AUDITED CONSOLIDATED FINANCIAL STATEMENTS

HIGHLY FOCUSED ON DEVELOPING THE **EXCEPTIONAL** MONTNEY PLAY

FOR THE YEAR ENDED DECEMBER 31, 2020

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, 2020, and the consolidated statements of loss and comprehensive loss, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, 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, 2020, and its consolidated financial performance and its consolidated cash flows for the years then ended 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.

Other matter

The consolidated financial statements of the Company for the year ended December 31, 2019 were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on March 17, 2020.

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.

Impairment of property, plant and equipment

As at December 31, 2020, the carrying value of property, plant and equipment was $582 million. For the period ended December 31, 2020, no impairment charge was recorded with respect to PP&E. Refer to Note 3 for a description of the Company's impairment of non-financial assets accounting policy. Refer to Note 7 for the Company's PP&E impairment disclosures. PP&E is tested for impairment only when circumstances indicate that the carrying value of a cash generating unit ('CGU') may exceed the recoverable amount. Impairment is determined by estimating a CGU's respective recoverable amount. The recoverable amount of the CGUs was based on

To test the Company's estimated recoverable amount, we performed the following procedures, among others:

- Evaluated management's experts' competence, capability and objectivity as well as obtained an understanding of the work they performed. The appropriateness of their work as audit evidence was evaluated by considering the relevance and reasonableness of the methods and inputs utilized
- Involved our internal valuation specialists to assess the methodology applied and the various inputs utilized in determining the discount rate by referencing current industry, economic, and comparable company information, as well as company and cash-flow specific risk premiums

expected after-tax future net cash flows from the production of proved and probable reserve volumes using forecast commodity prices and costs, discounted using market-based rates. Proved and probable reserves were determined by the Company's independent petroleum reservoir engineers (management's experts). Auditing the Company's estimated recoverable amount was complex due to the subjective nature of the various management inputs and assumptions and the significant effect changes in these would have on the recoverable amount. Additionally, the evaluation of this estimate required specialized skills and knowledge. The primary inputs noted in the recoverable amount models were the discount rate and after-tax future net cash flows from the production of proved plus probable reserve volumes.	• Compared forecasted benchmark commodity price estimates against historically realized prices and to other third-party price forecasts • Assessed forecasted production, royalty, operating cost, and capital cost data by comparing it to historical performance of the Company • With the assistance of our valuation specialists, we also assessed the market capital deficiency against control premiums observed in comparable market transactions and investigated any contrary information Evaluated the adequacy of the property and equipment note disclosure included in Note 7 of the accompanying financial statements in relation to this matter

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.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within Pipestone to express an opinion on the financial statements. We are responsible for the direction, supervision, and performance of Pipestone's audit. We remain solely responsible for our audit opinion.

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.

Ernst & Young LLP

Chartered Professional Accountants

Calgary, Alberta
March 9, 2021

Pipestone Energy Corp.

Consolidated Statements of Financial Position

(amounts in thousands of Canadian dollars)

	Note	**December 31, 2020**	December 31, 2019
		$	$
Assets			
Current assets			
Cash and cash equivalents		**-**	28,647
Accounts receivable	4(c)	**17,003**	22,368
Risk management contracts	4(e)	**-**	330
Prepaid expenses and deposits		**5,201**	2,077
Total current assets		**22,204**	53,422
Non-current assets			
Exploration and evaluation assets	6	**34,225**	38,881
Property and equipment	7	**582,406**	518,199
Right-of-use assets	8	**55,164**	53,225
Risk management contracts	4(e)	**472**	89
Total assets		**694,471**	663,816
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	9	**59,367**	59,071
Risk management contracts	4(e)	**6,775**	2,749
Lease liabilities	11	**4,665**	3,617
Total current liabilities		**70,807**	65,437
Non-current liabilities			
Bank debt	10	**133,466**	163,048
Lease liabilities	11	**53,560**	50,300
Decommissioning provisions	12	**9,239**	6,722
Risk management contracts	4(e)	**1,228**	-
Convertible preferred share obligation	13	**68,132**	-
Deferred tax liabilities	18(b)	**2,981**	8,234
Total liabilities		**339,413**	293,741
Shareholders' Equity			
Share capital	14(b)	**380,367**	379,469
Warrants	5	**15,307**	15,307
Contributed surplus		**2,613**	1,251
Deficit		**(43,229)**	(25,952)
Total shareholders' equity		**355,058**	370,075
Total liabilities and shareholders' equity		**694,471**	663,816

Commitments and contingencies (note 21)

Approved by the Board of Directors.

(Signed) "GR", Director (Signed) "BL", Director

See accompanying notes to the financial statements.

Pipestone Energy Corp.
Consolidated Statements of Loss and Comprehensive Loss
(amounts in thousands of Canadian dollars, except for per share amounts)

	Note	Years ended December 31, 2020	2019
		$	$
Revenue			
Sales of liquids and natural gas	16	**135,950**	62,521
Royalties		**(4,185)**	(2,912)
Liquids and natural gas revenue		**131,765**	59,609
Realized gain (loss) on commodity risk management contracts	4(e)	**14,030**	(819)
Unrealized loss on commodity risk management contracts	4(e)	**(4,523)**	(891)
Total revenue		**141,272**	57,899
Expenses			
Operating		**63,732**	24,140
Transportation		**19,708**	7,156
General and administrative		**6,302**	8,875
Share-based compensation	15	**2,022**	754
Exploration and evaluation	6	**414**	3,315
Depletion and depreciation	7,8	**53,145**	17,971
Transaction costs	5	**-**	4,305
Total expenses		**145,323**	66,516
Operating Loss		**(4,051)**	(8,617)
Realized loss on interest rate risk management contracts	4(e)	**(1,361)**	(192)
Unrealized gain (loss) on interest rate risk management contracts	4(e)	**(678)**	1,318
Financing income		**190**	1,038
Financing expense	17	**(16,630)**	(18,660)
Loss Before Income Taxes		**(22,530)**	(25,113)
Deferred income tax recovery	18(a)	**5,253**	11,128
Loss and Comprehensive Loss for the Year		**(17,277)**	(13,985)
Loss per Share			
Basic and diluted	14(c)	**(0.09)**	(0.07)

See accompanying notes to the financial statements.

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

	Note	Share capital	Warrants	Contributed surplus	Retained earnings (deficit)	Total
		$	$	$	$	$
Balance at January 1, 2019		126,025	-	-	(11,967)	114,058
Issuance of common shares for cash	14(b)	47,000	-	-	-	47,000
Corporate acquisition	5	206,061	15,307	772	-	222,140
Exercise of stock options	15 (a)	168	-	(168)	-	-
Share-based compensation	15	107	-	647	-	754
Employee share purchase plan	15 (d)	108	-	-	-	108
Loss for the year		-	-	-	(13,985)	(13,985)
Balance at December 31, 2019		379,469	15,307	1,251	(25,952)	370,075
Conversion of restricted share units	15 (c)	427	-	(427)	-	-
Exercise of stock options	15 (a)	10	-	(3)	-	7
Share-based compensation	15	230	-	1,792	-	2,022
Employee share purchase plan	15 (d)	231	-	-	-	231
Loss for the year		-	-	-	(17,277)	(17,277)
Balance at December 31, 2020		**380,367**	**15,307**	**2,613**	**(43,229)**	**355,058**

See accompanying notes to the financial statements.

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

	Note	Years ended December 31, 2020	2019
		$	$
Cash flows related to:			
Operating Activities			
Loss		**(17,277)**	(13,985)
Add (deduct) items not involving cash:			
Unrealized loss (gain) on interest rate risk management contracts	4(e)	**678**	(1,318)
Unrealized loss on commodity risk management contracts	4(e)	**4,523**	891
Share-based compensation	15	**2,022**	754
Exploration and evaluation	6	**414**	3,315
Depletion and depreciation	7, 8	**53,145**	17,971
Deferred income tax recovery	18(a)	**(5,253)**	(11,128)
Non-cash financing expense	17	**2,246**	6,288
Decommissioning provision costs incurred	12	**(18)**	(3)
Change in non-cash working capital	19	**1,158**	7,777
Cash from operating activities		**41,638**	10,562
Investing Activities			
Exploration and evaluation asset expenditures	6	**(605)**	(1,131)
Property and equipment expenditures	7	**(103,988)**	(161,063)
Property and equipment acquisitions	7	**-**	(214)
Proceeds on asset under construction	7	**-**	13,967
Corporate acquisition, cash acquired	5	**-**	20,295
Change in non-cash working capital	19	**1,379**	(26,351)
Cash used in investing activities		**(103,214)**	(154,497)
Financing Activities			
Proceeds from issuance of preferred shares	13	**67,900**	-
Preferred share issuance costs	13	**(1,236)**	-
Issuance of common shares	15(d)	**231**	47,108
Exercise of stock options	15(a)	**7**	-
Advances (repayments) of bank debt	10	**(28,996)**	108,714
Bank debt issuance costs	10	**(1,271)**	(2,839)
Principal portion of lease payments	11	**(3,706)**	(839)
Cash from financing activities		**32,929**	152,144
Increase (decrease) in cash and cash equivalents		**(28,647)**	8,209
Cash and cash equivalents, beginning of year		**28,647**	20,438
Cash and cash equivalents, end of year		**-**	28,647

Supplemental cash flow information (note 19)

See accompanying notes to the financial statements.

1. Reporting entity and description of the business

Pipestone Energy Corp. ("Pipestone Energy" or the "Company") is engaged in the 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. The Company's shares are listed on the Toronto Stock Exchange ("TSX"). The address and principal place of business of the Company is Suite 3700, 888 – 3rd Street S.W., Calgary, Alberta, T2P 5C5.

On January 4, 2019 the Company completed its reverse takeover of, and amalgamation with, Blackbird Energy Inc. (the "Corporate Acquisition"). Prior to the Corporate Acquisition, Pipestone Energy was a privately held entity, operating under the name Pipestone Oil Corp. ("Predecessor Pipestone"), incorporated under the Business Corporations Act (Alberta) and 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. At December 31, 2020, CNOR LP held approximately 54 percent of Pipestone Energy's issued and outstanding common shares.

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 the 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 9, 2021.

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

Use of estimates and judgments

In March 2020, the World Health Organization declared a global pandemic following the emergence and rapid spread of a novel strain of the coronavirus ("COVID-19"). The outbreak and subsequent measures intended to limit the pandemic contributed to significant declines and volatility in financial markets. The pandemic adversely impacted global commercial activity, including significantly reducing worldwide demand for crude oil. Crude oil prices were also severely impacted early in 2020 by increased global supply due to disagreements over production restrictions between the Organization of Petroleum Exporting Countries ("OPEC") and non-OPEC members, primarily Saudi Arabia and Russia.

The full extent of the impact of COVID-19 on the Company's operations and future financial performance is uncertain. It will depend on further future developments that are uncertain and unpredictable, including the duration and spread of COVID-19 and any variants, its continued impact on capital and financial markets on a macro-scale. These uncertainties may persist beyond when it is determined how to contain the virus or treat its impact. The outbreak presents uncertainty and risk with respect to the Company, its performance, and estimates and assumptions used by management in the preparation of its financial results.

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.

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 criterion, 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 financial statements:

a) New or amended standards adopted by the Company

IFRS 3, *Business Combinations*

The following amendment as issued by the IASB has been adopted by the Company effective January 1, 2020. This amendment had no impact on the Company's financial statements in the current year. IFRS 3, *Business Combinations,* sets out the principles in accounting for the acquisition of a business. The amendments to this standard include a change in the definition of a business and the addition of an optional concentration test to determine if the acquisition is a business. The definition of a business under the amendment to IFRS 3 is now that a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are defined as follows:

- Input: any economic resource that creates outputs, or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.
- Process: Any system, standard, protocol, convention or rule that, when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs.
- Output: The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income or generate other income from ordinary activities.

The optional concentration test permits a simplified assessment of whether an acquired set of activities and assets is in fact a business. An entity may elect to apply, or not apply, the test separately for each transaction or other event. The concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. If the concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed.

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) 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, 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.

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, 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.

f) 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.

g) 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.

h) 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.

i) 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.

j) 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.

k) 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.

l) 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.

m) 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 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 – 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;
- 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 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.

n) 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.

o) 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 Program ("CEWS") and received $0.5 million in wage subsidies which have been offset directly against gross general and administrative expenses for the year.

p) New or revised IFRS not yet adopted

There are currently no 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 year. Further quantitative disclosure is included throughout these 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 of Directors has overall responsibility for Pipestone Energy's risk management framework, Pipestone Energy's management monitors the risks and administers the risk management measures.

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

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.

The fair value of financial derivatives, including interest rate 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)).

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 large 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,	**2020**	2019
	$	$
Liquids and natural gas sales	**15,969**	18,046
GST, joint interest billings and other	**1,034**	4,322
Accounts receivable	**17,003**	22,368

As at December 31, 2020, approximately 87 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, 2020, $Nil is past due (December 31, 2019 – $Nil) and the Company's expected credit losses are nominal. 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, 2020.

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

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 10 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 adverse impacts that the COVID-19 pandemic has had on the state of the global economy, the resulting weakness in commodity prices from COVID-19's demand destruction as well as global oversupply of crude oil; 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, 2020 is outlined below:

	1 year	2 years	3 years	>3 years	Total
	$	$	$	$	$
Accounts payable and accrued liabilities	59,367	-	-	-	59,367
Interest rate risk management contracts	889	985	243	-	2,117
Commodity risk management contracts	5,886	-	-	-	5,886
Bank debt [(1)]	-	133,466	-	-	133,466

(1) Excludes future interest payable on amounts drawn on the bank debt.

The Company is also subject to lease liabilities as disclosed in note 11 and commitments as disclosed in note 21.

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 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, 2020 and 2019, 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. During the year ended December 31, 2020, the Company blended the interest rate and extended out the term of this swap contract until March 31, 2023, in order to defer part of the current liability and associated cash outflows beyond 2021.

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

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

Years ended December 31,	**2020**	2019
	$	$
Fair value of contracts, beginning of year	**(1,439)**	(2,757)
Change in the fair value of contracts	**(2,039)**	1,318
Fair value of contracts realized	**1,361**	-
Fair value of contracts, end of year	**(2,117)**	(1,439)
Current liability	**(889)**	(1,439)
Long-term liability	**(1,228)**	-

At December 31, 2020, 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, 2020, through unrealized gains or losses, by $1.5 million (year ended December 31, 2019 – $0.7 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 management continuously monitors commodity prices.

The Company's policy is to limit swap commodity price contracts to approximately 50 percent of forecasted production volumes while also meeting the minimum hedging requirements, if any, imposed by the Company's external lenders. The Company may also enter other types of commodity risk management contracts to achieve this objective from time to time. 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.

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,	**2020**	2019
	$	$
Crude oil	**(6,040)**	3,092
Natural gas	**712**	(1,320)
Condensate	**(86)**	(2,663)
Net commodity risk management contract liability	**(5,414)**	(891)

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

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,	2020			2019		
	$	$	$	$	$	$
	Asset	Liability	Net	Asset	Liability	Net
Current asset	-	-	-	2,206	(1,876)	330
Long-term asset	774	(302)	472	93	(4)	89
Current liability	1,269	(7,155)	(5,886)	1,359	(2,669)	(1,310)
Net position	**2,043**	**(7,457)**	**(5,414)**	3,658	(4,549)	(891)

At December 31, 2020, 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. '21	4,250	56.82	3,000	0.17	40,365	2.32
Apr. – Jun. '21	4,000	57.51	-	-	42,870	2.34
Jul. – Sept. '21	3,750	57.30	-	-	42,870	2.34
Oct. – Dec. '21	3,750	57.30	-	-	41,210	2.33
Jan. – Dec. '22	-	-	-	-	12,530	2.27

(1) Weighted-average volumes and prices are presented.
(2) EdCon refers to Edmonton Condensate.

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

Years ended December 31,	2020	2019
	$	$
Fair value of contracts, beginning of year	(891)	-
Change in the fair value of contracts	9,507	(1,710)
Fair value of contracts realized	(14,030)	819
Fair value of contracts, end of year	**(5,414)**	(891)

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, 2020, affecting profit or loss for the year as follows:

Commodity	Sensitivity range	Increase	Decrease
		$	$
Crude oil	± Cdn$1 per bbl – WTI NYMEX	(1,304)	1,304
Natural gas	± Cdn$0.10 per GJ – AECO 5A	(1,544)	1,544
Condensate	± Cdn$1 per bbl – Edmonton Condensate	(140)	140

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

f) Capital management

The Company considers its capital structure to include shareholders' equity, convertible preferred share obligations, bank debt and adjusted working capital. The balance of each of these items is as follows:

As at December 31,	2020	2019
	$	$
Adjusted working capital deficit [1]	37,163	5,979
Bank debt	133,466	163,048
Net debt	170,629	169,027
Convertible preferred share obligation	68,132	-
Shareholders' equity	355,058	370,075
Total capitalization	593,819	539,102

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

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 and to fund high-return development growth. Future expenditures are anticipated to be funded by the Company's adjusted funds flow from operations and draws under the credit facility.

Pipestone Energy manages its liquidity risk through its capital structure, cash flow forecasting and available credit. 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.

The Company has no externally imposed formal capital requirements. 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, 2020.

5. Corporate acquisition

On January 4, 2019 the Company completed an arrangement with Blackbird Energy Inc. ("Blackbird") providing for the combination of Blackbird and Predecessor Pipestone (the "Corporate Acquisition"), under the name Pipestone Energy Corp. ("Pipestone Energy"). The substance of the Corporate Acquisition is a go-public reverse takeover of Blackbird, a publicly traded company that was listed on the TSXV.

The reverse takeover involved a business combination of Blackbird and Predecessor Pipestone which formed a new amalgamated corporation, Pipestone Energy, which carries on Predecessor Pipestone's and Blackbird's combined businesses. Pursuant to the Corporate Acquisition, Blackbird acquired all issued and outstanding shares of the Company at an exchange ratio of 0.5996 Blackbird shares to one Predecessor Pipestone share. This resulted in Blackbird issuing 1,037,500,000 common shares to Predecessor Pipestone's shareholder. Blackbird shares were then converted to 0.1 common shares of Pipestone Energy upon amalgamation, which resulted in Predecessor Pipestone's shareholder holding 103,750,000 common shares (approximately 55 percent at the time) and Blackbird shareholders holding 85,858,516 common shares (approximately 45 percent at the time) of Pipestone Energy. 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". The Company has subsequently graduated to the TSX in December 2020 and its shares continue to trade under the same symbol.

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

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

The Corporate Acquisition was accounted for as a business combination under IFRS 3, *Business Combinations*, using the acquisition method. Predecessor Pipestone was considered the accounting acquirer of Blackbird and the assets acquired and liabilities assumed of Blackbird are recorded at their fair values as at January 4, 2019.

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)
Exploration and evaluation assets (note 6)	36,942
Liquids and natural gas interests (note 7)	197,755
ROU assets (note 8)	1,630
Lease liability (note 11)	(1,630)
Decommissioning provisions (note 12)	(908)
Deferred income taxes	(19,362)
Total assets acquired and liabilities assumed	**222,140**
Consideration	
Warrants [(1)]	15,307
Stock options [(1)]	772
Share consideration	206,061
Total purchase price	**222,140**

(1) Following closing of the Corporate Acquisition, each Blackbird warrant and stock option is exercisable for 0.1 of a common share of Pipestone Energy.

Share consideration was based on 858,585,668 common shares of Blackbird at January 4, 2019 (85,858,516 based on the 10:1 share consolidation) with a closing price of $0.24 per share. Warrant consideration was based on 175,188,092 Blackbird warrants at January 4, 2019 (17,518,809 based on the 10:1 share consolidation) with a closing price of $0.09 per warrant. On January 4, 2019 there were 35,477,945 Blackbird stock options outstanding (3,547,793 based on the 10:1 share consolidation) continued as part of the Corporate Acquisition.

These consolidated financial statements include the results of operations of Blackbird for the periods following closing of the Corporate Acquisition on January 4, 2019. For the year ended December 31, 2020, the acquisition contributed revenues of approximately $12.6 million, royalties of approximately $0.6 million and operating expenses of approximately $7.4 million (year ended December 31, 2019 – revenues, royalties and operating expenses of approximately $13.2 million, $0.7 million and $7.8 million, respectively). As a result of the proximity of the closing to the start of 2019, these figures are materially the same as though the acquisition had occurred on January 1, 2019.

During the year ended December 31, 2019 Pipestone Energy incurred $4.3 million of acquisition-related costs that were expensed in profit or loss as transaction costs.

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

6. Exploration and evaluation (E&E) assets

Years ended December 31,	2020	2019
	$	$
Balance, beginning of year	38,881	6,742
Additions	605	1,131
Expiries	(414)	(3,315)
Transfers to P&E (note 7)	(4,847)	(2,619)
Corporate acquisition (note 5)	-	36,942
Balance, end of year	**34,225**	38,881

At December 31, 2020, the Company assessed its transfers of E&E assets to property and equipment for impairment and determined there was none (December 31, 2019 – no impairment).

7. Property and equipment (P&E)

The Company's P&E is comprised of the following:

	Liquids and natural gas interests	Corporate	Total
Cost	$	$	$
Balance, January 1, 2019	183,826	123	183,949
Additions	160,445	618	161,063
Transfer to assets under construction	(13,967)	-	(13,967)
Corporate acquisition (note 5)	197,755	-	197,755
Property acquisition	214	-	214
Transfers from E&E (note 6)	2,619	-	2,619
Decommissioning provisions (note 12)	3,622	-	3,622
Balance, December 31, 2019	534,514	741	535,255
Additions	103,876	112	103,988
Transfers from E&E (note 6)	4,847	-	4,847
Decommissioning provisions (note 12)	2,442	-	2,442
Balance, December 31, 2020	**645,679**	**853**	**646,532**
Accumulated depletion and depreciation			
Balance, January 1, 2019	591	25	616
Depletion and depreciation	16,370	70	16,440
Balance, December 31, 2019	16,961	95	17,056
Depletion and depreciation	46,986	84	47,070
Balance, December 31, 2020	**63,947**	**179**	**64,126**
Carrying amount			
Balance, December 31, 2019	517,553	646	518,199
Balance, December 31, 2020	**581,732**	**674**	**582,406**

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

Pipestone Energy has a single P&E CGU.

Pipestone Energy capitalized direct general and administrative expenses of $2.6 million during the year ended December 31, 2020 (year ended December 31, 2019 – $3.4 million).

Future capital costs required to develop proved plus probable reserves in the amount of $935.4 million (December 31, 2019 – $1,114.0 million) are included in the depletion calculation for liquids and natural gas interests at December 31, 2020.

At December 31, 2020, Pipestone Energy identified an indicator of impairment as a result of the Company's carrying value of non-current assets continuing to be in excess of its market capitalization (December 31, 2019 – no impairment indicators). As such, an impairment test was performed on the Company's single CGU. Based on this impairment test, the Company concluded there was no impairment at December 31, 2020, as the estimated recoverable amount of the CGU exceeded the carrying value.

A 1.0 percent increase in the discount rate, from the baseline 15.0 percent discount rate applied for the test, or a 5.0 percent decrease in the forecasted average realized prices would not have triggered an impairment as at December 31, 2020. The forecast future prices used in the impairment evaluation reflect the benchmark prices set-forth in the table below.

As at December 31, 2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026 (1)**
Edmonton Condensate *(C$/bbl)*	59.24	63.19	67.34	69.77	71.18	72.61
Edmonton Light Crude Oil *(C$/bbl)*	55.76	59.89	63.48	65.76	67.13	68.53
WTI Crude Oil *(US$/bbl)*	47.17	50.17	53.17	54.97	56.07	57.19
AECO Spot *(C$/MMBtu)*	2.78	2.70	2.61	2.65	2.70	2.76
Henry Hub *(US$/MMBtu)*	2.83	2.87	2.90	2.96	3.02	3.08
Exchange rate (*US$/C$)*	0.768	0.765	0.763	0.763	0.763	0.763

(1) Prices escalate at 2.0 percent and exchange rates remain constant thereafter.

(2) Prices are from the 3 consultant average (McDaniel & Associates Ltd., GLJ Petroleum Consultants Ltd. and Sproul Associates Ltd.) forecast at January 1, 2021.

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

8. ROU assets

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 fee commitment with this third-party for the right to operate and use the asset, which became available for use in late 2019. The infrastructure remains under the third-party's ownership. During the fourth quarter of 2020, an additional compressor was added by the third-party to increase the capacity of the compressor station. The Company recognized an additional $8.0 million ROU asset related to the expansion fees upon this lease's commencement in the fourth quarter of 2020.

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

	Office leases	Field equipment leases	Compressor lease	Total
	$	$	$	$
Cost				
Balance, January 1, 2019	44	-	-	44
Additions	1,492	-	51,590	53,082
Corporate acquisition (note 5)	-	1,630	-	1,630
Balance, December 31, 2019	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**
Accumulated depreciation				
Balance, January 1, 2019	-	-	-	-
Depreciation	187	483	861	1,531
Balance, December 31, 2019	187	483	861	1,531
Depreciation	322	527	5,226	6,075
Balance, December 31, 2020	**509**	**1,010**	**6,087**	**7,606**
Carrying amount				
Balance, December 31, 2019	1,349	1,147	50,729	53,225
Balance, December 31, 2020	**1,070**	**620**	**53,474**	**55,164**

9. Accounts payable and accrued liabilities

As at December 31,	**2020**	2019
	$	$
Accruals	**30,675**	43,019
Trade	**28,411**	14,521
Other	**281**	1,531
Total accounts payable and accrued liabilities	**59,367**	59,071

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

10. Bank debt

a) Reserve-based loan

Years ended December 31,	2020	2019
	$	$
Balance, beginning of year	163,048	53,436
Increase (decrease) in borrowing	(28,996)	100,000
Debt issuance costs, cash	(1,271)	(2,839)
Amortization of debt issuance costs	685	6,178
Debt issuance costs, deferred financing	-	(2,441)
Interest added to principal	-	8,714
Balance, end of year	**133,466**	163,048
Current portion	-	-
Long-term portion	133,466	163,048

On July 20, 2020, Pipestone Energy reconfirmed and executed an amendment to its $225.0 million reserve-based loan (the "RBL") comprised of a $125.0 million senior facility (the "Senior Facility"), a $70.0 million additional facility (the "Additional Facility") and a $30.0 million operating facility (the "Operating Line"). As part of the amendment to the RBL, the Company's banking syndicate did not undertake a fall 2020 borrowing base review, and the next redetermination now scheduled for May 2021. In addition, previously imposed capital spending restrictions from the June 2020 re-determination were removed, and the Company has agreed to implement a hedging program with respect to expected condensate volumes through calendar 2021.

At December 31, 2020, the Company had $125.0 million drawn against the Senior Facility (December 31, 2019 - $150.0 million), $Nil drawn against the Additional Facility (December 31, 2019 – no Additional Facility) and $9.1 million drawn on the Operating Line (December 31, 2019 - $13.0 million), for an aggregate draw on the RBL of $134.1 million (December 31, 2019 - $163.0 million). At December 31, 2020, as a result of the establishment of the stand-alone EDC Letter of Credit Facility, the Company had no letters of credit issued against its Operating Line (December 31, 2019 - $14.1 million).

As at December 31,	2020
	$
RBL – portion drawn	134,052
Unamortized debt issuance costs	(586)
Balance, end of period	**133,466**

The borrowing base on the facility is scheduled to be redetermined in May 2021, subject to further amendments, and 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 0.50 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 2.00 in any material jurisdiction where Pipestone Energy operates.

Advances under the RBL are available by way of Canadian prime rate, and U.S. base rate loans with interest rates ranging between 2.00 percent and 6.00 percent, on the Senior Facility and Operating Line, and 4.00 percent and 8.00 percent, on the Additional Facility, over the bank's prime lending rate, as well as bankers' acceptances, which are subject to stamping fees and margins ranging from 3.00 percent to 7.00 percent, on the Senior Facility and Operating Line, and 5.00 percent to 9.00 percent, on the Additional Facility. The applicable interest rate varies, depending upon the Company's senior debt to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) ratio calculated at the Company's previous quarter end. Given the start-up nature of Pipestone Energy's operations in 2020, for purposes of calculating EBITDA, the credit agreement allowed for annualized EBITDA calculations for the first three quarters of 2020.

As at December 31, 2020, Pipestone Energy's applicable pricing included a 2.75 percent to 4.75 percent per annum margin on prime loans, a 3.75 percent to 5.75 percent per annum stamping fee and margin on bankers' acceptances along with a 0.45 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, 2020 borrowing costs averaged 4.9 percent (year ended December 31, 2019 – 8.3 percent).

The credit agreement contains customary borrowing base provisions and negative covenants including, but not limited to, restrictions on the Company's ability to incur indebtedness, grant liens or security interests on assets, sell or otherwise transfer assets, make distributions, make investments or provide financial assistance and the Company's ability to merge and consolidate with other companies or change the Company's line of business, in each case, subject to certain exceptions.

The credit agreement contains customary positive covenants including, but not limited to, delivery of financial and other information to the lenders, maintenance of existence, payment of taxes and other claims, maintenance of properties and insurance, access to books and records by the lenders, compliance with applicable laws and regulations, including environmental laws, and further assurances and provision of additional collateral and guarantees.

The credit agreement provides that, upon the occurrence of certain events of default, the Company's obligations thereunder may be accelerated and the lending commitments terminated. Such events of default include payment defaults to the lenders, covenant defaults, inaccuracies of representations and warranties, bankruptcy and insolvency proceedings, business suspension, material money judgments, cross defaults, change of control and other customary events of default. As is customary, the facility contains material adverse change clauses which would enable the lenders to demand immediate repayment of amounts outstanding if determined to represent an event of default.

The indebtedness under the credit agreement is secured by floating charges and a security interest against all of the Company's current and future real and personal property. The Company does not currently have any material subsidiaries and, as such, no guarantees have been provided under the credit agreement.

The revolving period of the RBL currently ends on May 31, 2021 with an additional one-year term out period thereafter if the revolving period is not extended. An extension of the revolving period is subject to majority lender consent.

b) Letter of credit facility

On July 16, 2020, Pipestone Energy closed a $15.0 million unsecured letter of credit facility (the "EDC Letter of Credit Facility") under Export Development Canada's performance security guarantee program. During the third quarter of 2020 the Company transferred $14.3 million of letters of credit outstanding from its Operating Line to the EDC Letter of Credit Facility, all of which remain in place at December 31, 2020 with no additional letters of credit issued. 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.

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

11. Lease liabilities

Years ended December 31,	**2020**	2019
	$	$
Balance, beginning of year	**53,917**	44
Additions	**8,014**	53,082
Interest expense (note 17)	**6,314**	1,239
Lease payments	**(10,020)**	(2,078)
Corporate acquisition (note 5)	**-**	1,630
Balance, end of year	**58,225**	53,917
Current portion	**4,665**	3,617
Long-term portion	**53,560**	50,300

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 and compressors added in the years disclosed was 8.0 percent, 8.0 percent and 12.0 percent, respectively.

The following table details the undiscounted cash flows and contractual maturities of Pipestone Energy's lease liabilities, as at December 31, 2020:

	$
2021	11,362
2022	10,870
2023	10,752
2024	10,752
2025	10,376
Thereafter	39,644
Total undiscounted future lease payments	93,756
Amounts representing lease interest expense over the term of the lease	(35,531)
Present value of net lease payments	58,225

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.

12. 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 $8.7 million at December 31, 2020 (December 31, 2019 – $7.5 million). This was inflated using a weighted-average rate of 1.5 percent (December 31, 2019 – 1.4 percent) to arrive at undiscounted future cash flows of approximately $12.6 million (December 31, 2019 – $10.3 million) and then discounted using a weighted-average risk-free rate of 1.2 percent at December 31, 2020 (December 31, 2019 – 1.8 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 (1.2 percent) and the real rate of interest (negative 0.3 percent) at December 31, 2020, and was treated as a change in estimates from the prior year. 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 34 years, with the majority of the costs expected to be incurred between 2045 and 2055.

The following reconciles the decommissioning provisions:

Years ended December 31,	**2020**	2019
	$	$
Balance, beginning of year	**6,722**	2,085
Additions	**1,083**	2,309
Accretion	**93**	110
Changes in estimates	**521**	(1,086)
Change in discount rates	**838**	481
Costs incurred	**(18)**	(3)
Corporate acquisition (note 5)	**-**	908
Change in discount rate, corporate acquisition (1)	**-**	1,918
Balance, end of year	**9,239**	6,722

(1) Revaluation of the liabilities acquired in the Corporate Acquisition (note 5) using the risk-free discount rate. At the date of acquisition, acquired decommissioning provisions are fair-valued using a market discount rate.

13. Convertible preferred shares

	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**

On September 15, 2020, Pipestone Energy issued 70,000 convertible preferred shares (“CP Shares”) to existing 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, 2020, the CP Shares had a Liquidation Preference of $71.3 million. If converted by the holders of the CP Shares at $0.85, this would result in the issuance of 83,917,840 common shares. If the CP Shares were to be settled at 95% of Pipestone Energy's previous 20-day volume weighted average common share price from December 31, 2020, which was $0.67 per share, , this would have resulted in the issuance of 111,453,381 common shares.

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 at a future date. The CP Share obligation will be settled and reclassified into equity of the Company on its statement of financial position upon any of the optional or mandatory conversion features being triggered.

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 equals 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.

14. Share capital

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

b) Issued

	Shares	Amount
	(000s)	**$**
Balance, January 1, 2019 [(1)]	75,568	126,025
Issuance of common shares [(1)]	28,182	47,000
Issued on Corporate Acquisition (note 5) [(1)]	85,859	206,061
Issued on exercise of stock options (note 15(a))	19	168
Issued on employee share purchase plan	155	215
Balance, December 31, 2019	189,783	379,469
Issued on conversion of restricted share units	302	427
Issued on exercise of stock options	16	10
Issued on employee share purchase plan	698	461
Balance, December 31, 2020	**190,799**	**380,367**

(1) The number of common shares has been adjusted retrospectively to reflect a 10:1 share consolidation, as well as the 0.5996 exchange ratio, as part of the Corporate Acquisition (note 5).

c) Loss per share

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

Years ended December 31,	**2020**	2019
Numerator		
Loss attributable to common shares ($)	**(17,277)**	(13,985)
Denominator		
Weighted-average number of shares outstanding for basic and diluted per-share calculation (000s) [(1)]	**190,288**	188,401
Basic and diluted loss per share attributable to common shares ($/share)	**(0.09)**	(0.07)

(1) The number of common shares has been adjusted retrospectively in the prior period to reflect the 10:1 share consolidation, as well as the 0.5996 exchange ratio, as part of the Corporate Acquisition (note 5).

The Company has issued 70,000 preferred shares which are convertible, at the holder's option, to 83,917,840 common shares of the Company at a price of $0.85 per share as of December 31, 2020 (note 13). The preferred shares, along with all other potentially dilutive instruments, were considered anti-dilutive in 2020 as the Company is in a loss position (year ended December 31, 2019 – all dilutive instruments excluded from the diluted weighted-average share calculation as they were anti-dilutive).

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

d) Warrants

At December 31, 2020, there are 17,518,809 warrants outstanding (December 31, 2019 - 17,518,809) that were continued from the Corporate Acquisition (note 5). Each warrant is exercisable for 1 common share at a price of $3.00 (exercisable for 0.1 common share at a price of $0.30 prior to the 10:1 share consolidation) and expires on May 19, 2021 if not previously exercised.

15. 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, 2020, Pipestone Energy recognized $2.0 million of share-based compensation expense (year ended December 31, 2019 - $0.8).

The following provides information with respect to outstanding equity compensation units at December 31, 2020:

	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)]	1,777,000	3.3	1.95	720,667	3.55
PSUs	1,918,970	1.9	-	-	-
RSUs	1,994,155	2.1	-	-	-
Units outstanding	**5,690,125**	**2.4**		**720,667**	

(1) Following the Corporate Acquisition (note 5), holders of Blackbird stock options are entitled to Pipestone Energy common shares, after adjusting the quantity of awards outstanding based on the 10:1 share consolidation. The fair value of the awards, all of which vested upon the closing of the transactions, was included in the consideration. Therefore, the exercise prices and quantities of awards shown are post-conversion of every 10 Blackbird options into 1 Pipestone Energy common share.

a) Stock options

Pipestone Energy is authorized to issue stock options exercisable for up to 5,688,690 common shares of the Company under its LTIP. 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, 2020, the Company granted 774,600 stock options (year ended December 31, 2019 – 530,000 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.

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

The initial fair value of the stock options granted have been determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

Years ended December 31,	**2020**	2019
Fair value of options granted ($)	**0.31**	0.57
Risk-free interest rate (%)	**0.82**	1.48
Expected life (years)	**3.6**	3.6
Expected forfeiture rate (%)	**5.0**	5.0
Expected volatility (%)	**67.5**	59.3
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,	**2020**		2019	
	Options	**Weighted-average exercise price**	Options	Weighted-average exercise price
	#	**$**	#	$
Outstanding, beginning of year	**1,499,643**	**2.99**	-	-
Granted	**774,600**	**0.67**	530,000	1.29
Exercised[2]	**(15,713)**	**0.44**	(250,000)	1.80
Forfeited / expired	**(481,530)**	**3.16**	(2,328,150)	3.79
Continued from Corporate Acquisition [1]	**-**	**-**	3,547,793	3.68
Outstanding, end of year	**1,777,000**	**1.95**	1,499,643	2.99

1) Post the 10:1 share consolidation the Company had 3,547,793 stock options continued as part of the Corporate Acquisition (note 5). At December 31, 2020, there are 560,000 stock options outstanding (December 31, 2019 – 969,643) that are related to the Corporate Acquisition which will continue in accordance with their existing terms.

2) In 2019 the Company temporarily permitted holders of stock options related to the Corporate Acquisition to exercise their in-the-money stock options on a non-cash basis. These transactions resulted in 18,571 Pipestone Energy common shares being issued which was the equivalent of the implied value of the 250,000 in-the-money stock options based on market prices at the time of exercise.

The following provides information about stock options outstanding at December 31, 2020:

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	600,000	4.3	0.46	-	-
1.00 – 2.99	617,000	3.8	1.37	160,667	1.30
3.00 – 4.99	360,000	2.0	3.30	360,000	3.30
5.00 – 5.80	200,000	0.9	5.80	200,000	5.80
	1,777,000	**3.3**	**1.95**	**720,667**	**3.55**

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

At December 31, 2020, the Company has 3,645,977 stock options remaining available for issuance from its reserve (December 31, 2019 – 4,189,047).

b) PSUs

Pipestone Energy is authorized to issue PSUs exchangeable for up to 5,688,690 common shares of the Company under its LTIP. At December 31, 2020, the Company has 1,850,750 PSUs remaining available for issuance from its reserve (December 31, 2019 – 4,390,750).

During the year ended December 31, 2020, the Company granted 1,270,000 PSUs (year ended December 31, 2019 – 648,970). 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). No cash settlement option exists on the PSUs currently issued and outstanding. 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, 2020, the weighted-average fair value of PSUs granted was $0.44 per unit (year ended December 31, 2019 – $1.41 per unit).

The following provides information with respect to PSUs transactions:

Years ended December 31,	**2020**	2019
	$	$
Balance, beginning of year	**648,970**	**-**
Granted	**1,270,000**	648,970
Balance, end of year	**1,918,970**	648,970

c) RSUs

Pipestone Energy is authorized to issue RSUs exchangeable for up to 5,688,690 common shares of the Company under its LTIP. At December 31, 2020, the Company has 3,392,886 RSUs remaining available for issuance from its original reserve (December 31, 2019 – 4,829,709).

During the year ended December 31, 2020, the Company granted 1,454,001 RSUs (year ended December 31, 2019 – 858,981) 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. No cash settlement option exists on the RSUs currently issued and outstanding.

During the year ended December 31, 2020, the weighted-average fair value of RSUs granted was $0.51 per unit (year ended December 31, 2019 – $1.44 per unit).

The following provides information with respect to RSU transactions:

Years ended December 31,	**2020**	2019
	$	$
Balance, beginning of year	**858,981**	**-**
Granted	**1,454,001**	858,981
Settled	**(301,649)**	-
Forfeited	**(17,178)**	-
Balance, end of year	**1,994,155**	858,981

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

d) Employee share purchase plan (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. Common shares purchased by the employee are available for immediate transacting while the employer matched portion is subject to a 12-month holding period.

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, 2020, the Company issued 698,138 common shares at an average price of $0.66 per share pursuant to the ESPP (year ended December 31, 2019 – 155,353 common shares at an average price of $1.39 per share).

During the year ended December 31, 2020, the Company collected $0.2 million of cash proceeds from employees for their share of ESPP contributions which was recorded directly to share capital (year ended December 31, 2019 - $0.1 million). The Company also contributed $0.2 million to the plan in the year ended December 31, 2020, which was recognized as share-based compensation expense (year ended December 31, 2019 – $0.1 million).

16. Sales of liquids and natural gas

Years ended December 31,	**2020**	2019
	$	$
Product type		
Condensate	**76,086**	44,552
Other natural gas liquids	**11,384**	1,802
Total natural gas liquids	**87,470**	46,354
Crude oil	**1,406**	1,257
Natural gas	**47,074**	14,910
Sales of liquids and natural gas	**135,950**	62,521

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, 2020. 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, 2020 is $16.0 million (December 31, 2019 - $18.0 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)

17. Financing expense

Years ended December 31,	2020	2019
	$	$
Lease liabilities interest expense (note 11)	6,314	1,239
Interest on bank debt, including interest added to principal (note 10)	7,029	9,432
Letter of credit fees	401	1,639
Bank charges	640	62
Foreign exchange loss on U.S. denominated debt	1,609	-
Realized gain on cross-currency swaps	(1,609)	-
Cash financing expense	14,384	12,372
Amortization of bank debt issuance costs	685	6,178
Preferred share dividends paid in-kind (note 13)	1,330	-
Accretion of preferred share discount (note 13)	86	-
Amortization of preferred share issuance costs (note 13)	52	-
Accretion on decommissioning provisions (note 12)	93	110
Non-cash financing expense	2,246	6,288
Total financing expense	16,630	18,660

18. Income tax

a) Deferred income tax 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,	2020	2019
	$	$
Loss before income taxes	(22,530)	(25,113)
Canadian federal-provincial statutory tax rate	24.0%	26.5%
Expected income tax recovery	(5,407)	(6,655)
Corporate income tax rate change	(239)	(1,552)
Recognition of previously unrecognized deferred tax asset	(94)	(3,229)
Share-based compensation	485	200
Other	2	108
Actual deferred income tax recovery	(5,253)	(11,128)

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

(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,	2020	2019
	$	$
Deferred tax assets		
Non-capital losses	**60,615**	54,280
Debt and share issuance costs	**1,206**	896
Risk management contracts	**1,732**	536
Decommissioning provisions	**2,125**	1,546
Lease liabilities	**13,397**	12,401
Deferred tax liabilities		
P&E, E&E and ROU assets	**(82,056)**	(77,893)
Net deferred tax liability	**(2,981)**	(8,234)

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 asset or 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 asset (liability)	(8,234)	5,253	**(2,981)**

Movement in the deferred tax asset or liability during the year ended December 31, 2019:

	Balance, January 1, 2019	Corporate acquisition	Recognized in loss	**Balance, December 31, 2019**
	$	$	$	**$**
P&E, E&E and ROU assets	(16,730)	(33,622)	(27,541)	**(77,893)**
Deferred financing	(660)	-	660	**-**
Risk management contracts	744	-	(208)	**536**
Decommissioning provisions	563	245	738	**1,546**
Lease liabilities	-	-	12,401	**12,401**
Non-capital losses	19,210	13,034	22,036	**54,280**
Unrecognized deferred tax asset	(3,229)	-	3,229	**-**
Debt and share issuance costs	102	981	(187)	**896**
Deferred tax asset (liability)	-	(19,362)	11,128	**(8,234)**

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

c) Tax pools

Estimated tax pools are as follows:

As at December 31,	**2020**	2019
	$	$
Canadian oil and gas property expense	**28,625**	31,667
Canadian development expense	**140,040**	118,410
Canadian exploration expense	**49,016**	46,165
Non-capital losses	**263,547**	235,957
Undepreciated capital cost (UCC) pools	**97,353**	75,398
Debt and share issuance costs	**5,244**	3,897
	583,825	511,494

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.

19. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

Years ended December 31,	**2020**	2019
	$	$
Cash flows relating to:		
Accounts receivable	**5,365**	(19,766)
Prepaid expenses and deposits	**(3,124)**	(1,333)
Accounts payable and accrued liabilities	**296**	15,107
Non-cash working capital acquired (note 5)	**-**	(12,582)
Changes in non-cash working capital	**2,537**	(18,574)
Changes in non-cash working capital relating to:		
Operating activities	**1,158**	7,777
Investing activities	**1,379**	(26,351)
	2,537	(18,574)

During the year ended December 31, 2020, the Company paid $nil in income taxes (December 31, 2019 - $nil). See note 17 for details of interest paid during the years ended December 31, 2020 and 2019.

20. 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,	**2020**	2019
	$	$
Salaries, fees and short-term benefits	**2,928**	2,970
Share-based compensation [(1)]	**1,341**	597

(1) Represents the amortization of share-based compensation expense as recorded in the financial statements.

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

During the year ended December 31, 2020, Pipestone Energy incurred $nil of general and administrative expenses from CNOR LP for management and related services as the Services Agreement between Pipestone Energy and CNOR LP expired on December 31, 2019 (year ended December 31, 2019 - $3.6 million). At December 31, 2020, $1.7 million (December 31, 2019 –$3.0 million) was included in accrued liabilities. All related-party transactions are recorded at the exchange amount.

21. Commitments and contingencies

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, 2020:

	2021	2022	2023	2024	2025	Thereafter
	$	$	$	$	$	$
Gathering commitments	14,447	18,132	18,228	18,330	18,424	90,335
Processing commitments	25,976	33,512	39,381	39,629	39,669	181,354
Transportation commitments	18,368	20,167	18,363	18,425	18,386	100,904
Total payments	**58,791**	**71,811**	**75,972**	**76,384**	**76,479**	**372,593**

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 11.

Legal

Lawsuits may be filed against the Company from time to time for incidents which arise in the ordinary course of business. In the opinion of management, the outcome of any of the lawsuits, currently pending, are not determinable and in total not material to the Company's operations. Should any loss result from the resolution of these claims, such loss will be charged to earnings in the year of resolution.

Insurance claim

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 which resulted in lost profits. As this insurance claim represents a contingent asset, the Company has not recognized any financial impact during the current year and will recognize any proceeds and income in a future period upon actual settlement. The Company expects to settle this claim in early 2021 and recover approximately $1.8 million in lost profits.