Southern ENERGY

Consolidated Financial Statements of

SOUTHERN ENERGY CORP.

For the years ended December 31, 2022 and 2021

(US Dollars)

Management's Report

Management's Responsibility for the Financial Statements

The accompanying consolidated financial statements of Southern Energy Corp. are the responsibility of management and have been approved by the Board of Directors of Southern Energy Corp. The consolidated financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto. In Management's opinion, the consolidated financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, have been prepared within acceptable limits of materiality, and have utilized supportable, reasonable estimates.

Management ensures the integrity of the consolidated financial statements by maintaining high-quality systems of internal control. We also ensure our organizational structure provides appropriate delegation of authority and division of responsibilities.

The Board of Directors approves the consolidated financial statements. The Board carries out this responsibility primarily through the Audit Committee which is composed entirely of independent directors. The Audit Committee meets periodically with Management and the external auditors to discuss reporting and control issues. The Audit Committee also considers the independence of the external auditors and reviews their fees.

The consolidated financial statements have been audited by Deloitte LLP, Chartered Professional Accountants, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders.

(signed) "*Ian Atkinson*"

Ian Atkinson
President & Chief Executive Officer
April 18, 2023

(signed) "*Calvin Yau*"

Calvin Yau
Chief Financial Officer

Deloitte.

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Independent Auditor's Report

To the Shareholders and the Board of Directors of Southern Energy Corp.

Opinion

We have audited the consolidated financial statements of Southern Energy Corp. (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2022, and 2021, and the consolidated statements of earnings and comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2022, and 2021, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2022. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Property, Plant and Equipment – Oil and Natural Gas Assets — Refer to Notes 3 and 4 to the financial statements.

Key Audit Matter Description

The Company's property, plant and equipment includes oil and natural gas assets. Oil and natural gas assets are depleted using the unit-of-production method ("depletion") based on total estimated proved and probable oil and natural gas reserves. The Company engages an independent reserve evaluator to estimate oil and natural gas reserves using estimates, assumptions and engineering data. The development of the Company's proved plus probable oil and natural gas reserves and the related future net cash flows used to evaluate the depletion requires management to make significant estimates and assumptions related to future oil and natural gas prices, reserves, and future operating and development costs.

Given the significant judgments made by management related to future oil and natural gas prices, reserves and future operating and development costs, these estimates and assumptions are subject to a high degree of estimation uncertainty. Auditing these estimates and assumptions required auditor judgment in applying audit procedures and in evaluating the results of those procedures. This resulted in an increased extent of audit effort including the involvement of fair value specialists.

How the Key Audit Matter Was Addressed in the Audit

Our audit procedures related to future oil and natural gas prices, reserves and future operating and development costs used to measure oil and natural gas assets included the following, among others:

- With the assistance of fair value specialists, evaluated future oil and natural gas prices by independently developing a reasonable range of forecasts based on reputable third-party forecasts and market data and comparing those to the future oil and natural gas prices selected by management.

- Evaluated the reasonableness of reserves by:
  - Examining reports provided by the external expert and assessing their scope of work and findings.
  - Assessing the competence, capability, and objectivity of the Company's independent reserve evaluator by evaluating their relevant professional qualifications and experience.
  - Testing the source financial information underlying the reserves and comparing the reserve volumes to historical production volumes.

- Evaluated the reasonableness of future operating and development costs by testing the source financial information underlying the estimate, comparing future operating and development costs to historical results, and evaluating whether they are consistent with evidence obtained in other areas of the audit.

Other Information

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

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

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

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

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group 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 Mr. Kyle Hawkins.

/s/ Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
April 18, 2023

($000s of US Dollars)	December 31, 2022	December 31, 2021
Assets		
Current assets		
Cash and cash equivalents	$ 28,350	$ 9,622
Accounts receivable and other (Note 12)	3,739	2,532
Prepaid expenses and deposits (Note 16)	5,532	422
Derivative assets (Note 12)	17	46
	37,638	12,622
Property, plant and equipment (Note 4)	59,800	33,242
Right-of-use assets (Note 5)	214	348
Total assets	$ 97,652	$ 46,212
Liabilities and Equity		
Current liabilities		
Accounts payable and accrued liabilities	11,147	3,367
Royalties payable (Note 13)	5,073	4,480
Current portion of lease liabilities (Note 5)	107	128
Current portion of long-term debt (Note 7)	1,106	1,183
Derivative liabilities (Note 12)	-	632
	17,433	9,790
Long-term liabilities		
Convertible debentures (Note 8)	3,041	6,185
Long-term debt (Note 7)	3,071	2,429
Lease liabilities (Note 5)	126	233
Decommissioning provisions (Note 6)	6,579	3,762
Total liabilities	30,250	22,399
Shareholders' equity (Note 9)		
Share capital	75,271	41,018
Equity component of convertible debenture	245	497
Warrants (Note 9)	2,154	2,723
Contributed surplus	5,117	4,144
Deficit	(14,595)	(23,894)
Accumulated other comprehensive income	(790)	(675)
	67,402	23,813
Total liabilities and shareholders' equity	$ 97,652	$ 46,212

Commitments (Note 19)

(See accompanying Notes to the Consolidated Financial Statements)

Approved by Board of Directors

(signed) "*Michael G. Kohut*"
Director

(signed) "*Bruce Beynon*"
Chairman

($000s of US Dollars, except for per share amounts)	Year ended December 31, 2022	Year ended December 31, 2021
Revenues		
Petroleum and natural gas revenue (Note 14)	$ 45,217	$ 19,942
Royalties	(9,763)	(4,064)
	35,454	15,878
Expenses		
Production and operating	6,446	4,990
Transportation	139	183
Depletion, depreciation and amortization (Note 4)	6,606	4,010
Impairment recovery (Note 4)	-	(7,808)
Loss on derivatives (Note 12)	6,635	2,949
Gain on dispositions (Note 4)	(398)	(793)
Financing, net (Note 15)	1,562	1,875
Gain on debt retirement (Note 7)	-	(4,543)
General and administrative	4,098	3,049
Share-based compensation	1,244	200
Transaction costs	265	2,154
Foreign exchange gain	(442)	(51)
	26,155	6,215
Total net earnings before income tax	9,299	9,663
Income tax recovery	-	(430)
Total net earnings for the year	9,299	10,093
Currency translation adjustment	(115)	(93)
Comprehensive income for the year	$ 9,184	$ 10,000
Net earnings per common share (Note 10)		
Basic	$ 0.09	$ 0.24
Diluted	$ 0.08	$ 0.19

(See accompanying Notes to the Consolidated Financial Statements)

($000s of US Dollars, except share amounts)	Common Shares	Shareholders' Capital	Equity Component of Convertible Debentures	Warrants	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, December 31, 2020	27,596,303	$ 29,271	$ 497	$ 1,100	$ 3,944	$(33,987)	$ (582)	$ 243
Shares issued, net	50,525,555	11,747	-	(14)	-	-	-	11,733
Warrants issued (Note 9)	-	-	-	1,637	-	-	-	1,637
Share-based compensation	-	-	-	-	200	-	-	200
Net earnings	-	-	-	-	-	10,093	-	10,093
Other comprehensive income	-	-	-	-	-	-	(93)	(93)
Balance, December 31, 2021	78,121,858	$ 41,018	$ 497	$ 2,723	$ 4,144	$(23,894)	$ (675)	$ 23,813
Shares issued, net (Note 9)	59,935,052	$ 34,253	$ (252)	$ (569)	$ -	$ -	$ -	$ 33,432
Share-based compensation	-	-	-	-	973	-	-	973
Net earnings	-	-	-	-	-	9,299	-	9,299
Other comprehensive income	-	-	-	-	-	-	(115)	(115)
Balance, December 31, 2022	138,056,910	$ 75,271	$ 245	$ 2,154	$ 5,117	$(14,595)	$ (790)	$ 67,402

(See accompanying Notes to the Consolidated Financial Statements)

($000s of US Dollars)	Year ended December 31, 2022	Year ended December 31, 2021
Operating activities		
Total net earnings for the year	$ 9,299	$ 10,093
Changes in non-cash items:		
Depletion, depreciation and amortization (Note 4)	6,436	4,010
Impairment recovery (Note 4)	-	(7,808)
Gain on dispositions (Note 4)	(398)	(793)
Financing expense, net	1,562	1,875
Gain on debt retirement	-	(4,543)
Unrealized (gain) loss on derivatives (Note 12)	(603)	230
Unrealized (gain) loss on foreign exchange	(384)	26
Share-based compensation	1,244	200
Deferred income tax recovery (Note 11)	-	(430)
Decommissioning provisions liabilities settled (Note 6)	(77)	(31)
Changes in non-cash working capital (Note 16)	1,524	78
Net cash provided by operating activities	18,603	2,907
Investing activities		
Capital expenditures	(29,858)	(2,562)
Acquisitions	(576)	-
Proceeds from dispositions	759	790
Changes in non-cash working capital (Note 16)	591	941
Net cash used by investing activities	(29,084)	(831)
Financing activities		
Proceeds from share issuances, net	30,425	12,685
Paydown of long-term debt (Note 7)	(3,743)	(10,007)
Draw on credit facility (Note 7)	4,000	6,000
Payment of interest, net	(1,108)	(843)
Finance lease payments	(141)	(227)
Transaction costs on debt refinance (Note 7)	(26)	(720)
Changes in non-cash working capital (Note 16)	(139)	(303)
Net cash provided by financing activities	29,268	6,585
Net increase in cash and cash equivalents	18,787	8,661
Effect of foreign exchange rate changes	(59)	51
Cash and cash equivalents, beginning of year	9,622	910
Cash and cash equivalents, end of year	$ 28,350	$ 9,622

(See accompanying Notes to the Consolidated Financial Statements)

1. Reporting Entity and Nature of Operations

Southern Energy Corp. ("Southern" or the "Company") is an oil and natural gas exploration and production company. Southern has a primary focus on acquiring and developing conventional natural gas and light oil resources in the Southeast Gulf States of Mississippi, Louisiana, and East Texas.

Southern's head office is located in Calgary, Alberta, Canada. Southern trades on the TSX Venture Exchange ("TSXV") under the trading symbol "SOU" and on the AIM market of the London Stock Exchange ("AIM") under the trading symbol "SOUC". The financial statements were authorized for issue by the Board of Directors on April 18, 2023.

2. Basis of Presentation

The consolidated financial statements of Southern include the accounts of all domestic and foreign subsidiaries. Wholly-owned subsidiaries included in the Company's accounts include Southern Energy Corp., Southern Energy Corp (Delaware), Southern Energy Operating, LLC, Southern Energy CMS, LLC, Southern Energy LA, LLC and Southern Energy BWB, LLC. Southern accounts for joint operations by recognizing the Company's share of assets, liabilities, income and expenses. All intercompany balances and transactions have been eliminated.

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These consolidated financial statements are presented in United States dollars ("US dollars"). All financial information presented has been rounded to the nearest thousand unless otherwise indicated.

3. Significant Accounting Policies

a) Use of Estimates

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Key areas where management has made judgements, estimates, and assumptions include:

- Decommissioning provision: The calculation of decommissioning provisions depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures, including the impact of inflation and the timing of these expenditures.
- Determination of Cash Generating Units ("CGUs"): The Company's petroleum and natural gas assets are grouped into CGUs based on the ability of these assets to generate separately identifiable independent cash inflows. The classification of assets into CGUs requires judgement and interpretation. Management considers factors such as integration among assets, shared infrastructure, common sales points, geography and how management makes decision about the Company's operations.

- Assessment of impairments or recovery of previous impairments: Management applies judgment in assessing the existence of indicators of impairment or impairment reversal based on various internal and external factors. The calculation of the recoverable amount of a CGU is based on market factors (including estimates of future commodity prices) and estimates of reserves and resources. Reserve and resource estimates are based on: engineering data, estimated future commodity prices, expected future rates of production, and assumptions regarding the timing and amount of future expenditures. Changes in these judgments, estimates and assumptions can directly impact the calculated recoverable amount of a CGU and the recorded impairment loss or recovery.
- Measurement of right-of-use ("ROU") assets and lease liabilities are subject to management's judgment of the applicable incremental borrowing rate when the rate implicit in a lease is not readily determinable. Applicable incremental borrowing rates are based on management's judgements of the economic environment, term, the underlying risk inherent to the asset (which may vary due to changes in the market conditions) and the expected lease term.
- Stock based compensation: From time to time the Company issues stock options and share purchase warrants. Estimating the value attributable to these share purchase instruments requires management to make assumptions to inputs for a Black-Scholes pricing model, which include average expected volatility and estimated forfeiture rates.

b) Cash and Cash Equivalents

Southern considers all highly liquid investments to be cash equivalents if they have original maturities of three months or less at the date of purchase.

c) Business Combinations

Southern uses the purchase method of accounting for acquisitions that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued, and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of an acquisition over the fair value of the identifiable assets acquired net of liabilities assumed is recorded as goodwill. If the cost of an acquisition is less than the fair value of the net assets acquired, the difference is recognized in the statement of operations and comprehensive income.

As part of the assessment to determine if the acquisition constitutes a business, Southern may elect to apply the concentration test on a transaction by transaction basis. The test is met if substantially all of the fair value related to the gross assets acquired is concentered in a single identifiable asset (or group of similar assets) resulting in the acquisition not being deemed a business and recorded as an asset acquisition.

d) Property, Plant and Equipment

Exploration and evaluation assets - Pre-licence expenditures incurred before the Company has obtained legal rights to explore an area are expensed as exploration and evaluation expenditures.

Exploration and evaluation assets may include the costs of acquiring licences, exploratory drilling, geological and geophysical activities, acquisition of mineral and surface rights and technical studies. Exploration and evaluation costs are capitalized as exploration and evaluation assets when the technical feasibility and commercial viability of extracting petroleum and natural gas reserves have yet to be determined. Exploration and evaluation assets are measured at cost and are not depleted or depreciated. Exploration and evaluation assets, net of any impairment loss, are transferred to property and equipment when proved and/or probable reserves are determined to exist. Southern does not currently have any exploration and evaluation assets.

Property and equipment of the Company consists of development and production assets and office furniture and equipment.

All costs directly associated with the development and production of petroleum and natural gas interests are capitalized by components (i.e. by well, area or combination thereof) within cash generating units and are measured at cost less accumulated depletion and depreciation and impairment losses. These costs include expenditures for areas where technical feasibility and commercial viability have been determined. These costs include property acquisitions with proved and/or probable reserves, development drilling, completion, gathering and infrastructure, decommissioning liabilities and transfers from exploration and evaluation assets.

Gains or losses on disposal of assets are determined by comparing the proceeds from disposal with the carrying amount of the assets sold and are recognized separately in the statement of earnings.

Depletion, depreciation and amortization – Capital assets are grouped into depletion units, which are groups of assets within a specific production area that have similar economic lives. Depletion units represent the lowest level of disaggregation for which costs are accumulated for the purposes of calculating depletion and depreciation.

Petroleum and natural gas interests are depleted using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development costs. Production and reserves of natural gas are converted to equivalent barrels of crude petroleum on the basis of six thousand cubic feet of gas to one barrel of petroleum. Changes to estimates used in prior periods, such as proved and probable reserves, that affect the unit-of-production calculations do not give rise to prior period adjustments and are dealt with on a prospective basis.

Well and production equipment and facilities are depleted using the unit-of-production method along with the related reserves when the assets have a life similar to the reserves of the related wells and little to no residual value. Where costs of facilities and equipment, including major components, are significant in relation to the total costs of the assets and have differing useful lives, they are depreciated separately on a straight-line basis over the estimated useful life of the facilities and equipment and other related components.

Office furniture and equipment, referred to as corporate and other, are depreciated on a declining balance basis at a rate of 30% approximating their estimated useful lives.

e) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets are reviewed for indicators of impairment at each reporting date. If indicators of impairment exist, the recoverable amount of the asset is estimated.

For the purposes of assessing impairment, property and equipment are grouped into CGUs, defined as the lowest levels for which there are separately identifiable independent cash inflows. Any goodwill is allocated to the CGUs that are expected to benefit from the synergies of the business combination creating the goodwill.

The recoverable amount of a CGU is the greater of its fair value less costs of disposal and its value in use. Fair value is determined to be the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties. Fair value less estimated costs of disposal may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs and including future development costs. These cash flows are discounted at an appropriate discount rate which would be applied by a market participant. Value in use is determined by estimating the present value of the future net cash flows to be derived from the continued use of the cash-generating unit in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its recoverable amount. An impairment loss recognized in respect of a CGU is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis. Impairment losses are recognized in net profit or loss in the period determined.

Exploration and evaluation assets are assessed for impairment when they are reclassified to property and equipment and if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. Exploration and evaluation assets are tested for impairment separately. If, at any time, it is determined that the Company has no future exploration plans and commercial production cannot be achieved in relation to an area, the associated costs are written down to the estimated recoverable amount and the amount of the write-down is expensed.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, as if no impairment loss had been recognized. A goodwill impairment loss is not reversed.

f) Lease obligations and right-of-use assets

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. At the lease commencement date, a lease obligation is recognized at the present value of future lease payments, typically using the applicable incremental borrowing rate. A corresponding ROU asset is recognized at the amount of the lease obligation. Short-term leases and leases of low-value assets are not recognized on the balance sheets and lease payments are instead recognized in the financial statements as incurred.

Payments are applied against the lease obligation and interest expense is recognized on the lease obligations using the effective interest rate method. Depreciation is recognized on the ROU asset over the lease term.

g) Decommissioning provisions

Decommissioning provisions are recognized for decommissioning and restoration obligations associated with the Company's exploration and evaluation assets and property and equipment. The best estimate of the expenditure required to settle the present obligation at the reporting date is recorded on a discounted basis using a pre-tax risk-free interest rate at each reporting date. The future cash flow estimates are adjusted to reflect the risks specific to the liability. The value of the obligation is added to the carrying amount of the associated asset and is depleted or amortized over the useful life of the asset. The provision is accreted over time through charges to finance expense. Changes in the future cash flow estimates resulting from revisions to the estimated timing, amount of undiscounted cash flows or the discount rate are recognized as changes in the decommissioning provision and related asset. Actual decommissioning expenditures, up to the recorded liability recorded at the time, are charged against the provision as the costs are incurred.

h) Fair Value Measurement

On initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods depends on the classification of the financial instrument as described below:

- Fair value through profit or loss - Financial instruments under this classification include cash and cash equivalents and derivative assets and liabilities.
- Amortized cost - Financial instruments under this classification include accounts receivable, accounts payable and accrued liabilities, and long-term debt.

Southern utilizes oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future oil and natural gas production. Typical derivative contracts could consist of options, in the form of price floors, collars or three-way collars and fixed-price swaps.

The Company uses various methods, including the income approach and market approach, to determine the fair values of our financial instruments that are measured at fair value on a recurring basis, which depend on a number of factors, including the availability of observable market data over the contractual term of the underlying instrument. For some of our instruments, the fair value is calculated based on directly observable market data or data available for similar instruments in similar markets. For other instruments, the fair value may be calculated based on these inputs as well as other assumptions related to estimates of future settlements of these instruments. Financial instruments are separated into three levels (levels 1, 2 and 3) based on our assessment of the availability of observable market data and the significance of non-observable data used to determine the fair value of our instruments. The assessment of an instrument can change over time based on the maturity or liquidity of the instrument, which could result in a change in the classification of the instruments between levels.

Each of these levels and our corresponding instruments classified by level are further described below:

- Level 1 Inputs— unadjusted quoted market prices in active markets for identical assets or liabilities.
- Level 2 Inputs—quotes which are derived principally from or corroborated by observable market data.
- Level 3 Inputs—unobservable inputs for the asset or liability, such as discounted cash flow models or valuations, based on various assumptions and future commodity prices.

i) Convertible Debentures

The Debentures are a non-derivative financial instrument that creates financial liability of the entity and grants an option to the holder of the instrument to convert it into common shares of the Company. The liability component of the Debentures is initially recorded at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially, net of deferred taxes, as the difference between gross proceeds and the fair value of the liability component. Transaction costs are allocated to the liability and equity components in proportion to the allocation of proceeds. Subsequent to initial recognition, the liability component of the Debentures is measured at amortized cost using the effective interest method and is accreted each period, such that the carrying value will equal the principal amount outstanding at maturity. The equity component is not re-measured. The carrying amounts of the liability and equity components of the Debentures are reclassified to shareholders' capital on conversion to common shares.

j) Revenue Recognition

Revenue associated with sale of crude oil, natural gas and natural gas liquids is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when or as Southern satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. The transfer of control of crude oil, natural gas, natural gas liquids usually coincides with title passing to the customer and the customer taking physical possession. Southern principally satisfies its performance obligations at a point in time and the amounts of revenue recognized relating to performance obligations satisfied over time are not significant.

The revenue is typically collected the month following production.

k) Foreign Currency Translation

The Company's consolidated financial statements are reported in US dollars, which is the Company's presentation currency. Transactions of Southern Energy Corp. are recorded in Canadian dollars, as this is the primary economic environment in which this company operates. Southern Energy Corp. has a Canadian dollar functional currency. In translating the financial results from Canadian dollars to US dollars, the Company uses the following method: assets and liabilities are translated at the exchange rate in effect as at the date of the consolidated statement of financial position; revenues and expenses are translated at the rate effective at the time of the transaction or the average rate for the period; and changes in shareholders' equity are translated at the rate effective at the time of the transaction. Unrealized gains and losses resulting from the translation to the US dollar presentation currency are included in other comprehensive income.

Transactions of Southern Energy Corp. that are denominated in a currency other than the Canadian dollar are translated to the Canadian dollar using the following method: monetary assets and liabilities are translated at the exchange rate in effect at the date of the consolidated statement of financial position; non-monetary assets and liabilities are translated at the exchange rate on the date such assets or liabilities are assumed; and revenues and expenses are translated at the average rate for the period. Realized gains and losses resulting therefrom are reflected in the statements of operations as foreign exchange gain or loss.

l) Government Grants

Government grants are recognized when the Company has reasonable assurance that it has complied with the relevant conditions of the grant and that it will be received. If a grant is received before it is certain whether compliance with all conditions will be achieved, the grant is recognized as a deferred liability until such conditions are fulfilled. When the conditions of a grant relate to income or expense, it is recognized in the Consolidated Statements of Earnings and Comprehensive Income in the period in which the expenditures are incurred or income is earned. When the conditions of a grant relate to an underlying asset, it is recognized as a reduction to the carrying amount of the related asset and amortized into income on a systematic basis over the expected useful life of the underlying asset through depletion and depreciation.

m) Income Taxes

Tax expense is comprised of current and deferred tax. Current tax expense is recognized in the statement of loss and comprehensive loss except to the extent that it relates to items recognized directly in equity or other comprehensive income (loss).

Current tax is the expected tax payable on the taxable income for the year and any adjustments to tax payable in respect of previous years.

Deferred tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities and the amounts used for taxation purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same taxation authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously

n) Commitments and Contingencies

The Company could be subject to audits for various taxes (income, sales and use, and severance) in the various states in which it operates, and from time to time receive assessments for potential taxes that it may owe. Currently, Southern has no material assessments for potential taxes, legal contingencies or other potential claims.

The Company could be subject to various possible contingencies that arise primarily from interpretation of federal and state laws and regulations affecting the oil and natural gas industry. Such contingencies include differing interpretations as to the prices at which oil and natural gas sales may be made, the prices at which royalty owners may be paid for production from their leases, environmental issues and other matters. Although Southern believes that it has complied with the various laws and regulations, administrative rulings and interpretations thereof, adjustments could be required as new interpretations and regulations are issued. In addition, production rates, marketing and environmental matters are subject to regulation by various federal and state agencies.

Provisions are recognized by the Company when it has a legal or constructive obligation as a result of past events, it is probable that an outflow of economic resources will be required to settle the obligation and a reliable estimate can be made of the amount of that obligation. Provisions are stated at the present value of the expenditure expected to settle the obligation. The obligation is not recorded and is disclosed as a contingent liability if it is not probable that an outflow will be required, if the amount cannot be estimated reliably or if the existence of the outflow can only be confirmed by the occurrence of a future event.

o) Share-based payments

Southern accounts for share-based transactions using fair value and recognize compensation expense over the vesting period. The fair value of each option or common share purchase warrant award is estimated using an option valuation model with various assumptions based on various estimates and market conditions of the instrument. The assumptions include expected volatility, expected term of option, risk-free interest rate and dividend yield.

p) Per Share Amounts

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as restricted and performance awards granted to employees and warrants.

Amounts in ($000s of US Dollars), except for per share amounts

4. Property, Plant and Equipment

The following table presents the reconciliation of the beginning and ending amounts of our PP&E balances including accumulated depletion, depreciation, amortization and impairment:

	Oil and Natural Gas Assets	Other	Total
Net book value as at December 31, 2020	$ 27,227	$ 13	$ 27,240
Additions	2,522	40	2,562
Dispositions, net	(293)	-	(293)
Change in decommissioning provision (Note 6)	(260)	-	(260)
Depletion, depreciation and amortization	(3,809)	(6)	(3,815)
Impairment reversal	7,808	-	7,808
Net book value as at December 31, 2021	**33,195**	**47**	**33,242**
Additions	29,719	193	29,912
Acquisitions, including decommissioning costs	1,015	-	1,015
Dispositions, net	(366)	-	(366)
Change in decommissioning provision (Note 6)	2,314	-	2,314
Depletion, depreciation and amortization	(6,272)	(48)	(6,320)
Foreign exchange	6	(3)	3
Net book value as at December 31, 2022	**$ 59,611**	**$ 189**	**$ 59,800**

Additions

For the year ended December 31, 2022, Southern incurred $29.7 million of capital additions related to the development of the Central Mississippi CGU (“CMS CGU”).

Asset Acquisition

On October 3, 2022, Southern closed an acquisition to acquire assets in its core area in the CMS CGU for $0.6 million. The acquisition resulted in an increase to property, plant and equipment of approximately $1.0 million and the assumption of $0.4 million in decommissioning liabilities.

Dispositions

On February 1, 2022, Southern disposed of all its properties in the Smackover CGU (“SO CGU”) for net proceeds of $0.8 million.

Depletion and depreciation

For the year ended December 31, 2022, the Company recorded depletion expense of $6.3 million (December 31, 2021 – $3.8 million). In the calculation of depletion expense at December 31, 2022, an estimated $164.5 million of future development costs associated with the proven plus probable reserves were included ($78.9 million for 2021).

Amounts in ($000s of US Dollars), except for per share amounts

Impairment

At the end of each reporting period, the Company performs an assessment to determine whether there are any indications of impairment for the CGUs that comprise oil and natural gas properties. At December 31, 2022, Southern did not identify any indicators of impairment for any of its CGUs.

September 2021

At September 30, 2021, Southern viewed the increase in the forward benchmark commodity prices as an indication of impairment reversal. Southern estimated the recoverable amount of all CGUs at September 30, 2021. Southern determined that the recoverable amounts of the CMS and SO CGUs exceeded their carrying values. A non-cash full impairment recovery of $7.8 million related to the CMS CGU and $44 thousand related to the SO CGU was recorded in the consolidated statement of earnings and comprehensive income.

The Company estimated the recoverable amounts as fair value less costs of disposal, using the net present value of the cash flows from proved developed producing oil and gas reserves of each CGU, and a 7% discount rate (equivalent to 10% pre-tax), based on reserves estimated by Southern's independent reserves evaluator at April 1, 2021, and updated by the Company's internal reserves evaluator to September 30, 2021 for production, production and operating costs, royalty costs, and price estimates.

The following table details the forward pricing used in estimating the recoverable amounts of Southern's CGUs at September 30, 2021:

Period Ending	West Texas Intermediate ($US/bbl)	Henry Hub ($US/MMBtu)
12-31-2021	73.38	5.30
12-31-2022	69.83	4.21
12-31-2023	66.43	3.43
12-31-2024	63.76	3.18
12-31-2025	65.05	3.24
12-31-2026	66.34	3.30
12-31-2027	67.67	3.38
12-31-2028	69.03	3.44
12-31-2029	70.41	3.51
12-31-2030	71.82	3.58

Thereafter, WTI and HH prices escalated 2% on January 1 of each year.

The fair value less costs of disposal values used to determine the recoverable amounts of Southern's CGUs at September 30, 2021, was classified as Level 3 fair value measurements as certain key assumptions are not based on observable market data, but rather, Management's best estimates. Refer to Note 3 "*Significant Accounting Policies*" for information on fair value hierarchy classifications.

Amounts in ($000s of US Dollars), except for per share amounts

5. Right-of-Use Assets and Lease Liabilities

Right-of-Use Assets

The following table presents the reconciliation of the beginning and ending amounts of our ROU balances including accumulated depreciation:

		Total
Carrying value as at December 31, 2020	**$**	**276**
Additions		440
Depreciation		(195)
Terminations		(154)
Effect of foreign exchange rates		(19)
Carrying value as at December 31, 2021		**348**
Depreciation		(116)
Effect of foreign exchange rates		(18)
Carrying value as at December 31, 2022	**$**	**214**

Lease Liabilities

Southern had the following lease obligations outstanding as at the dates indicated:

		Total
As at December 31, 2020	**$**	**299**
Additions		440
Terminations		(177)
Interest expense		35
Lease payments		(227)
Effect of foreign exchange rates		(9)
As at December 31, 2021		**361**
Interest expense		36
Lease payments		(141)
Effect of foreign exchange rates		(23)
As at December 31, 2022	**$**	**233**

At December 31, 2022, Southern had future commitments relating to lease liabilities as follows:

		Total
Less than 1 year	$	136
1 – 3 years		125
Total undiscounted future lease payments	$	261
Amounts representing interest		(28)
Present value of net lease payments	$	233
Less current portion of lease liabilities		(107)
Non-current portion of lease liabilities	**$**	**126**

On June 1, 2021, Southern entered into a new office space lease for a term of 3.5 years. As part of the execution of the new lease, the old office lease that was set to expire on November 29, 2021 was terminated. The new office lease liability is being discounted using the Company's incremental borrowing rate of 12.0%.

Amounts in ($000s of US Dollars), except for per share amounts

6. Decommissioning Provisions

The Company's decommissioning provisions result from its ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The total decommissioning provision is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The total estimated, inflated undiscounted risked cash flows required to settle the provision, is approximately $14.8 million at December 31, 2022 (December 31, 2021 – $4.3 million). The increase was due to revised cost estimates based on actual abandonments completed in 2022 and industry wide cost inflation. The decommissioning provision was inflated using a rate of 2.4% (December 31, 2021 – 2.3%) and discounted using a risk-free interest rate of 3.9% at December 31, 2022 (December 31, 2021 – 1.5%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 50 years into the future and will be funded from general corporate resources at the time of abandonment.

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of legal obligations associated with the retirement of property, plant and equipment:

	Year ended December 31,	
	2022	**2021**
Balance, beginning of year	$ 3,762	$ 4,272
Liabilities incurred	54	-
Liabilities acquired	439	-
Liabilities settled	(77)	(44)
Changes in estimates	2,314	(260)
Accretion expense	87	57
Property disposal	(5)	(259)
Effect of foreign exchange rate changes	5	(4)
Balance, end of year	**$ 6,579**	**$ 3,762**
Long term liability	**$ 6,579**	**$ 3,762**

7. Long-term Debt

Southern had the following long-term debt obligations outstanding as at the dates indicated:

	Year ended December 31,	
	2022	**2021**
Current portion of senior secured term loan	$ 1,340	$ 1,582
Long-term portion of senior secured term loan	3,460	2,961
Unamortized transaction costs	(623)	(931)
Total Long-Term Debt	**$ 4,177**	**$ 3,612**

Southern Energy Corporation (Delaware), one of the wholly-owned subsidiaries of Southern, held the existing senior secured term loan ("Credit Facility") at December 31, 2022. The Credit Facility is comprised of Tranche A of $5.5 million that was advanced at closing on April 30, 2021 and effective September 1, 2022, Tranche B of $29.5 million with an availability until September 30, 2023. Interest on the Credit Facility is 12% per annum on amounts outstanding and includes a 1% per annum standby fee on the unused portion of Tranche B, both paid monthly in arrears on the last day of the month. The Credit Facility is secured against the oil and gas properties of Southern and matures on August 31, 2025. The retirement of the previous senior secured credit facility on April 30, 2021 resulted in a gain on debt retirement of $4.5 million. As at December 31, 2022, Southern had $4.8 million drawn on the Credit Facility and $25.0 million available from Tranche B.

Amounts in ($000s of US Dollars), except for per share amounts

In Q2 2022, the Company entered into amending agreements to the Credit Facility:

- on April 8, 2022 to increase Tranche B to $4.5 million and extend the availability to June 30, 2022 from April 30, 2022; and
- on May 2, 2022 to increase flexibility in payment of interest of the convertible debentures.

Effective September 1, 2022, Southern entered into the fourth amendment to the Credit Facility (the "Fourth Amendment"). The Fourth Amendment includes an increase of $25.0 million to Tranche B of the Credit Facility, with a maximum draw of $10.0 million in any rolling sixty-day period, and an extension of the commitment period and maturity of the Credit Facility to September 30, 2023 and August 31, 2025 for Tranche A and Tranche B, respectively.

In addition, quarterly positive free cash flow ("FCF") (as described below) repayments that were 50% of the previous quarter's FCF are now replaced by a quarterly FCF grid whereby quarterly repayments are X% of the preceding quarter where X is equal to 50% if the ACR (as defined below) is < 3.0x or DSCR (as defined below) is < 1.4x; or X is equal to 0% if the ACR is > 5.0x and DSCR >1.7x; otherwise is 25%. A standby fee of 1.0% per annum on any undrawn Tranche B amounts.

The Credit Facility includes a monthly repayment of the principal amount outstanding computed as the sum of: (a) outstanding amount multiplied by 1/A, where A equals the number of whole or part months remaining to the maturity date plus 12 months; and (b) on the last day of the second month following each fiscal quarter, the amount determined by the FCF grid (as described above). FCF is calculated as Earnings Before Interest, Taxes, Depreciation, Amortization, and Impairment ("EBITDAX"), less the aggregate of the Credit Facility principal and interest payments.

Below are the financial covenant calculations for the Credit Facility for December 31, 2022 and December 31, 2021:

Financial covenant	Limit	As at Dec 31, 2022	As at Dec 31, 2021
Asset Coverage ratio	Minimum 2.00	9.77	6.55
Debt Service Coverage ratio	Minimum 1.25	3.87	1.73

The asset coverage ratio ("ACR") of at least 2:1 is calculated as the ratio of the net present value of proved developed producing oil and gas properties as determined by an independent qualified engineer, using a price deck based on the forward commodity prices, discounted at 12% to the principle amount outstanding under the Credit Facility.

The debt service coverage ratio ("DSCR") of greater than 1.25:1 is the ratio of EBITDAX to scheduled principal payments and interest expense.

As at December 31, 2022, Southern was in compliance with the above covenants.

8. Convertible Debentures

	Number of Convertible Debentures	Liability Component ($000s)	Equity Component ($000s)
Balance at December 31, 2020	8,389	$ 5,866	$ 497
Accretion of discount	-	298	-
Effect of foreign exchange rate changes	-	21	-
Balance at December 31, 2021	**8,389**	**6,185**	**497**
Conversion of debentures	(4,103)	(3,007)	(252)
Accretion of discount	-	117	-
Effect of foreign exchange rate changes	-	(254)	-
Balance at December 31, 2022	**4,286**	**$ 3,041**	**$ 245**

The convertible debentures (the "Debentures") were issued at a price of CAD$1,000 per Debenture that accrue interest at the rate of 8.00% per annum payable semi-annually in arrears on December 31 and June 30 of each year (each an "Interest Payment Date"). The Debentures have a maturity date of June 30, 2024 (the "Maturity Date").

At the Company's election, interest on the Debentures, on the date it is payable can be settled a) in cash; b) by delivering freely tradeable, treasury common shares ("Common Shares") of the Company to a trustee for sale, in which event holders of the Debentures will be entitled to receive a cash payment equal to the interest payable from the proceeds of the sale of such Shares; or c) any combination of a) and b) above. At the holder's option, the Debentures are convertible into Common Shares at any time prior to the close of business on the earlier of the business day immediately preceding (i) the Maturity Date, or (ii) if called for redemption, the date specified for redemption by the Company, at a conversion price of CAD$0.80 per Common Share, subject to adjustment in certain events. This represents a conversion rate of approximately 1,250 Common Shares for each CAD$1,000 principal amount of Debentures, subject to the operation of certain anti-dilution provisions contained in the indenture governing the Debentures. Holders who convert their Debentures will receive accrued and unpaid interest for the period from the date of the last Interest Payment Date prior to the date of conversion to the date of conversion.

The Debentures are direct, subordinated unsecured obligations of the Company, subordinated to any senior indebtedness of the Company, including the senior secured term loan, and ranking equally with one another and with all other existing and future subordinated unsecured indebtedness of the Company to the extent subordinated on the same terms.

Prior to the Maturity Date, the Debentures are redeemable by the Company, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to 102.5% of their principal amount plus accrued and unpaid interest, if any.

Amounts in ($000s of US Dollars), except for per share amounts

During the year ending December 31, 2022, 5.1 million Common Shares were issued to satisfy the convertible debenture rights of 4,103 convertible debentures at a price of CAD$0.80 per Common Share.

The fair value of the Debentures at December 31, 2022 was $3.2 million.

9. Shareholders' Equity

Share Capital

The authorized share capital of the Company consists of an unlimited number of voting common shares and an unlimited number of preferred shares.

The following table reflects the Company's outstanding Common Shares at December 31, 2022 and 2021:

	Number of Shares	Share Capital
Balance as at December 31, 2020	27,596,303	$ 29,271
April Issuance of common shares by private placement, net of issue costs	17,078,125	2,531
July issuance of common shares to settle convertible debenture interest	487,722	268
Issuance of common shares to satisfy unit warrant exercise	162,500	55
November issuance of common shares by 2021 offering, net of issue costs	31,788,002	8,678
December issuance of common shares to settle convertible debenture interest	1,009,206	215
Balance as at December 31, 2021	**78,121,858**	**$ 41,018**
July issuance of common shares by 2022 offering	46,371,927	30,715
Issuance of common shares to satisfy unit warrant exercise	7,184,375	2,232
Issuance of common shares to satisfy conversion of convertible debentures	5,128,750	3,259
Issuance of common shares to satisfy bonus warrant exercise	1,250,000	490
Share issuance costs	-	(2,443)
Balance as at December 31, 2022	**138,056,910**	**$ 75,271**

On April 30, 2021, Southern completed a non-brokered private placement of 17.1 million units of the Company (the "Units") at a price of CAD$0.32 per Unit, for aggregate gross proceeds of $4.4 million (the "Private Placement"). Each Unit is comprised of one Common Share and one Common Share purchase warrant (a "Unit Warrant"). The Unit Warrants are exercisable at CAD$0.32 with an expiry date of April 29, 2023.

On August 10, 2021, Southern was admitted to the AIM and the Company's Common Shares began trading on August 10, 2021. Southern incurred $2.0 million as part of the AIM listing process that is included in the consolidated statement of earnings and comprehensive income as transaction costs.

On November 24, 2021, Southern closed an equity financing for aggregate gross proceeds of $10.0 million through the issuance of a total of 31.8 million Common Shares (the "2021 Offering"), of which $5.3 million was raised pursuant to a private placement of 16.9 million Common Shares to UK investors at a price of 23.52 pence per Common Share and the remaining $4.7 million was raised pursuant to a short form prospectus offering of 14.9 million Common Shares at a price of CAD$0.40 per Common Share.

On July 7, 2022, Southern closed an equity financing raising aggregate gross proceeds of $31.0 million through the issuance of a total of 46,371,927 Common Shares (the “2022 Offering”), of which $17.5 million was raised pursuant to a bought deal prospectus offering of 26.1 million Common Shares at a price of CAD$0.87 per Common Share and the remaining $13.5 million was raised pursuant to an accelerated bookbuild of 20.3 million Common Shares at a price of 54.5 pence per Common Share.

Subsequent to December 31, 2022, 984,375 Common Shares were issued related to the exercise of Unit Warrants at a price of CAD$0.32 from the April 2021 non-brokered private placement for proceeds of CAD$0.3 million. There are 8,746,875 remaining Unit Warrants with an expiry date of April 30, 2023.

Warrants

As at December 31, 2022, 7,346,875 of the 17,078,125 Unit Warrants had been exercised at a price of CAD$0.32 for proceeds of CAD$2.4 million.

As at December 31, 2022, 1,250,000 purchase warrants (“Bonus Warrant”) issued with the closing of the Credit Facility in April 2021 were exercised at a price of CAD$0.40 for proceeds of CAD$0.5 million. There are 3,906,250 remaining Bonus Warrants with an expiry date on the earlier of: (a) a liquidity event resulting in the sale of Southern Energy Corporation (Delaware); or (b) April 30, 2024.

As at December 31, 2022, 2,413,333 performance-based Common Share purchase warrants (“Performance Warrants”) had vested as the 20-day volume weighted average trading price (“Market Price”) of the Common Shares had exceeded CAD$1.20. The Performance Warrants have an exercise price of CAD$0.80 and expire on December 19, 2023.

On April 21, 2022, an amendment was adopted by the Board to the acceleration provisions of the 7,240,000 Performance Warrants issued in 2018. Pursuant to such amendment, the Performance Warrants vest and become exercisable as to one-third upon the Market Price equaling or exceeding CAD$1.20, an additional one-third upon the Market Price equaling or exceeding CAD$1.35 and a final one-third upon the Market Price equaling or exceeding CAD$1.50. In addition, in the event the Market Price equals or exceeds CAD$1.65, each Performance Warrant shall be exercisable for 1.5 Common Shares, provided that, at the time of exercise in respect of the additional 0.5 of a Common Share per Performance Warrant, the Common Shares are listed on the facilities of a recognized stock exchange (other than the TSXV) or the Common Shares are acquired for cash or for the securities of a company listed on a recognized stock exchange (other than the TSXV). These acceleration thresholds were previously set at CAD$1.20, CAD$1.60, CAD$2.00, and CAD$3.20, respectively, prior to the amendments that were adopted by the Board.

Stock Option Plan

Under the Company’s security based compensation arrangement, which includes the stock option plan and share award incentive plan, the Company may grant options or share awards to its directors, officers, employees and consultants up to a maximum of 10% of the issued and outstanding common shares at the time of the grant, with a maximum of 5% of the Company’s issued and outstanding shares reserved for any one person on a yearly basis. The maximum stock option term is 10 years from the grant date with vesting terms set at the discretion of the board of directors.

The following table reflects the Company's outstanding common stock options at December 31, 2022 and 2021:

	Number of stock options	Weighted average exercise price (CAD)
Balance at December 31, 2021	3,628,125	$ 0.71
Granted	4,000,000	1.01
Balance at December 31, 2022	**7,628,125**	**$ 0.87**

The following table summarizes information regarding stock options outstanding as at December 31, 2022:

Exercise Price ($CAD/share)	Number of options outstanding (000s)	Weighted average remaining terms (years)	Weighted average exercise price for options outstanding ($CAD/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable ($CAD/share)
$0.56 - $1.01	**7,628**	**3.6**	**$0.87**	**4,485**	**$0.81**

On September 12, 2022, pursuant to the Company's stock option plan, an aggregate of 4.0 million stock options to purchase Common Shares of the Company were granted to directors, officers and employees of Southern. The stock options expire in five years from the date of grant and are exercisable at a price of CAD$1.01 per Common Share. The stock options vest as to one third on grant date and one third on each of the first and second anniversaries of the grant day. The fair value of the September 12, 2022, stock option grant was estimated on the date of grant using the Black-Scholes pricing model with the following assumptions:

	2022
Risk free interest rate	3.164%
Expected volatility	78%
Expected life	5.0 years
Dividend yield	nil
Expected forfeiture rate	10%
Stock price on grant date (CAD)	$1.010
Fair value per option (CAD)	$0.588

Southern recognized $1.0 million of share-based compensation expense relating to stock options during 2022 ($200 thousand in 2021).

Share Award Incentive Plan

On September 12, 2022, Southern issued 2.5 million restricted share awards ("RSAs") under its Share Award Incentive Plan. The RSAs vest as to one third on each of the first, second and third anniversaries of the grant date. On the vesting dates of such RSAs, the holder is entitled to receive a cash payment or its equivalent in fully paid Common Shares, at the Company's discretion, equal to the closing market value per Common Share on the TSXV on the business day prior to such payment. For the purpose of calculation share-based compensation, the fair value of the RSAs is based on the market value of Southern's Common Shares at each period end. The fair value is recognised as share-based compensation over the vesting period. Fluctuations in fair values are recognized as share-based compensation in the period they occur. Southern recognized $278 thousand of share-based compensation expense relating to the RSAs during 2022 (nil in 2021).

Amounts in ($000s of US Dollars), except for per share amounts

10. Earnings Per Share

The following table presents the Company's net earnings per share:

	2022	2021
Net earnings	$ 9,299	$ 10,093
Basic - weighted average common shares outstanding	108,144,191	42,544,557
Dilutive effect of warrants, options and convertible debentures	14,828,197	12,502,179
Diluted – weighted average common shares outstanding	122,972,388	55,046,735
Net earnings per share, basic	$ 0.09	$ 0.24
Net earnings per share, diluted	$ 0.08	$ 0.19

When the impact is anti-dilutive, Unit Warrants, Bonus Warrants, Performance Warrants, stock options and Debentures are excluded from the calculation of diluted weighted average common shares. For the year ended December 31, 2022, 4.0 million common shares on exercise of stock options were excluded. For the year ended December 31, 2021, 10.9 million common shares on exercise of Performance Warrants and 3.6 million common shares on exercise of stock options were excluded.

11. Income Taxes

The provision for income taxes recorded in the financial statements varies from the amount that would be computed by applying the Canadian statutory income tax rate of 23.0% as a result of the following:

	Year ended December 31,	
	2022	2021
Net earnings before tax	$ 9,299	$ 9,663
Statutory income tax rate	23.0%	23.0%
Expected income tax	2,139	2,222
Effect on income tax of:		
Tax rate changes – current year movement	(179)	(195)
Unrecognized deferred tax asset	(2,189)	(2,079)
Deferred tax recovery related to warrants	-	(430)
Other	229	52
Deferred tax expense (recovery)	**$ -**	**$ (430)**

Amounts in ($000s of US Dollars), except for per share amounts

The components of the Company's unrecognized deferred tax assets (liabilities) are as follows:

	Year ended December 31, 2022	2021
Property and equipment and exploration	$ (35,352)	$ (7,326)
ROU asset	(214)	(348)
Decommissioning provisions	6,587	3,770
Unamortized share issuance costs	2,710	(349)
Lease obligation	126	360
Convertible debenture – debt portion	(293)	(432)
Convertible debenture – equity portion	(71)	(71)
Derivative (asset) liability	(621)	586
Unrealized Foreign Exchange	(384)	-
Non-capital losses	44,193	27,560
Total	**$ 16,681**	**$ 23,752**

Canadian non-capital tax losses of approximately $12.4 million at December 31, 2022 (December 31, 2021 – $13.6 million) will expire in future years ranging from 2023 – 2042. US net operating losses of approximately $31.7 million at December 31, 2022 (approximately $14.1 million at December 31, 2021) can be carried forward unlimited years.

12. Financial Instruments and Financial Risk Management

Financial Derivative Contracts

Southern utilizes oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future oil and natural gas production. Typical derivative contracts could consist of options, in the form of price floors, collars or three-way collars and fixed-price swaps. The derivative financial instruments are recorded on the consolidated statement of financial position as either an asset or a liability measured at fair value. Southern does not apply hedge accounting to its commodity derivative contracts; accordingly, changes in the fair value of these instruments are recognized in the consolidated statement of earnings and comprehensive income in the period of change.

Southern had the following commodity derivative contracts in place as at December 31, 2022:

Natural Gas	Volume	Pricing
Costless Collar		
January 1, 2023 – March 31, 2023	2,000 MMBtu/d	NYMEX – HH $3.50 - $20.00/MMBtu

Subsequent to December 31, 2022, Southern entered into the following commodity derivative contract:

Natural Gas	Volume	Pricing
Fixed Basis Swap		
April 1, 2023 – October 31, 2023	1,000 MMBtu/d	NYMEX – HH + $0.320/MMBtu

Amounts in ($000s of US Dollars), except for per share amounts

Financial Derivative Contracts Financial Statement Recognition

The Company's financial instruments that were accounted for at fair value as of December 31, 2022 and 2021 are presented below. The classification within the fair value hierarchy for these financial instruments is Level 2.

	Year ended December 31,	
Comprised of:	**2022**	**2021**
Current derivative asset	$ 17	$ 46
Current derivative liability	-	(632)
Net fair value of contracts, end of year	**$ 17**	**$ (586)**

Below is a reconciliation of the loss (gain) on derivatives from the consolidated statement of earnings and comprehensive income:

	Year ended December 31,	
	2022	**2021**
Realized loss on derivatives	$ 7,238	$ 2,719
Unrealized (gain) loss on derivatives	(603)	230
Loss on derivative instruments	**$ 6,635**	**$ 2,949**

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 carrying amount of the Company's cash and cash equivalents and accounts receivable and the positive fair value of any financial derivatives represent the maximum credit exposure.

Cash and cash equivalents

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

Accounts receivable and other

Substantially all of the Company's accounts receivable are due from purchasers of the Company's petroleum and natural gas production, joint interest partners and government agencies, and are subject to normal industry credit risk.

Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Management of the Company believes the risk is mitigated by the size and reputation of the companies to which they extend credit.

Southern had no provision for doubtful accounts as at December 31, 2022 or 2021.

Amounts in ($000s of US Dollars), except for per share amounts

	Year ended December 31,	
	2022	2021
Accrued receivables	$ 3,480	$ 2,242
Accounts receivable – joint venture	259	290
Total accounts receivable and other	**$ 3,739**	**$ 2,532**

0 to 30 days	$ 3,579	$ 2,353
31 to 60 days	15	15
61 to 90 days	8	11
Greater than 90 days	137	153
Total accounts receivable	**$ 3,739**	**$ 2,532**

Liquidity Risk

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its current and future liquidity requirements. The financial liabilities in the statement of financial position consist of accounts payable, royalties payable, lease liabilities, financial derivative liabilities, convertible debentures and the senior secured credit facility. Strategies to manage liquidity include, having adequate sources of financing available through its Credit Facilities, estimating future cash flows generated from operations based on reasonable production and pricing assumptions, adding additional commodity derivative contracts, reducing capital spending and utilizing equity to settle interest payments on Convertible Debentures. Southern may also consider sale of non-core oil and gas assets along with alternative sources of financing.

The Company has the following financial liabilities:

	Year ended December 31,	
	2022	2021
Accrued payables	$ 5,169	$ 1,317
Accounts payables – trade	5,979	2,050
Royalties payables	5,073	4,480
Convertible debentures (face value)	3,164	6,617
Long-term debt (excluding unamortized transaction costs)	4,800	4,543
Total	**$ 24,185**	**$ 19,007**

Market Risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its asset and liabilities. The object of market risk management is to manage and control market risk exposure within acceptable parameters.

To partially mitigate exposure to commodity price risk, Southern entered into various financial derivative instruments. The instruments currently outstanding are described above. As at December, 2022, a 10% change in future commodity prices applied against these contracts would have no impact on net income.

Amounts in ($000s of US Dollars), except for per share amounts

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. This risk is mitigated as the Credit Facility has a fixed interest rate.

13. Royalties Payable

As at December 31, 2022, Southern had $5.1 million ($4.5 million at December 31, 2021) of non-interest bearing royalty payables related to unresolved title or ownership issues. The royalty payable account is made up of balances due to approximately 5,000 royalty holders with over 95% of the balances outstanding for greater than 120 days. The royalty holders have deficiencies with their accounts that precludes Southern from making payments.

14. Oil and Natural Gas Sales

Southern sells its production pursuant to variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for the quality, location and other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contract, Southern is required to deliver a fixed or variable volume of crude oil, natural gas liquids or natural gas to the contract counterparty. Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed transaction price. Revenues are typically collected in the month following production.

The following table presents Southern's oil and natural gas sales disaggregated by revenue source:

	Year ended December 31,	
Commodity sales from production, by product	**2022**	**2021**
Crude oil	$ 3,988	$ 3,597
Natural gas liquids	287	355
Natural gas	40,942	15,990
Total Oil and Natural Gas Sales	**$ 45,217**	**$ 19,942**

15. Financing

The following table presents a breakdown of Southern's financing expenses:

	Year ended December 31,	
	2022	**2021**
Credit facility interest	$ 689	$ 662
Convertible debentures interest	369	535
Interest income	(90)	-
Accretion	558	643
Interest on lease obligations	36	35
Total Financing Expenses	**$ 1,562**	**$ 1,875**

Amounts in ($000s of US Dollars), except for per share amounts

16. Supplemental Cash Flow Information

The changes in non-cash working capital were comprised of the following:

	Year ended December 31, 2022	2021
Source (use) of cash:		
Accounts receivable and other	$ (1,207)	$ (849)
Prepaid expenses and deposits	(5,110)	(183)
Accounts payables	7,780	1,607
Royalties payable	593	117
Foreign exchange	(80)	24
Changes in non-cash working capital	**$ 1,976**	**$ 716**
Related to:		
Operating activities	$ 1,524	$ 78
Investing activities	591	941
Financing activities	(139)	(303)
	$ 1,976	**$ 716**
Interest paid, net	**$ 1,101**	**$ 843**
Income taxes paid	**$ -**	**$ -**

At December 31, 2022, prepaid expenses included $5.0 million related to capital equipment and commitments that Southern had paid for but not yet taken possession of.

17. Capital Risk Management

The Company monitors its capital based on projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by or reviewed with the Company's Board of Directors. The budget results are regularly reviewed and updated as required.

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

18. Related Party Disclosures

There were no related party transactions in 2022 or 2021.

Amounts in ($000s of US Dollars), except for per share amounts

Key management personnel

Southern has determined that the key management personnel of Southern consists of its President & Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and directors. The following table summarizes the compensation of directors and other members of key management personnel during the years ended December 31, 2022 and 2021:

	Year ended December 31, 2022	2021
Salaries, incentives and short term benefits	$ 525	$ 433
Directors' fees	169	83
Share based compensation	660	151
Total	**$ 1,354**	**$ 667**

Directors Remuneration

	Cash compensation 2022	2021	Share – based compensation 2022	2021
Ian Atkinson	$ 181	$ 149	$ 162	$ 39
Bruce Beynon	27	14	31	7
Paul Baay	10	-	26	-
Michael Kohut	25	13	31	7
Tamara MacDonald	19	10	31	7
Andrew McCreath	19	10	31	7
John Joseph Nally	19	10	30	4
C. Neil Smith	25	13	31	7
R. Steven Smith	25	13	31	7
Total	**$ 350**	**$ 232**	**$ 404**	**$ 85**

19. Commitments

At December 31, 2022, Southern had total commitments of $3.0 million including $2.1 million related to the purchase of capital equipment and an early termination fee on a drilling rig contract if terminated by Southern to a maximum of $0.9 million.