requirement.

Advances under the RBL are available by way of Canadian prime rate and U.S. base rate loans with interest rates ranging between 1.75 percent and 5.75 percent on the Senior Facility and Operating Line, over the bank's prime lending rate, as well as bankers' acceptances, which are subject to stamping fees and margins ranging from 2.75 percent to 6.75 percent on the Senior Facility and Operating Line. The applicable interest rate varies, depending upon the Company's senior debt to adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) ratio calculated at the Company's previous quarter end for the last twelve months.

As at December 31, 2021, Pipestone Energy's applicable pricing included a 2.3 percent per annum margin on prime loans, a 3.3 percent per annum stamping fee and margin on bankers' acceptances along with a 0.81 percent per annum standby fee on the portion of the RBL that is not drawn. Borrowing margins and fees are reviewed annually as part of the bank syndicate's annual renewal. For the year ended December 31, 2021 borrowing costs averaged 4.9 percent (year ended December 31, 2020 – 4.9 percent). Effective April 1, 2022, future pricing applicable to the RBL will be reduced to 2.0 percent per annum on prime loans, 3.0 percent per annum on bankers' acceptances and 0.75 percent per annum on standby fees.

b) Letter of credit facility

Pipestone Energy has a $22.5 million unsecured letter of credit facility (the "EDC Letter of Credit Facility") under Export Development Canada's ("EDC") performance security guarantee program. During the second quarter of 2021, the capacity of the EDC Letter of Credit Facility was expanded from $15.0 million to $22.5 million. At December 31, 2021, the Company had $12.3 million of letters of credit issued and outstanding against the EDC Letter of Credit Facility (December 31, 2020 - $14.3 million). Letters of credit issued under the EDC Letter of Credit Facility do not impact Pipestone Energy's borrowing capacity under the RBL, and as such provides the Company with additional liquidity. The term of the EDC Letter of Credit Facility currently ends on June 30, 2022.

9. Lease liabilities

Years ended December 31,	**2021**	2020
	$	$
Balance, beginning of year	**58,225**	53,917
Additions	**34,889**	8,014
Interest expense (note 15)	**7,299**	6,314
Lease payments	**(12,195)**	(10,020)
Balance, end of year	**88,218**	58,225
Current portion	**6,144**	4,665
Long-term portion	**82,074**	53,560

Leases are negotiated on an individual basis and contain a range of terms and conditions. The discount rates used to determine lease liabilities for offices, field equipment, compressors and the pipeline added in the years disclosed was 5.0 - 8.0 percent, 8.0 percent, 12.0 percent and 10.1 percent, respectively.

The following table details the undiscounted cash flows and contractual maturities of Pipestone Energy's lease liabilities, as at December 31, 2021:

	$
2022	15,743
2023	15,713
2024	15,811
2025	15,535
2026	15,601
Thereafter	62,814
Total undiscounted future lease payments	141,217
Amounts representing lease interest expense over the term of the lease	(52,999)
Present value of net lease payments	88,218

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

Lease payments that were expensed under short-term and low dollar value exemptions in the years ended December 31, 2021 and 2020 were trivial.

10. Decommissioning provisions

The Company's decommissioning provisions result from its ownership interest in liquids and natural gas assets, including well sites, facilities and gathering systems. The total decommissioning provision is estimated based on the Company's net ownership interest, estimated costs to reclaim and abandon its wells, facilities and gathering systems and the estimated timing of the costs to be incurred in future years. The estimated cash flows required to settle the provisions are approximately $14.9 million at December 31, 2021 (December 31, 2020 – $8.7 million). This was inflated using a rate of 1.8 percent (December 31, 2020 – 1.5 percent) to arrive at undiscounted future cash flows of approximately $25.1 million (December 31, 2020 – $12.6 million) and then discounted using a risk-free rate of 1.7 percent at December 31, 2021 (December 31, 2020 – 1.2 percent) to arrive at the present value of the decommissioning provision as disclosed below. The inflation rate was determined using the Fisher equation, which is calculated as the difference between the Government of Canada nominal rate of interest (1.7 percent) and the real rate of interest (negative 0.1 percent) at December 31, 2021, and was treated as a change in estimates from the prior year. The risk-free rate is based on Government of Canada benchmark bond rates. These obligations are to be settled based on the estimated economic lives of the underlying assets, which currently extend up to 36 years, with the majority of the costs expected to be incurred between 2045 and 2055 and which are expected to be funded from general corporate resources at the time of abandonment.

The following reconciles the decommissioning provisions:

Years ended December 31,	**2021**	2020
	$	$
Balance, beginning of year	**9,239**	6,722
Additions	**5,880**	1,083
Accretion	**172**	93
Changes in estimates	**889**	521
Change in discount rates	**(744)**	838
Costs incurred	**(153)**	(18)
Balance, end of year	**15,283**	9,239

11. Convertible preferred shares

	Preferred shares	**Face value**	**Discount**	**Issuance costs**	**Accrued dividends**	**Carrying value**
	(000s)	**$**	**$**	**$**	**$**	**$**
Balance, September 15, 2020	70	70,000	(2,100)	(1,236)	-	66,664
Dividends paid in-kind	-	-	-	-	1,330	1,330
Discount accretion	-	-	86	-	-	86
Amortization of share issuance costs	-	-	-	52	-	52
Balance, December 31, 2020	70	70,000	(2,014)	(1,184)	1,330	68,132
Dividends paid in-kind	-	-	-	-	4,751	4,751
Discount accretion	-	-	314	-	-	314
Amortization of share issuance costs	-	-	-	199	-	199
Balance, December 31, 2021	**70**	**70,000**	**(1,700)**	**(985)**	**6,081**	**73,396**

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

The face value of the CP Shares plus any accrued dividends paid in-kind at a point in time forms the "Liquidation Preference" of the CP Shares. The Liquidation Preference of the CP Shares is convertible into common shares of the Company at a price of $0.85 per common share, subject to customary adjustments, at the discretion of the holders at any time. After two years, if among other things, the closing price of Pipestone Energy common shares is above $1.70 for 20 days over a 30-day trading period, the Liquidation Preference of the CP Shares will automatically convert into common shares at $0.85 per common share. In the event that there are CP Shares outstanding at the end of the five year term the Liquidation Preference of the CP Shares will automatically convert into common shares at either $0.85 per common share, if Pipestone Energy common shares are trading at a price at or in excess of $0.85 per share, or otherwise at a price equal to 95 percent of the previous 20-day volume weighted average common share price.

At December 31, 2021, the CP Shares had a Liquidation Preference of $76.1 million (December 31, 2020 - $71.3 million). If converted by the holders of the CP Shares at $0.85, this would have resulted in the issuance of 89,506,903 common shares at December 31, 2021 (December 31, 2020 – 83,917,840). At December 31, 2021, Pipestone Energy's common shares were trading on the TSX at a price in excess of $0.85 per share with a closing price of $3.89 per share on this date.

Other than the dividends which may be paid in cash at the sole election of the Company after 2 years from the issuance of the CP Shares, under all circumstances the CP Shares will convert to common shares and will not result in any additional cash obligations payable by Pipestone Energy at a future date.

Holders of the CP Shares are entitled to vote on all shareholder matters and receive dividends paid on common shares, if any, alongside existing holders of the common shares on an "as-converted" basis. The CP Shares rank in priority to common shares as to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up.

As certain conversion features may result in the Company issuing a variable number of its own common shares upon settlement of the CP Shares, they are accounted for as a financial liability.

The related discount and issuance costs reduce the carrying amount of the liability. The discount is accreted and the issuance costs are amortized over the term of the CP Shares using the effective interest rate method so that the liability will equal the face value of the CP Shares upon maturity, both of which are included as a non-cash financing expense in the statement of operations. Any dividends paid in-kind are accrued and added to the carrying value of the liability with the associated expense presented as a non-cash financing expense on the statement of operations. At settlement, the face value of the CP Shares plus any accrued dividends paid in-kind will be reclassified from a liability into equity of the Company on its statement of financial position upon determination of the conversion price and the number of common shares issuable to satisfy the contractual obligation. If dilutive, the impact of the CP Shares is factored into the Company's calculation of diluted earnings per share.

12. Share capital

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

b) Income (loss) per share

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

Years ended December 31,	**2021**	2020
Numerator		
Income (loss) attributable to common shares ($)	**67,920**	(17,277)
Denominator		
Weighted-average number of shares outstanding for basic per-share calculation (000s)	**191,525**	190,288
Weighted-average number of shares outstanding for diluted per-share calculation (000s)	**281,656**	190,288
Basic income (loss) per share attributable to common shares ($/share)	**0.35**	(0.09)
Diluted income (loss) per share attributable to common shares ($/share)	**0.24**	(0.09)

All potentially dilutive instruments were included in the diluted weighted-average share calculation as they were considered dilutive for the year ended December 31, 2021 given the Company was in an income position (year ended December 31, 2020 – all potentially dilutive instruments were excluded from the diluted weighted-average share calculation as they were anti-dilutive to the loss for the period).

c) Warrants

During the year ended December 31, 2021, 250 warrants were exercised with the remaining 17,518,559 warrants expiring on May 19, 2021. Accordingly, at December 31, 2021, there are no warrants outstanding (December 31, 2020 – 17,518,809). The fair value of $15.3 million initially assigned to the warrants has been reclassified to share capital upon their expiry.

d) Normal course issuer bid (“NCIB”)

On November 22, 2021, the Company announced its inaugural NCIB. The NCIB allows the Company to purchase up to 9,598,347 common shares, representing 5 percent of its 191,966,942 common shares outstanding at November 12, 2021, over a period of twelve months commencing on November 25, 2021. Under the NCIB, common shares may be repurchased at prevailing market prices and any common shares that are purchased will be cancelled upon their settlement by the Company. For the year ended December 31, 2021, the Company purchased 949,100 common shares for cancellation at a weighted-average price of $3.60 per share and total consideration of $3.4 million, which includes related commissions and fees. The total cost paid is charged against share capital.

13. Share-based compensation

Pipestone Energy's long-term incentive plan ("LTIP") allows for the granting of equity incentive units to its directors, officers, employees and consultants. The Company's current share-based compensation plan consists of stock options, performance share units ("PSUs") and restricted share units ("RSUs"). The Company has also implemented an employee share purchase plan ("ESPP") which allows employees to voluntarily contribute up to a capped portion of their base salary, which is then matched by the Company, and exchanged for Pipestone Energy common shares.

During the year ended December 31, 2021, Pipestone Energy recognized $3.5 million of share-based compensation expense (year ended December 31, 2020 - $2.0 million).

The following provides information with respect to outstanding equity compensation units at December 31, 2021:

	Units outstanding	Weighted-average remaining contractual life (years)	Units outstanding – weighted-average exercise price ($)	Units exercisable	Units exercisable – weighted-average exercise price ($)
Stock options [(1)]	2,034,600	3.2	1.69	609,733	2.26
PSUs	2,596,410	1.4			
RSUs	2,478,300	1.7			
Units outstanding	**7,109,310**	**2.0**			

(1) Quantities and exercise prices of stock options that were continued as part of a historical acquisition are shown on a post-conversion basis with every 10 options exchangeable for 1 Pipestone Energy common share to reflect the 10:1 common share consolidation that took place on January 4, 2019.

a) Stock options

Pipestone Energy is authorized to issue stock options exercisable for up to 2.0 percent of its rolling issued and outstanding common share balance under its current LTIP (December 31, 2021 – limit of 3,828,925 stock options with 1,794,325 available for issuance). The exercise price of stock options issued pursuant to the plan are equal to the preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from their grant date. It is the Company's intention for the stock options it grants to generally vest one-third on each of the first, second and third anniversaries of the grant date and expire five years from grant.

During the year ended December 31, 2021, the Company granted 801,000 stock options (year ended December 31, 2020 – 774,600 stock options granted) to acquire common shares on a 1:1 basis. The stock options vest one-third on each of the first, second and third anniversaries of their grant date and expire five years from grant.

The initial fair value of the stock options granted in 2021 was $0.99 per share (2020 - $0.31 per share), determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

Years ended December 31,	**2021**	2020
Exercise / share price ($)	**1.91**	0.67
Risk-free interest rate (%)	**0.64**	0.82
Expected life (years)	**3.4**	3.6
Expected forfeiture rate (%)	**5.0**	5.0
Expected volatility (%)	**76.1**	67.5
Expected dividend yield (%)	**-**	-

The fair value of stock options is recognized as share-based compensation expense over the vesting period with a corresponding increase to contributed surplus. Upon exercise of the stock option, the previously recognized value in contributed surplus and any cash proceeds received will be recorded as an increase to share capital.

The following provides information with respect to stock option transactions:

Years ended December 31,	**2021**		2020	
	Options	**Weighted-average exercise price**	Options	Weighted-average exercise price
	#	**$**	#	$
Outstanding, beginning of year	**1,777,000**	**1.95**	1,499,643	2.99
Granted	**801,000**	**1.91**	774,600	0.67
Exercised	**(268,200)**	**1.04**	(15,713)	0.44
Forfeited / expired	**(275,200)**	**4.70**	(481,530)	3.16
Outstanding, end of year	**2,034,600**	**1.69**	1,777,000	1.95

The following provides information about stock options outstanding at December 31, 2021:

Range of exercise prices ($)	**Number outstanding**	**Weighted-average remaining contractual life (years)**	**Options outstanding – weighted-average exercise price ($)**	**Number exercisable**	**Options exercisable – weighted-average exercise price ($)**
0.44 – 0.99	515,600	3.4	0.49	90,400	0.49
1.00 – 1.99	1,081,000	3.7	1.67	189,333	1.29
2.00 – 2.99	108,000	4.8	2.67	-	-
3.00 – 3.30	330,000	1.0	3.30	330,000	3.30
	2,034,600	**3.2**	**1.69**	**609,733**	**2.26**

b) PSUs

Pipestone Energy is authorized to issue PSUs exchangeable for up to 4.0 percent of its rolling issued and outstanding common share balance under its current LTIP (December 31, 2021 – limit of 3,828,925 PSUs with 1,232,515 available for issuance factoring in the maximum exchange ratio of 1 PSU for 2 common shares).

During the year ended December 31, 2021, the Company granted 1,013,297 PSUs (year ended December 31, 2020 – 1,270,000). Each PSU entitles the holder to be issued the number of common shares designated in the performance award, multiplied by a payout multiplier ranging from 0 to 2.0x, at a future date (typically three years from the grant date). The payout multiplier for performance-based awards will be determined by the Board based on an assessment of the Company's achievement of predefined corporate performance measures in respect of the applicable period.

During the year ended December 31, 2021, the weighted-average fair value of PSUs granted was $1.88 per unit (year ended December 31, 2020 – $0.44 per unit). The fair value of PSUs is determined based on the preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from their grant date.

During the year ended December 31, 2021, there were 166,120 PSUs that were settled with a weighted-average payout multiplier of 1.08x, resulting in the issuance of 179,772 common shares (year ended December 31, 2020 – no PSUs settled).

The following provides information with respect to PSUs transactions:

Years ended December 31,	**2021**	2020
	$	$
Balance, beginning of year	**1,918,970**	648,970
Granted	**1,013,297**	1,270,000
Settled	**(166,120)**	-
Forfeited	**(169,737)**	-
Balance, end of year	**2,596,410**	1,918,970

c) RSUs

Pipestone Energy is authorized to issue RSUs exchangeable for up to 2.0 percent of its rolling issued and outstanding common share balance under its current LTIP (December 31, 2021 – limit of 3,828,925 RSUs with 1,350,625 available for issuance).

During the year ended December 31, 2021, the Company granted 1,415,798 RSUs (year ended December 31, 2020 – 1,454,001) that are exchangeable for common shares on a 1:1 basis. The RSUs vest one-third on each of the first, second and third anniversaries of their grant date.

During the year ended December 31, 2021, the weighted-average fair value of RSUs granted was $1.61 per unit (year ended December 31, 2020 – $0.51 per unit). The fair value of RSUs is determined based on the preceding 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX from their grant date.

The following provides information with respect to RSU transactions:

Years ended December 31,	**2021**	2020
	$	$
Balance, beginning of year	**1,994,155**	858,981
Granted	**1,415,798**	1,454,001
Settled	**(837,850)**	(301,649)
Forfeited	**(93,803)**	(17,178)
Balance, end of year	**2,478,300**	1,994,155

d) ESPP

Pipestone Energy has an ESPP to provide its employees with an opportunity to purchase common shares of the Company. Employees may direct up to 10 percent of their base salary for the purchase of shares under the ESPP at the 5-day volume weighted average trading price of Pipestone Energy common shares on the TSX with the Company matching such personal contributions 100 percent. Effective June 1, 2020, the Company administratively capped the maximum contribution to the ESPP to 5 percent of base salary for all participants to limit common share dilution. Effective July 1, 2021, the Company reinstated the maximum contribution to the ESPP to 10 percent. Common shares purchased by the employee are available for immediate transacting while the employer matched portion is subject to a 12-month holding period.

The maximum number of common shares issuable under the current ESPP is equal to 1.0 percent of the Company's issued and outstanding common share balance (December 31, 2021 – limit of 1,914,463 ESPP common shares with 749,589 available for issuance). Under the terms of the ESPP, common shares may be issued from treasury or acquired by the plan administrator in the open market. To date all common shares have been issued from treasury. Proceeds collected from employees are recognized directly to share capital. The fair value of employer contributed common shares to the plan are recognized as share-based compensation expense with the offset to share capital in the period of issuance.

During the year ended December 31, 2021, the Company issued 310,383 common shares at a weighted-average price of $1.98 per share pursuant to the ESPP (year ended December 31, 2020 – 698,138 common shares at a weighted-average price of $0.66 per share).

During the year ended December 31, 2021, the Company collected $0.3 million of cash proceeds from employees for their share of ESPP contributions which was recorded directly to share capital (year ended December 31, 2020 - $0.2 million). The Company also contributed $0.3 million to the plan in the year ended December 31, 2021, which was recognized as share-based compensation expense with the offset to share capital (year ended December 31, 2020 – $0.2 million).

14. Sales of liquids and natural gas

Years ended December 31,	**2021**	2020
	$	$
Product type		
Condensate	**224,857**	76,086
Other natural gas liquids	**42,263**	11,384
Total natural gas liquids	**267,120**	87,470
Crude oil	**1,904**	1,406
Natural gas	**122,271**	47,074
Sales of liquids and natural gas	**391,295**	135,950

Pipestone Energy's sales are comprised of liquids and natural gas to various customers. The Company had four customers which each individually accounted for 10 percent or more of the total sales made during the year ended December 31, 2021. Sales from the transfer of liquids and natural gas volumes to customers are recognized at the time when Pipestone Energy's performance obligations are fully satisfied upon transfer of these volumes to customers.

Included in accounts receivable at December 31, 2021 is $45.0 million (December 31, 2020 - $16.0 million) of accrued liquids and natural gas sales which has been settled subsequent to year end.

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

15. Financing expense

Years ended December 31,	2021	2020
	$	$
Lease liabilities interest expense (note 9)	7,299	6,314
Interest on bank debt [(1)]	7,859	6,839
Letter of credit fees	660	401
Standby and bank charges	668	640
Foreign exchange loss on U.S. denominated debt	-	1,609
Realized gain on cross-currency swaps	-	(1,609)
Cash financing expense	**16,486**	14,194
Preferred share dividends paid in-kind (note 11)	4,751	1,330
Accretion of preferred share discount (note 11)	314	86
Amortization of preferred share issuance costs (note 11)	199	52
Amortization of bank debt issuance costs (note 8)	893	685
Accretion on decommissioning provisions (note 10)	172	93
Non-cash financing expense	**6,329**	2,246
Total financing expense	**22,815**	16,440

(1) Immaterial amounts of financing income earned on cash balances held with the Company's bank have been netted against interest expense on bank debt in the current and comparative periods' presentation.

16. Income tax

a) Deferred income tax expense (recovery)

The following table reconciles income taxes calculated at the Canadian federal-provincial statutory rate with the recorded income tax provision included in profit or loss:

Years ended December 31,	2021	2020
	$	$
Income (loss) before income taxes	90,444	(22,530)
Canadian federal-provincial statutory tax rate	23.0%	24.0%
Expected income tax expense (recovery)	20,802	(5,407)
Share-based compensation	806	485
Preferred share dividends paid in-kind	1,093	319
Other deductions	(177)	(317)
Corporate income tax rate change	-	(239)
Recognition of previously unrecognized deferred tax asset	-	(94)
Actual deferred income tax expense (recovery)	22,524	(5,253)

Effective July 1, 2020, the provincial corporate tax rate was reduced to 8 percent, bringing the federal combined corporate tax rate to 23 percent. The new proposal became enacted on December 9, 2020. For the year ended December 31, 2020, the deferred income tax recovery included $0.2 million attributable to accelerated decreases in the Alberta provincial income tax rate.

b) Deferred income taxes

Temporary differences that give rise to deferred income taxes are as follows:

As at December 31,	**2021**	2020
	$	$
Deferred tax assets		
Non-capital losses	**53,627**	60,615
Debt and share issuance costs	**749**	1,206
Risk management contracts	**1,366**	1,732
Decommissioning provisions	**3,515**	2,125
Lease liabilities	**20,290**	13,397
Deferred tax liabilities		
P&E, E&E and ROU assets	**(105,052)**	(82,056)
Net deferred tax liability	**(25,505)**	(2,981)

For purposes of the above table, deferred income tax liabilities are shown net of offsetting deferred income tax assets where these occur in the same jurisdiction.

Movement in the deferred tax liability during the year ended December 31, 2021:

	Balance, January 1, 2021	Recognized in income	**Balance, December 31, 2021**
	$	$	$
P&E, E&E and ROU assets	(82,056)	(22,996)	**(105,052)**
Risk management contracts	1,732	(366)	**1,366**
Decommissioning provisions	2,125	1,390	**3,515**
Lease liabilities	13,397	6,893	**20,290**
Non-capital losses	60,615	(6,988)	**53,627**
Debt and share issuance costs	1,206	(457)	**749**
Deferred tax liability	(2,981)	(22,524)	**(25,505)**

Movement in the deferred tax liability during the year ended December 31, 2020:

	Balance, January 1, 2020	Recognized in loss	**Balance, December 31, 2020**
	$	$	$
P&E, E&E and ROU assets	(77,893)	(4,163)	**(82,056)**
Risk management contracts	536	1,196	**1,732**
Decommissioning provisions	1,546	579	**2,125**
Lease liabilities	12,401	996	**13,397**
Non-capital losses	54,280	6,335	**60,615**
Debt and share issuance costs	896	310	**1,206**
Deferred tax (liability) asset	(8,234)	5,253	**(2,981)**

c) Tax pools

Estimated tax pools are as follows:

As at December 31,	2021	2020
	$	$
Canadian oil and gas property expense	26,079	28,625
Canadian development expense	192,503	140,040
Canadian exploration expense	44,520	49,016
Non-capital losses	233,160	263,547
Undepreciated capital cost (UCC) pools	116,548	97,353
Debt and share issuance costs	3,474	5,244
	616,284	583,825

The above tax pools include $1.8 million of non-capital losses that expire between the years 2024 and 2029, with the remaining balance not expiring until after 2030.

17. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

Years ended December 31,	2021	2020
	$	$
Cash flows relating to:		
Accounts receivable	(28,829)	5,365
Prepaid expenses and deposits	1,458	(3,124)
Accounts payable and accrued liabilities	22,760	296
Changes in non-cash working capital	(4,611)	2,537
Changes in non-cash working capital relating to:		
Operating activities	(8,341)	1,158
Investing activities	3,730	1,379
	(4,611)	2,537

During the year ended December 31, 2021, the Company paid $Nil in income taxes (December 31, 2020 - $Nil). See note 15 for details of interest paid during the years ended December 31, 2021 and 2020.

18. Related-party transactions

Key management personnel include executive officers and the Board of the Company. The compensation included in general and administrative expenses relating to key management personnel was comprised of the following:

Years ended December 31,	2021	2020
	$	$
Salaries, fees and short-term benefits	3,268	2,928
Share-based compensation [1]	2,405	1,341

[1] Represents the amortization of share-based compensation expense as recorded in the consolidated financial statements.

19. Commitments, contingencies and insurance proceeds

In addition to those recorded on the Company's statement of financial position, the following is a summary of Pipestone Energy's contractual obligations and commitments that it has entered as part of its normal operations at December 31, 2021:

	2022	2023	2024	2025	2026	Thereafter
	$	$	$	$	$	$
Gathering commitments	12,504	12,504	12,510	12,504	12,504	35,281
Processing commitments	33,512	39,381	39,629	39,669	39,816	141,537
Transportation commitments	23,937	21,655	21,717	21,678	21,690	105,003
Total payments	**69,953**	**73,540**	**73,856**	**73,851**	**74,010**	**281,821**

Pipestone Energy's commitments related to its accounts payable and accrued liabilities and bank debt are disclosed in note 4(d), risk management program in note 4(e) and lease liabilities in note 9.

Legal, regulatory and tax

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

Insurance proceeds

During the year ended December 31, 2020, Pipestone Energy initiated a Contingent Business Interruption claim with its insurers in relation to an unplanned and extended outage that the Company experienced at one of its third-party processing facilities. As the insurance claim represented a contingent asset at that time, the Company did not recognize any financial impact during 2020. During the first quarter of 2021, the Company settled this insurance claim for total proceeds of $1.9 million which has been recognized as a recovery netted against operating expense in the period.

20. Subsequent events

Commodity risk management contracts

Subsequent to December 31, 2021, the Company entered additional commodity hedges with the following weighted-average volumes and prices:

	C$ WTI swaps		AECO 5A swaps	
Term	**bbls/d**	**C$/bbl**	**GJ/d**	**C$/GJ**
Jan. – Mar. '22	344	129.06	-	-
Apr. – Jun. '22	668	121.12	19,000	3.47
Jul. – Sept. '22	-	-	19,000	3.47
Oct. – Dec. '22	500	91.12	6,402	3.47

NCIB

Subsequent to December 31, 2021, the Company purchased 792,600 common shares for cancellation at a weighted-average price of $4.64 per share and total consideration of $3.7 million under its NCIB.