Pipestone Oil Corp.

Audited Financial Statements

For the Year Ended December 31, 2018

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Pipestone Oil Corp.

Opinion

We have audited the financial statements of Pipestone Oil Corp. (the "Company"), which comprise:

- the statements of financial position as at December 31, 2018 and December 31, 2017
- the statements of income (loss) and comprehensive income (loss) for the years then ended
- the statements of changes in equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the financial statements, including a summary of significant accounting policies

Hereinafter referred to as the "financial statements".

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

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 "*Auditors' Responsibilities for the Audit of the Financial Statements*" section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 the financial statements.

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

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.
- 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.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is Gregory Ronald Caldwell.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
March 28, 2019

Pipestone Oil Corp.
Statements of Financial Position
(amounts in thousands of Canadian dollars)

	Note	**December 31, 2018**	December 31, 2017
		$	$
Assets			
Current assets			
Cash and cash equivalents		**20,438**	18,315
Accounts receivable	4(c)	**2,602**	2,664
Prepaid expenses and deposits		**744**	31
Total current assets		**23,784**	21,010
Non-current assets			
Exploration and evaluation assets	5	**6,742**	8,648
Property and equipment	6	**183,333**	70,296
Deferred financing		**2,441**	-
Total assets		**216,300**	99,954
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	8	**43,964**	10,809
Financial derivative instruments	4(e)	**1,548**	-
Total current liabilities		**45,512**	10,809
Non-current liabilities			
Bank debt	9	**53,436**	-
Decommissioning provisions	10	**2,085**	907
Financial derivative instruments	4(e)	**1,209**	-
Deferred tax liabilities	14	**-**	58
Total liabilities		**102,242**	11,774
Shareholder’s Equity			
Share capital	11(b)	**126,025**	88,025
Retained earnings (deficit)		**(11,967)**	155
Total shareholder’s equity		**114,058**	88,180
Total liabilities and shareholder’s equity		**216,300**	99,954

Commitments (note 17)
Subsequent events (note 18)

Approved by the Board of Directors.

See accompanying notes to the financial statements.

Pipestone Oil Corp.

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

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

	Note	Years ended December 31, 2018	2017
		$	$
Revenue			
Liquids and natural gas sales	12	**1,628**	958
Royalties		**(137)**	(44)
Liquids and natural gas revenue		**1,491**	914
Expenses			
Operating and transportation		**337**	79
General and administrative		**6,957**	458
Depletion and depreciation	6	**376**	240
Transaction costs	18	**2,536**	-
Total expenses		**10,206**	777
Operating Income (Loss)		**(8,715)**	137
Unrealized loss on financial derivative instruments	4(e)	**(316)**	-
Financing income		**325**	88
Financing expense	13	**(3,474)**	(12)
Income (Loss) Before Income Taxes		**(12,180)**	213
Deferred income tax recovery (expense)	14	**58**	(58)
Income (Loss) and Comprehensive Income (Loss) for the Year		**(12,122)**	155
Income (Loss) per Share			
Basic and diluted	11(c)	**(0.01)**	0.00

See accompanying notes to the financial statements.

Pipestone Oil Corp.
Statements of Changes in Equity
(amounts in thousands of Canadian dollars)

	Note	Share capital	Retained earnings (deficit)	Total
		$	$	$
Balance at January 1, 2017		-	-	-
Issuance of common shares for cash	11(b)	88,025	-	88,025
Income for the year		-	155	155
Balance at December 31, 2017		88,025	155	88,180
Issuance of common shares for cash	11(b)	38,000	-	38,000
Loss for the year		-	(12,122)	(12,122)
Balance at December 31, 2018		**126,025**	**(11,967)**	**114,058**

See accompanying notes to the financial statements.

Pipestone Oil Corp.
Statements of Cash Flows
(amounts in thousands of Canadian dollars)

	Note	Years ended December 31, 2018	2017
		$	$
Cash flows related to:			
Operating Activities			
Income (loss)		**(12,122)**	155
Add (deduct) items not involving cash:			
Unrealized loss on financial derivative instruments	4(e)	**316**	-
Depletion and depreciation	6	**376**	240
Deferred income tax expense (recovery)	14	**(58)**	58
Non-cash financing expense	13	**3,328**	10
Adjusted funds flow from (used in) operations		**(8,160)**	463
Change in non-cash working capital	15	**4,292**	74
Cash from (used in) operating activities		**(3,868)**	537
Investing Activities			
Exploration and evaluation asset expenditures	5	**(190)**	(1,110)
Exploration and evaluation asset acquisitions	5	**-**	(15,328)
Property and equipment expenditures	6	**(109,074)**	(57,588)
Property and equipment acquisitions	6	**(1,098)**	(4,261)
Change in non-cash working capital	15	**28,212**	8,040
Cash used in investing activities		**(82,150)**	(70,247)
Financing Activities			
Issuance of common shares	11(b)	**38,000**	88,025
Advances of bank debt		**51,641**	-
Debt issuance costs	9	**(1,500)**	-
Cash from financing activities		**88,141**	88,025
Increase in cash and cash equivalents		**2,123**	18,315
Cash and cash equivalents, beginning of year		**18,315**	-
Cash and cash equivalents, end of year		**20,438**	18,315

See accompanying notes to the financial statements.

1. Reporting entity and description of the business

Pipestone Oil Corp. ("Pipestone" or the "Company") is engaged in the exploration for, and development and production of, liquids and natural gas in Western Canada, with a significant portion located in the Montney resource play in Alberta. The Company is a privately held entity incorporated under the *Business Corporations Act* (Alberta). Pipestone is a wholly-owned subsidiary of Canadian Non-Operated Resources LP ("CNOR LP"), a privately held partnership formed under the laws of the Province of Alberta. The address and principal place of business of the Company is 1800, 421 – 7th Avenue S.W., Calgary, Alberta, T2P 4K9.

2. Basis of preparation

Statement of compliance

The 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 financial statements were approved and authorized for issuance by Pipestone's Board of Directors on March 28, 2019.

Basis of measurement

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

The Company conducts many of its liquids and natural gas production activities through jointly owned assets and the financial statements reflect only the Company's proportionate interest in such revenues, expenses, assets and liabilities.

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

Use of estimates and judgments

The preparation of 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 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 financial statements could be material. Significant estimates and judgments made by management in the preparation of the financial statements are outlined below:

a) Reserves

Reserve estimates, although not reported as part of the Company's 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 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.

Evaluations of discounted future cash flows are conducted using pre-tax discount rates, which is common industry practice and used by the Company's independent petroleum reservoir engineers in preparing their reserve reports. 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 upstream assets are grouped into CGUs, defined as the lowest level of assets for which there is separately identifiable independent cash inflow. 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'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-specific factors.

f) Financial derivative instruments

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

3. Significant accounting policies

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

a) New or amended standards adopted by the Company

(i) Effective January 1, 2018, the Company adopted IFRS 9, *Financial Instruments*, which replaced International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*. The Company adopted the new standard retrospectively and, in accordance with the transitional provisions, comparative figures have not been restated. The adoption of IFRS 9 did not have a material impact on the Company's financial statements.

The nature and effects of the key changes to the Company's accounting policies resulting from the adoption of IFRS 9 are summarized below.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The previous IAS 39 categories of held to maturity, loans and receivables and available for sale are eliminated. IFRS 9 bases the classification of financial assets on the contractual cash flow characteristics and the company's business model for managing the financial asset. Additionally, embedded derivatives are not separated if the host contract is a financial asset within the scope of IFRS 9. Instead, the entire hybrid contract is assessed for classification and measurement.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. The main change arises in cases where the Company chooses to designate a financial liability as FVTPL. In these situations, the portion of the fair value change related to the Company's own credit risk is recognized in other comprehensive income rather than profit or loss. As a result of adopting IFRS 9, Pipestone's financial assets classified as loans and receivables at December 31, 2017 have been reclassified to financial assets at amortized cost; there is no impact, however, to the measurement of these financial assets.

Impairment of financial assets

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

Hedge accounting

The Company also adopted the new hedge accounting guidance in IFRS 9. It replaces strict quantitative tests of effectiveness with less restrictive assessments of how well the hedging instrument accomplishes the Company's risk management objectives for financial and non-financial risk exposures. IFRS 9 also allows the Company to hedge risk components of non-financial items which meet certain measurability or identifiable characteristics. The Company does not currently apply hedge accounting.

(ii) Effective January 1, 2018, the Company adopted IFRS 15, *Revenue from Contracts with Customers*, which replaced IAS 11, *Construction Contracts*, IAS 18, *Revenue*, and several revenue-related interpretations. The Company adopted IFRS 15 using the modified retrospective method. IFRS 15 presents a new single model for recognition of revenue from contracts with customers. The model features a contract-based five-step analysis of transactions to determine the nature of an entity's performance obligation related to whether, how much, and when revenue is recognized. Under IFRS 15, the revenue from the sale of commodities and other operating revenue the Company earns represent contractual arrangements with customers. The Company recognizes revenue when title of the product is transferred to the buyer and collection is reasonably assured in accordance with specified contract terms. All operating revenue is generally earned at a point in time and is based on the consideration that the Company expects to receive for the transfer of the goods to the customers.

The Company has reviewed its sources of revenue and major contracts with customers using the guidance found in IFRS 15 and determined there are no material changes to the timing and measurement of its revenue in the reporting period, as compared to the provisions of the previous standard; there were, however, new disclosure requirements.

b) Cash and cash equivalents

Cash and cash equivalents consist of deposits held with banks, and term deposits and other similar short-term money market instruments with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents.

c) Jointly owned assets

Some of the Company's liquids and natural gas activities involve jointly owned assets and are conducted under joint operating agreements. The financial statements include the Company's proportionate interest in such revenues, expenses, assets and liabilities.

d) 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 or the Company decides not to continue with its activity, the unrecoverable costs are charged to profit or loss as depletion and depreciation 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.

e) 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 costs, 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, depreciation, and amortization

Depletion of liquids and natural gas properties within the sole Pipestone 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, with a maximum of 50 years. 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 depleted 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.

f) Impairment of assets

Financial assets

The Company recognizes loss allowances for ECLs on its financial assets measured at amortized cost. Due to the nature of its financial assets, Pipestone 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 sole Pipestone CGU, which are 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 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. FVLCOD is based on the discounted after-tax cash flows of reserves and resources using forward prices and costs, consistent with the Company's independent petroleum reservoir engineers.

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 any goodwill allocated to the CGU 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 an impairment loss recognized in prior periods, for assets other than goodwill, should be reduced because the asset's expected recoverable amount has increased since the impairment loss was recorded. Impairment losses against goodwill cannot be reversed. 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 acted 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 crude oil and condensate, natural gas and natural gas liquids. Revenue is measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. Pipestone recognizes revenue when it transfers control of the commodity or service 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 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. Revenues associated with services provided as an agent are recorded as the services are provided.

The Company satisfies its performance obligations in contracts with customers upon the delivery of crude oil and condensate, natural gas and natural gas liquids, 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 sells its production of crude oil and condensate, natural gas and natural gas liquids pursuant to variable price contracts. The transaction price for variable price contracts is based on the commodity price, adjusted for 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 30 days of revenue recognition. 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 or services 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.

The Company enters into contracts with customers that can have performance obligations that are unsatisfied, or partially unsatisfied, at the reporting date. At December 31, 2018, the Company has a number of unfulfilled performance obligations including index-based commodity sales contracts. The Company applies a practical expedient of IFRS 15 and does not disclose quantitative information about remaining performance obligations that have original expected durations of one year or less, or for performance obligations where the Company has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the Company’s performance completed to-date. The Company also applies a practical expedient of IFRS 15 that allows any incremental costs of obtaining contracts with customers to be recognized as an expense when incurred rather than being capitalized.

j) Financing expense

Financing expense comprises interest expense on borrowing, financing costs, and accretion of the discount on decommissioning provisions.

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 options and other dilutive instruments where the market price exceeds option 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's financial assets include cash and cash equivalents and accounts receivable. The Company's financial liabilities include accounts payable and accrued liabilities, bank debt, and financial derivative instruments.

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.

Classification and measurement of financial assets

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;
- 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
- 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 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, stock options and warrants are recognized as a reduction to equity, net of any tax effects.

n) New or revised IFRS not yet adopted

On January 13, 2018, the IASB issued IFRS 16, *Leases*, which requires entities to recognize lease assets and obligations on the balance sheet. For lessees, IFRS 16 removes the classification of leases as either operating leases or finance leases, effectively treating all leases as finance leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements and may continue to be treated as operating leases.

The Company will adopt the standard on the effective date of January 1, 2019 and has applied the modified retrospective approach which does not require restatement of prior period financial information as the cumulative effect of applying the standard to prior periods is recorded as an adjustment to opening retained earnings. On initial adoption, management has elected to use the following practical expedients permitted under the standard:

1) Apply a single discount rate to a portfolio of leases with similar characteristics.
2) Account for leases with a remaining term of less than 12 months as at January 1, 2019 as short-term leases.
3) Account for lease payments as an expense and not recognize a right-of-use (ROU) asset if the underlying asset is of low dollar value.
4) Apply hindsight in determining the lease term where the contract contains terms to extend or terminate the lease.

On adoption of IFRS 16, the Company will recognize lease liabilities in relation to leases under the principles of the new standard. These liabilities will be measured at the present value of the remaining leases payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The associated ROU asset will initially be measured at the amount equal to the lease liability on January 1, 2019 with no impact on retained earnings.

Adoption of the new standard is anticipated to result in the recognition of additional lease liabilities and corresponding ROU assets is not expected to be material. Management has identified ROU assets and lease liabilities primarily related to field equipment. The impact is estimated to be as follows:

- Lower general and administrative expenses, operating expenses, transportation expenses, and plant and equipment expenditures;
- Higher financing expenses due to the interest recognized on the lease obligations; and
- Higher depreciation expense related to the ROU assets.

Office leases will not have an impact on adoption as the present office lease is not in the name of, or paid by, Pipestone.

There are no other not-yet-effective IFRS or IFRIC interpretations that are expected to have a material impact on the Company.

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 period. Further quantitative disclosure is included throughout these financial statements. Pipestone employs risk management strategies and policies to ensure its risk exposure is consistent with its business objectives and risk tolerance. While the Board of Directors has overall responsibility for Pipestone's risk management framework, Pipestone's management monitors the risks and administers the risk management measures.

b) Fair value of financial instruments

The fair values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of those instruments.

Bank debt is carried at amortized cost. The fair value of the bank debt at December 31, 2018, based on a discounted cash flow model assuming a 7.75 percent effective interest rate, is approximately $54.3 million (December 31, 2017 – $Nil).

The fair value of financial derivatives, including risk management contracts, is determined by discounting the difference between the contracted interest rates and forward rate curves at the balance sheet date, using a risk-free interest rate adjusted for the Company's and the counterparty's non-performance risk (see also note 4(e)).

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. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant inputs are observable, either directly or indirectly, and are based on valuation models and techniques in which the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable but are significant to the overall fair value measurement.

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. The bank debt fair value is determined based on a Level 3 designation.

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

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, cash and cash equivalents, and risk management contracts if in an unrealized asset position.

Substantially all of the Company's accounts receivable are due from purchasers of Pipestone'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. Joint interest receivables are typically collected within one to three months flowing production. The Company mitigates the credit risk associated with the marketing of its liquids and natural gas production by establishing marketing relationships with large, credit-worthy purchasers. The Company has not experienced any collection issues with its marketers.

Significant changes in industry conditions and risks that weaken joint interest partners' ability to generate cash flow will increase collection risk. Pipestone's management believes the risk is mitigated by the size and reputation of the companies to which the Company extends credit.

At December 31, 2018 and 2017, the Company's accounts receivable were comprised of:

As at December 31,	**2018**	2017
	$	$
Liquids and natural gas sales	**50**	-
Joint interest billings, GST and other	**2,552**	2,664
Accounts receivable	**2,602**	2,664

The Company considers all accounts receivable greater than 90 days to be past due. At December 31, 2018, $Nil is past due (December 31, 2017 – $Nil). The lifetime expected credit loss allowances related to the Company's liquids and natural gas sales and joint venture receivables recognized in accounts receivable were nominal as at and for the years ended December 31, 2018 and 2017.

As at December 31, 2018, approximately 98 percent of the Company's accruals, joint operations and trade receivables were investment grade, and over 97 percent were outstanding for less than 60 days. The average expected credit loss on the Company's accruals and trade accounts receivable was nominal as at December 31, 2018.

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

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's goal is to meet its liabilities when due, and its management of liquidity is structured accordingly. The Company's liquidity is affected by various external events and conditions, including commodity price fluctuations.

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 financings. Refer to the Company's bank debt (note 9) for further details on available amounts under existing banking arrangements and subsequent events (note 18) for additional credit facilities entered into after December 31, 2018.

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

The timing of undiscounted cash flows relating to the financial liabilities outstanding at December 31, 2018 is outlined below:

	1 year	2 years	3 years	>3 years	Total
	$	$	$	$	$
Accounts payable and accrued liabilities	43,964	-	-	-	43,964
Financial derivative instruments	1,548	1,209	-	-	2,757
Bank debt [1]	-	51,641	-	-	51,641
Bank debt interest	-	2,693	-	-	2,693

[1] Excludes future interest payable on amounts drawn on the bank credit facility, and unamortized debt issuance costs.

The Company is also subject to commitments as disclosed in note 17.

e) Market risk

Market risk is the risk that changes in market prices, 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. Market risks are as follows:

Foreign currency risk

Crude oil 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. An increase in the value of the Canadian dollar relative to the U.S. dollar will decrease the revenues received from the sale of liquids and natural gas. The impact of such exchange rate fluctuations cannot be predicted. At December 31, 2018 and 2017, 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 fall as a result of changes in market interest rates. The Company has minimal exposure to interest rate cash flow risk as its $79.5 million non-revolving loan credit facility (note 9) bearing interest at variable rates is accompanied by an equal and completely offsetting interest rate swap, matching the duration of the notional and principal amounts, dates of interest and principal receipts and payments, and basis for measuring interest rate of the bank debt.

The $79.5 million credit facility (note 9) bears a fixed/floating interest rate swap with the lending institution resulting in the bank debt bearing a fixed annual interest rate of 7.75 percent for the term from March 12, 2018 to February 28, 2019, 7.25 percent from March 1, 2019 to September 2, 2019 and 6.85 percent from September 3, 2019 to March 12, 2020.

The new $198.5 million credit facility (note 18) bears a fixed/floating interest rate swap with the lending institution resulting in the bank debt bearing a fixed annual interest rate of 9.75 percent for the term between January 4, 2019 to March 31, 2020 and 11.50 percent from April 1, 2020 until December 31, 2020.

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

Reconciliation of changes of fair value in Pipestone's financial derivative instruments:

Years ended December 31,	**2018**	2017
	$	$
Fair value of contracts, beginning of year	**-**	-
Contracts entered into	**(2,441)**	-
Change in fair value of contracts	**(316)**	-
Fair value of contracts, end of year	**(2,757)**	-
Current liability	**(1,548)**	-
Long-term liability	**(1,209)**	-

Commodity price risk

The Company's operations expose it to fluctuations in commodity prices. Commodity prices for liquids and natural gas are affected by global economic events that influence supply and demand. Pipestone's management continuously monitors commodity prices.

The Company's policy is to limit swap commodity price contracts to a maximum of 50 percent of forecast production volume. The Company may also enter into other derivative financial instruments, being put options, to achieve this objective. Collars (which are generally fee-offsetting put and call options for the same volume and time-frame) ensure that the realized commodity prices will fall into a contracted range for a contracted sale volume based on the monthly index price, while puts ensure the realized price will not fall below a price floor. The purchase of put options creates a floor for the realized price, while maintaining exposure to potential price upside. At December 31, 2018, the Company has not entered into any forward commodity contracts.

f) Capital management

The Company considers its capital structure to include shareholder's equity, bank debt and adjusted working capital. The balance of each of these items is as follows:

As at December 31,	**2018**	2017
	$	$
Adjusted working capital deficiency (surplus) [(1)]	**20,180**	(10,201)
Bank debt	**53,436**	-
Net debt (cash)	**73,616**	(10,201)
Shareholder's equity	**114,058**	88,180
Total capitalization	**187,674**	77,979

(1) Adjusted working capital is calculated as accounts payable and accrued liabilities, less cash and cash equivalents, accounts receivable, and prepaid expenses and deposits.

The Company maintains a flexible capital structure to maximize its ability to pursue liquids and natural gas exploration and asset acquisition opportunities and to sustain future development of the business. The Company monitors risks for each capital project to balance the proportion of debt and equity in its capital structure. Its officers manage its capital through monthly meetings and regular reviews of financial information, including budgets and forecasts. The Company's Board of Directors oversees this process.

The Company monitors capital based on its current working capital, projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated throughout the year as necessary. The annual and updated budgets are prepared by management and approved by the Board of Directors. Results are regularly reviewed and updated as required.

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

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

The Company has no externally imposed capital requirements other than its financial covenants related to its bank debt (note 9). The Company has not paid or declared any dividends. There were no changes to the Company's approach to capital management during the year ended December 31, 2018.

5. Exploration and evaluation (E&E) assets

Years ended December 31,	**2018**	**2017**
	$	**$**
Balance, beginning of year	**8,648**	-
Additions	**190**	1,110
Acquisitions	**-**	15,328
Transfers to P&E (note 6)	**(2,096)**	(7,790)
Balance, end of year	**6,742**	**8,648**

During the year ended December 31, 2017, the Company acquired $15.3 million of E&E assets, at cost from related parties. The costs were principally reflective of purchase costs originally incurred to acquire the land on which minimal exploitation activities had taken place.

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

6. Property and equipment (P&E)

	Liquids and natural gas interests	Corporate and other	Total
	$	$	$
Cost			
Balance, January 1, 2017	-	-	-
Additions	57,588	-	57,588
Acquisitions	4,261	-	4,261
Transfers from E&E (note 5)	7,790	-	7,790
Decommissioning provision (note 10)	897	-	897
Balance, December 31, 2017	70,536	-	70,536
Additions	108,951	123	109,074
Acquisitions	1,098	-	1,098
Transfers from E&E (note 5)	2,096	-	2,096
Decommissioning provision (note 10)	1,145	-	1,145
Balance, December 31, 2018	**183,826**	**123**	**183,949**
Accumulated depletion and depreciation			
Balance, January 1, 2017	-	-	-
Depletion and depreciation	240	-	240
Balance, December 31, 2017	240	-	240
Depletion and depreciation	351	25	376
Balance, December 31, 2018	**591**	**25**	**616**
Balance, January 1, 2017	-	-	-
Balance, December 31, 2017	70,296	-	70,296
Balance, December 31, 2018	**183,235**	**98**	**183,333**

During the year ended December 31, 2017, the Company acquired $4.3 million of P&E, at cost from related parties. The costs were principally reflective of purchase costs originally incurred to acquire the land on which minimal exploitation activities had taken place.

To date, the Company has not capitalized any interest nor general and administrative expenses to P&E.

Future capital costs required to develop proved plus probable reserves in the amount of $911.5 million (December 31, 2017 – $518.4 million) are included in the depletion calculation for liquids and natural gas interests. Pipestone has a sole P&E CGU, Pipestone.

7. Impairment

At December 31, 2018, the Company assessed its sole P&E CGU and its E&E assets for indicators of impairment and noted none.

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

8. Accounts payable and accrued liabilities

As at December 31,	**2018**	2017
	$	$
Accruals	**25,281**	4,737
Trade	**18,531**	5,963
Other	**152**	109
Total accounts payable and accrued liabilities	**43,964**	10,809

9. Bank debt

	2018	2017
	$	$
Balance, beginning of year	**-**	-
Increase in borrowing	**51,641**	-
Unpaid interest added to principal	**2,693**	-
Debt issuance costs	**(1,500)**	-
Amortization of debt issuance costs	**602**	-
	53,436	-
Current portion	**-**	-
Long-term	**53,436**	-

During 2018 the Company entered into a secured, non-revolving term loan credit facility with a lending institution. The facility has a borrowing base of $79.5 million due March 12, 2020 and consists of two facilities ("Facility 1" and "Facility 2", together the "Credit Facilities"). Facility 1 is in the amount of $59.5 million and consists of three tranches ("Tranche 1", "Tranche 2" and "Tranche 3"). Tranche 1 is non-revolving and was for a single advance in the amount of $30.0 million which occurred in March 2018. Tranche 2 is non-revolving and was for a single advance which occurred in July 2018 in the amount of $20.0 million. Tranche 1 and Tranche 2 are to be used solely to fund Pipestone's capital expenditure program. Tranche 3, in the amount of $9.5 million, is to be used solely for interest and fees that are due and payable in respect of Tranche 1 and Tranche 2. Facility 2 is in the amount of $20.0 million and Pipestone may request the issuance, cancellation and re-issuance of letters of credit up to the $20.0 million commitment amount. The Credit Facilities are secured by a $250.0 million demand debenture granting a first security interest and first floating charge over all assets of Pipestone.

The Company entered into a fixed/floating interest rate swap on March 12, 2018 resulting in the Credit Facilities bearing a fixed annual interest rate of 7.75 percent for the term from March 12, 2018 to February 28, 2019, 7.25 percent from March 1, 2019 to September 2, 2019 and 6.85 percent from September 3, 2019 to March 12, 2020. The termination date of the Credit Facilities is March 12, 2020 at which time the amount owing under Facility 1, including principal, interest and fees, will be $59.2 million.

The Credit Facilities are subject to various customary covenants, including restrictive covenants that limit Pipestone's ability to, among other things, incur additional indebtedness or guarantees; provide or incur liens on the assets; engage in mergers, consolidations, liquidations or dissolutions; and make restricted payments.

Before the end of February 2019, Pipestone was required to provide satisfactory evidence to the lending institution that the Company has received an equity contribution from its shareholder in an amount of no less than $85.0 million. During 2018 Pipestone received an equity contribution of $38.0 million (note 11(b)) and, subsequent to year-end, in January 2019 received a further $47.0 million from CNOR LP, and fulfilled the requirement with the lending institution. These proceeds are expected to be used to fund the Company's capital expenditure program.

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

Pipestone is not permitted to enter into commodity swap contracts prior to December 31, 2018. After such date Pipestone is permitted to enter into commodity swap contracts, as long as the completion schedule relating to the third-party Wapiti plant is on schedule (note 17), but not with a term exceeding 24 months or with an aggregate hedged amount exceeding 66 2/3 percent of the combined forecast average daily liquids and natural gas production (net of royalties) for the following 24 months. Subsequent to year-end, with the approval of the lending institution, the Company entered into a commodity swap transaction (note 18).

As at and for the year ended December 31, 2018 the Company is in compliance with all covenants.

As at December 31, 2018 Pipestone has drawn $54.3 million under the terms of the Credit Facilities. The average rate of interest on the Credit Facilities for the year ended December 31, 2018 is 7.75 percent.

As at December 31, 2018, as part of Facility 2, Pipestone has a letter of credit outstanding of $20.0 million, reducing the borrowing capacity under the Credit Facilities.

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, excluding salvage, are approximately $2.2 million at December 31, 2018 (December 31, 2017 – $1.0 million). This was inflated using a weighted-average rate of 2.0 percent (December 31, 2017 – 2.0 percent) to arrive at undiscounted future cash flows of approximately $3.6 million (December 31, 2017 – $1.8 million) and then discounted using a weighted-average risk-free rate of 2.2 percent at December 31, 2018 (December 31, 2017 – 2.3 percent) to arrive at the present value of the decommissioning provision as disclosed below. The weighted-average 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 33 years, and will be funded from general corporate resources at the time of abandonment.

The following reconciles the decommissioning provisions:

Years ended December 31,	**2018**	2017
	$	$
Balance, beginning of year	**907**	-
Additions	**1,078**	881
Accretion (note 13)	**33**	10
Change in estimates and discount rate	**67**	16
Balance, end of year	**2,085**	907

11. Share capital

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

b) Issued

	Shares	Amount
	(000's)	**$**
Balance, January 1, 2017	-	-
Issuance of common shares	880,252	88,025
Balance, December 31, 2017	880,252	88,025
Issuance of common shares	380,000	38,000
Balance, December 31, 2018	**1,260,252**	**126,025**

c) Income (loss) per share

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

Years ended December 31,	**2018**	2017
Numerator		
Income (loss) attributable to common shares ($)	**(12,122)**	155
Denominator		
Weighted-average number of shares outstanding for basic and diluted per-share calculation (000s)	**913,567**	436,507
Basic and diluted income (loss) per share attributable to common shares ($/share)	**(0.01)**	0.00

Pipestone had no dilutive instruments outstanding in 2017 or 2018.

12. Liquids and natural gas sales

Pipestone's sales are comprised of oil, condensate, natural gas liquids and natural gas sales to multiple customers. Sales from the transfer of liquids and natural gas volumes to customers is recognized at a point of time, when Pipestone's performance obligations are fully satisfied upon transfer of these volumes to customers. For the years ended December 31, 2018 and 2017, sales realized from liquids and natural gas sales was entirely comprised of condensate.

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

13. Financing expense

Years ended December 31,	**2018**	2017
	$	$
Financing expense		
Interest on bank debt	**141**	-
Bank charges	**5**	2
Cash financing expense	**146**	2
Interest on bank debt, unpaid	**2,693**	-
Accretion on decommissioning provisions	**33**	10
Amortization of bank debt issuance costs	**602**	-
Non-cash financing expense	**3,328**	10
Total financing expense	**3,474**	12

14. 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,	**2018**	2017
	$	$
Income (loss) before income taxes	**(12,180)**	213
Canadian federal-provincial statutory tax rate	**27.0%**	27.0%
Expected income tax expense (recovery)	**(3,289)**	58
Unrecognized asset	**3,229**	-
Other	**2**	-
Actual and expected deferred income tax expense (recovery)	**(58)**	58

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

b) Deferred income taxes

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

As at December 31,	**2018**	2017
	$	$
Deferred tax assets		
Non-capital losses	**15,981**	4,883
Debt issuance costs	**102**	-
Financial derivative instruments	**744**	-
Decommissioning provisions	**563**	245
Deferred tax liabilities		
Deferred financing	**(660)**	-
P&E and E&E assets	**(16,730)**	(5,186)
Net deferred tax asset (liability)	**-**	(58)

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.

Deferred tax assets have not been recognized in respect of the following items:

As at December 31,	**2018**	2017
	$	$
Non-capital losses	**11,959**	-
	11,959	-

Movement in the deferred tax asset or liability during the year ended December 31, 2018:

	Balance, January 1, 2018	Recognized in loss	**Balance, December 31, 2018**
	$	$	$
P&E and E&E assets	(5,186)	(11,544)	**(16,730)**
Deferred financing	-	(660)	**(660)**
Financial derivative instruments	-	744	**744**
Decommissioning provisions	245	318	**563**
Non-capital losses	4,883	11,098	**15,981**
Debt issuance costs	-	102	**102**
Deferred tax asset (liability)	(58)	58	**-**

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

Movement in the deferred tax liability during the year ended December 31, 2017:

	Balance, January 1, 2017	Recognized in income	**Balance, December 31, 2017**
	$	$	$
P&E and E&E assets	-	(5,186)	**(5,186)**
Decommissioning provisions	-	245	**245**
Non-capital losses	-	4,883	**4,883**
Deferred tax liability	-	(58)	**(58)**

c) Tax pools

Estimated tax pools are as follows:

As at December 31,	**2018**	2017
	$	$
Canadian oil and gas property expense	**17,485**	20,700
Canadian development expense	**83,121**	37,772
Canadian exploration expense	**825**	813
Non-capital losses	**71,143**	18,084
Undepreciated capital cost (UCC) pools	**26,683**	450
Debt issuance costs	**1,275**	-
	200,532	77,821

Deferred income tax assets have not been recognized as it is not probable given the Pipestone's anticipated future earnings that the tax pools will be utilized against future profits. The above tax pools include non-capital losses that expire in the years 2037 and 2038.

15. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

Years ended December 31,	**2018**	2017
	$	$
Cash flows relating to:		
Accounts receivable	**62**	(2,664)
Prepaid expenses and deposits	**(713)**	(31)
Accounts payable and accrued liabilities	**33,155**	10,809
Changes in non-cash working capital	**32,504**	8,114
Changes in non-cash working capital relating to:		
Operating activities	**4,292**	74
Investing activities	**28,212**	8,040
	32,504	8,114

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

16. Related-party transactions

i. During the year ended December 31, 2017, the Company acquired $19.0 million of assets from Canadian Non-Operated Resources I Ltd. ("CNOR I Ltd."), including $14.7 million of E&E and $4.3 million of P&E. The Company also acquired $0.6 million of E&E from CNOR LP. All acquisitions were at cost for undeveloped land, as well as initial exploitation and drilling costs. At December 31, 2018, $Nil for both CNOR I Ltd. and CNOR LP (December 31, 2017 – $4.0 million for CNOR I Ltd. and $0.6 million for CNOR LP) was included in accounts payable and accrued liabilities and was due under normal credit terms. All related-party transactions are recorded at the exchange amount.

ii. Key management are considered to be executive officers and non-executive directors of Pipestone's parent CNOR LP. They received no compensation from the Company. Instead, they are compensated by CNOR LP and recharged to the Company as part of a management charge, which is included in general and administrative expenses. The management charge, which amounted to $4.8 million for the year ended December 31, 2018 (2017 – $Nil) also includes administrative costs borne by CNOR LP on behalf of Pipestone and it is not possible to identify separately the amount of the executive officers' and non-executive directors' compensation. The compensation paid or payable to key management for services consists entirely of salaries, bonuses and other short-term benefits.

17. Commitments

As part of its normal operations, Pipestone has committed to paying certain amounts over the next five years and thereafter as follows:

	2019	2020	2021	2022	2023	Thereafter
	$	$	$	$	$	$
Firm gathering commitments	4,480	5,963	10,427	11,893	11,893	62,430
Firm processing commitments	5,111	6,802	11,894	13,566	13,566	71,217
Firm transportation commitments	640	3,843	6,505	8,623	8,623	40,793
Total payments	10,231	16,608	28,826	34,082	34,082	174,440

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

18. Subsequent events

Business combination

On October 29, 2018, the Company entered in an arrangement agreement with Blackbird Energy Inc. ("Blackbird") that provided for the combination of Blackbird and Pipestone (the "Transaction"), under the name Pipestone Energy Corp. ("Pipestone Energy"). The substance of the Transaction is a go-public reverse takeover of Blackbird, a publicly traded company listed on the TSX Venture Exchange ("TSXV").

The reverse takeover involves a business combination of Blackbird and the Company to form a new amalgamated corporation, Pipestone Energy, that will carry on Pipestone's and Blackbird's current business. Pursuant to the Transaction, Blackbird acquired all issued and outstanding shares of the Company at an exchange ratio of 0.5996 Blackbird shares to one Pipestone share. This resulted in Blackbird issuing 1,037,500,000 common shares to Pipestone's shareholder. Blackbird shares were then converted to 0.1 common shares of Pipestone Energy upon amalgamation, which resulted in Pipestone's shareholder holding 103,750,000 (55 percent) and Blackbird shareholders holding 85,858,516 (45 percent) of Pipestone Energy. The Transaction closed on January 4, 2019. The common shares of Pipestone Energy began trading on the TSXV in substitution of the common shares of Blackbird on January 9, 2019 under the trading symbol "PIPE".

Concurrently with the Transaction, Blackbird and Pipestone entered into agreements with certain of their existing shareholders who committed to common equity financings totaling $111.0 million, which was completed prior to closing. No finder's fees or commissions were payable with respect to the equity financings.

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

In conjunction with the closing, Pipestone Energy entered into a $198.5 million two-year first lien credit facility (the "New Credit Facility") with a syndicate of lenders. The New Credit Facility is comprised of a $10.0 million revolving credit facility, a $20.0 million letter of credit facility, and a $168.5 million term loan. The term loan is available in tranches between January 4, 2019 and the end of the first quarter of 2020 to fund capital expenditures and to repay existing debt. The New Credit Facility is not subject to any scheduled borrowing base redeterminations or financial covenants. Standby fees are charged on the undrawn New Credit Facility at a rate of 0.50 percent. Associated with the closing of the New Credit Facility, the Company entered into a fixed/floating interest rate swap transaction with the lending institution, resulting in the New Credit Facility bearing a fixed annual interest rate of 9.75 percent for the term between January 4, 2019 to March 31, 2020 and 11.50 percent from April 1, 2020 until December 31, 2020. The termination date of the New Credit Facility is December 31, 2020 at which time the amount owing, including principal, interest and fees, will be $167.9 million.

The Transaction will be accounted for as a business combination under IFRS 3, *Business Combinations*, using the acquisition method. Pipestone will be considered the accounting acquirer of Blackbird and the assets acquired and liabilities assumed of Blackbird will be recorded at their fair values. A preliminary estimate of the value attributed to the assets acquired is as follows:

	$
Fair value of assets acquired and liabilities assumed	
Cash and cash equivalents	20,295
Working capital deficit excluding cash and cash equivalents	(12,582)
E&E assets	36,942
P&E	198,235
Lease assets	1,630
Lease liability	(1,630)
Decommissioning provision	(908)
Deferred income taxes	(19,842)
Total assets acquired and liabilities assumed	222,140
Consideration	
Warrants	15,307
Stock options	772
Share consideration	206,061
Total purchase price	222,140

Share consideration is based on 858,585,668 common shares of Blackbird at January 4, 2019 with a closing price of $0.24 per share. Warrant consideration is based on 175,188,092 Blackbird warrants at January 4, 2019 with a closing price of $0.09 per warrant. Blackbird warrants and stock options are exercisable for 0.1 of a common share of Pipestone Energy. On January 4, 2019 there were 35,477,945 Blackbird stock options outstanding, of which 13,246,438 continue in accordance with their existing terms, with the remaining 22,231,507 options outstanding post-transaction for a 120 day period.

Acquisition-related costs of $2.5 million were incurred in the year-ended December 31, 2018. These costs have been expensed in profit or loss as transaction costs. On January 4, 2019 Pipestone incurred an additional $5.9 million of acquisition-related costs.

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

Risk management contract

Subsequent to year end, the Corporation entered into the following financial derivative instruments:

Term	**Commodity**	**Contract type**	**Notional quantity**	**Pricing point**	**Contract price**
Mar. 1/19 - Feb. 29/20	Crude oil	Costless collar	350 bbls/d	WTI Nymex	Cdn$65.00/bbl-Cdn$77.95/bbl
Dec. 1/19 - Jun. 30/20	Crude oil	Swap	500 bbls/d	WTI Nymex	Cdn$78.35/bbl