Consolidated Financial Statements of

# SOUTHERN ENERGY CORP.

For the years ended December 31, 2023 and 2022

(U.S. 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 26, 2024

(signed) "*Calvin Yau*"

Calvin Yau
Chief Financial Officer

Deloitte.

Deloitte LLP
Suite 700
850-2nd Street SW
Calgary AB T2P 0R8
Canada

Tel: 403-267-1700
Fax: 403-264-2871
www.deloitte.ca

# 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 statement of financial position as at December 31, 2023, and 2022, and the consolidated statement of earning (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including including material accounting policy information (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, 2023, and 2022, 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, 2023. 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 – Petroleum 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 petroleum and natural gas assets. Petroleum and natural gas assets are measured by depleting the assets on a unit-of-production method ("depletion") based on total estimated proved and probable petroleum and natural gas reserves. The Company engages an independent external reserve evaluator to estimate petroleum and natural gas reserves using estimates, assumptions and engineering data. The Company assesses at each reporting date whether there is an indicator of impairment. If an indicator exists, the Company estimates the recoverable amount of the cash generating unit ("CGU"), which is the higher of fair value less costs to sell or value-in-use. The determination of (1) the Company's proved and probable petroleum and natural gas reserves used to determine depletion and (2) the recoverable amount of a CGU requires management to make significant estimates and assumptions related to future oil and natural gas prices, discount rates, reserves, and future operating and development costs. The Company identified indicators of impairment related to the Central Mississippi ("CMS") CGU and recorded an impairment.

Given the significant judgments made by management related to future oil and natural gas prices, discount rate, reserves and future operating and development costs used to determine depletion of all petroleum and natural gas assets and the recoverable amount of the CMS CGU, 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, discount rate, and future operating and development costs used to determine depletion of all petroleum and natural gas assets and the recoverable amount of the CMS CGU included the following, among others:

- 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;
- With the assistance of fair value specialists, evaluated the reasonableness of the discount rate by developing a range of independent estimates and comparing those to the discount rate 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 external 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

Chartered Professional Accountants
April 26, 2024
Calgary, Alberta

SOUTHERN ENERGY CORP.
Consolidated Statement of Financial Position

| (in thousands of U.S. Dollars) | | December 31, 2023 | | December 31, 2022 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ | 3,112 | $ | 28,350 |
| Accounts receivable and other (Note 11) | | 2,134 | | 3,739 |
| Prepaid expenses and deposits | | 1,089 | | 5,532 |
| Derivative assets (Note 11) | | 1,022 | | 17 |
| | | 7,357 | | 37,638 |
| Property, plant and equipment (Note 4) | | 59,608 | | 59,800 |
| Right-of-use assets | | 105 | | 214 |
| Derivative assets | | 235 | | - |
| Total assets | $ | 67,305 | $ | 97,652 |
| **Liabilities and Equity** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities | | 5,535 | | 11,147 |
| Royalties payable (Note 12) | | 6,362 | | 5,073 |
| Current portion of lease liabilities | | 121 | | 107 |
| Current portion of long-term debt (Note 6) | | 4,657 | | 1,106 |
| Convertible debentures (Note 7) | | 3,196 | | - |
| Derivative liabilities (Note 11) | | 10 | | - |
| | | 19,881 | | 17,433 |
| Long-term liabilities | | | | |
| Derivative liabilities (Note 11) | | 37 | | - |
| Convertible debentures (Note 7) | | - | | 3,041 |
| Long-term debt (Note 6) | | 12,659 | | 3,071 |
| Lease liabilities | | - | | 126 |
| Decommissioning provisions (Note 5) | | 8,917 | | 6,579 |
| Total liabilities | | 41,494 | | 30,250 |
| Shareholders' equity (Note 8) | | | | |
| Share capital | | 79,764 | | 75,271 |
| Equity component of convertible debenture | | 245 | | 245 |
| Warrants (Note 8) | | 351 | | 2,154 |
| Contributed surplus | | 7,569 | | 5,117 |
| Deficit | | (61,412) | | (14,595) |
| Accumulated other comprehensive income | | (706) | | (790) |
| | | 25,811 | | 67,402 |
| Total liabilities and shareholders' equity | $ | 67,305 | $ | 97,652 |

*(See accompanying Notes to the Consolidated Financial Statements)*

Approved by Board of Directors

(signed) "*Reginald S. Smith*"
Director

(signed) "*Bruce Beynon*"
Chairman

| (in thousands of U.S. Dollars, except for per share amounts) | Year ended December 31, 2023 | Year ended December 31, 2022 |
|---|---|---|
| **Revenues** | | |
| Petroleum and natural gas revenue (Note 13) | $ 19,313 | $ 45,217 |
| Royalties | (3,737) | (9,763) |
| | 15,576 | 35,454 |
| **Expenses** | | |
| Production and operating | 6,435 | 6,446 |
| Transportation | 1,202 | 139 |
| Depletion, depreciation and amortization (Note 4) | 9,591 | 6,606 |
| Impairment (Note 4) | 38,000 | - |
| (Gain) loss on derivatives (Note 11) | (1,510) | 6,635 |
| Gain on dispositions (Note 4) | - | (398) |
| Financing, net (Note 14) | 2,555 | 1,562 |
| General and administrative | 4,843 | 4,098 |
| Share-based compensation | 857 | 1,244 |
| Transaction costs | 264 | 265 |
| Gain (loss) foreign exchange | 156 | (442) |
| | 62,393 | 26,155 |
| **Total net (loss) earnings for the year** | (46,817) | 9,299 |
| Currency translation adjustment | 84 | (115) |
| **Comprehensive (loss) income for the year** | $ (46,733) | $ 9,184 |
| **Net (loss) earnings per common share** (Note 9) | | |
| Basic | $ (0.33) | $ 0.09 |
| Diluted | $ (0.33) | $ 0.08 |

*(See accompanying Notes to the Consolidated Financial Statements)*

# SOUTHERN ENERGY CORP.

Consolidated Statement of Changes in Shareholders' Equity

| (in thousands of U.S. Dollars, except share amounts) | Common Shares | Shareholders' Capital | Equity Component of Convertible Debentures | Warrants | Contributed Surplus | Deficit | Accumulated Other Comprehensive (Loss) | Shareholders' Equity |
|---|---|---|---|---|---|---|---|---|
| Balance, December 31, 2021 | 78,121,858 | $ 41,018 | $ 497 | $ 2,723 | $ 4,144 | $(23,894) | $ (675) | $ 23,813 |
| Shares issued, net | 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 |
| Shares issued, net (Note 8) | 27,661,250 | $ 4,184 | $ - | $ - | $ - | $ - | $ - | $ 4,184 |
| Share-based compensation | - | - | - | - | 714 | - | - | 714 |
| Exercise of Warrants | - | 309 | - | (65) | - | - | - | 244 |
| Expiration of Warrants | - | - | - | (1,738) | 1,738 | - | - | - |
| Net loss | - | - | - | - | - | (46,817) | - | (46,817) |
| Other comprehensive income | - | - | - | - | - | - | 84 | 84 |
| Balance, December 31, 2023 | 165,718,160 | $ 79,764 | $ 245 | $ 351 | $ 7,569 | $(61,412) | $ (706) | $ 25,811 |

*(See accompanying Notes to the Consolidated Financial Statements)*

| (in thousands of U.S. Dollars) | Year ended December 31, 2023 | Year ended December 31, 2022 |
|---|---|---|
| **Operating activities** | | |
| Total net (loss) earnings for the year | $ (46,817) | $ 9,299 |
| Changes in non-cash items: | | |
| Depletion, depreciation and amortization (Note 4) | 9,495 | 6,436 |
| Impairment (Note 4) | 38,000 | - |
| Gain on dispositions (Note 4) | - | (398) |
| Financing expense, net | 2,750 | 1,562 |
| Unrealized (gain) on derivatives (Note 11) | (1,193) | (603) |
| Unrealized loss (gain) on foreign exchange | 135 | (384) |
| Share-based compensation | 857 | 1,244 |
| Decommissioning provisions liabilities settled (Note 5) | (45) | (77) |
| Changes in non-cash working capital (Note 15) | 521 | 1,524 |
| Net cash provided by operating activities | 3,703 | 18,603 |
| **Investing activities** | | |
| Capital expenditures | (41,783) | (29,858) |
| Acquisitions | (3,347) | (576) |
| Proceeds from dispositions | - | 759 |
| Changes in non-cash working capital (Note 15) | 1,789 | 591 |
| Net cash used by investing activities | (43,341) | (29,084) |
| **Financing activities** | | |
| Proceeds from share issuances, net | 4,428 | 30,425 |
| Paydown of long-term debt (Note 6) | (3,936) | (3,743) |
| Draw on credit facility (Note 6) | 17,000 | 4,000 |
| Payment of interest, net | (2,419) | (1,108) |
| Finance lease payments | (134) | (141) |
| Transaction costs on debt refinance (Note 6) | (210) | (26) |
| Changes in non-cash working capital (Note 15) | (378) | (139) |
| Net cash provided by financing activities | 14,351 | 29,268 |
| Net (decrease) increase in cash and cash equivalents | (25,287) | 18,787 |
| Effect of foreign exchange rate changes | 49 | (59) |
| Cash and cash equivalents, beginning of year | 28,350 | 9,622 |
| Cash and cash equivalents, end of year | $ 3,112 | $ 28,350 |

*(See accompanying Notes to the Consolidated Financial Statements)*

## 1. Reporting Entity and Nature of Operations

Southern Energy Corp. ("Southern" or the "Company") is a petroleum 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 26, 2024.

## 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 ("U.S. dollars"). All financial information presented has been rounded to the nearest thousand unless otherwise indicated.

## 3. Material 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 developed producing petroleum and natural gas 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 crude oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future crude 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 ("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. If the conversion option remains unexercised at the maturity date of the Debentures, the equity component of the Debentures will be transferred to contributed surplus. No gain or loss is recognized upon conversion or expiration of the conversion option. 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) Transportation**

Costs paid by Southern for the transportation of crude oil, natural gas, and natural gas liquids to the point of control transfer are recognized when the transportation is provided.

**l) 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.

**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 petroleum and natural gas industry. Such contingencies include differing interpretations as to the prices at which petroleum 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 Compensation Plans**

**Stock Options** - 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.

**Restricted Share Awards** - 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.

**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, warrants and convertible debentures.

**q) Warrants**

The amount of the warrant is recognized in equity at the time of issue. When and if the conversion option is exercised, the equity component of the warrants will be transferred to share capital. If the conversion option remains unexercised at the maturity date of the warrants, the equity component of the warrants will be transferred to contributed surplus. No gain or loss is recognized upon conversion or expiration of the conversion option.

**r) Adopted and Future Accounting Changes**

Southern adopted the amendments to IAS 1, Presentation of Financial Statements effective January 1, 2023. The amendments require entities to disclose their material accounting policy information rather than their significant accounting policies. To support this amendment the IASB also amended IFRS Practice Statement 2 Making Materiality Judgements. On adoption of this amendment, there is no impact to the Company's Consolidated Financial Statements.

Southern plans to adopt the following amendment to the IFRS Accounting Standards that are effective for annual periods beginning on or after January 1, 2024. The below accounting pronouncement will be adopted on its effective date however Southern does not expect to have a material impact upon initial adoption.

**IAS 1, Presentation of Financial Statements**

In October 2022, the IASB amended IAS 1 Presentation of Financial Statements to address the classification of liabilities with covenants as current or non-current in the Statements of Financial Position. The amendment is applicable to periods beginning on or after January 1, 2024.

Amounts in thousands of U.S. 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:

| | Petroleum and Natural Gas Assets | Other | Total |
|---|---|---|---|
| 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 5) | 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 | 41,778 | 56 | 41,834 |
| Acquisitions, including decommissioning costs | 6,309 | - | 6,309 |
| Change in decommissioning provision (Note 5) | (955) | - | (955) |
| Depletion, depreciation and amortization | (9,320) | (63) | (9,383) |
| Impairment | (38,000) | - | (38,000) |
| Foreign exchange | - | 3 | 3 |
| **Net book value as at December 31, 2023** | **$ 59,423** | **$ 185** | **$ 59,608** |

*Additions*

For the year ended December 31, 2023, Southern incurred $41.8 million of capital additions related to the development of the Central Mississippi CGU ("CMS CGU").

*Asset Acquisition*

On June 1, 2023, Southern closed an acquisition to acquire assets in its core area in the CMS CGU in the State of Mississippi for cash consideration of $3.2 million. The acquisition resulted in an increase to property, plant and equipment of approximately $6.3 million and the assumption of $3.0 million of decommissioning provisions.

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.

Amounts in thousands of U.S. Dollars, except for per share amounts

*Depletion and depreciation*

For the year ended December 31, 2023, the Company recorded depletion expense of $9.4 million (December 31, 2022 – $6.3 million). In the calculation of depletion expense at December 31, 2023, an estimated $161.8 million of future development costs associated with the proven plus probable reserves were included ($164.5 million for 2022).

*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 petroleum and natural gas properties. During the year ended December 31, 2023, Southern viewed the deterioration of current and future natural gas prices as well as the reduction of Southern's market capitalization below the net assets of the Company as indications of impairment. Southern estimated the recoverable amount of all CGUs at December 31, 2023. Southern determined that the carrying value of the CMS CGU exceeded its recoverable amount. A non-cash impairment charge of $38.0 million was recorded in the Consolidated Statements Earnings (Loss) and Comprehensive Income (Loss).

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 petroleum and natural gas reserves of each CGU, and a 10% discount rate, based on reserves estimated by Southern's independent reserves evaluator at December 31, 2023.

The following table details the forward pricing used in estimating the recoverable amounts of Southern's CGUs at December 31, 2023:

| Period Ending | West Texas Intermediate ($US/bbl) | Henry Hub ($US/MMBtu) |
|---|---|---|
| 12-31-2024 | 73.25 | 2.75 |
| 12-31-2025 | 74.09 | 3.62 |
| 12-31-2026 | 74.79 | 4.05 |
| 12-31-2027 | 76.28 | 4.14 |
| 12-31-2028 | 77.81 | 4.23 |
| 12-31-2029 | 79.37 | 4.30 |
| 12-31-2030 | 80.96 | 4.39 |
| 12-31-2031 | 82.57 | 4.48 |
| 12-31-2032 | 84.22 | 4.57 |
| 12-31-2033 | 85.91 | 4.66 |
| 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 December 31, 2023, were 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 "Material Accounting Policies" for information on fair value hierarchy classifications.

Amounts in thousands of U.S. Dollars, except for per share amounts

Changes in any of the key judgements, such as a revision in reserves, changes in forecast commodity prices, foreign exchange rates, capital or operating costs would impact the estimated recoverable amount. As at December 31, 2023, a 1% increase in the assumed discount rate would reduce the estimated recoverable amount by $1.5 million while a 5% decrease change in commodity price forecasts would reduce the estimated recoverable amount by $4.1 million.

## 5. 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 $20.3 million at December 31, 2023 (December 31, 2022 – $14.8 million). The decommissioning provision was inflated using a rate of 2.4% (December 31, 2022 – 2.4%) and discounted using a risk-free interest rate of 3.9% at December 31, 2023 (December 31, 2022 – 3.9%). 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, 2023 | 2022 |
|---|---|---|
| **Balance, beginning of year** | $ 6,579 | $ 3,762 |
| Liabilities incurred | 51 | 54 |
| Liabilities acquired | 2,962 | 439 |
| Liabilities settled | (45) | (77) |
| Changes in estimates | (955) | 2,314 |
| Accretion expense | 325 | 87 |
| Property disposal | - | (5) |
| Effect of foreign exchange rate changes | - | 5 |
| **Balance, end of year** | **$ 8,917** | **$ 6,579** |
| **Long term liability** | **$ 8,917** | **$ 6,579** |

Amounts in thousands of U.S. Dollars, except for per share amounts

## 6. Long-term Debt

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Current portion of senior secured term loan | $ 4,985 | $ 1,340 |
| Long-term portion of senior secured term loan | 12,879 | 3,460 |
| Unamortized transaction costs | (548) | (623) |
| **Total Long-Term Debt** | **$ 17,316** | **$ 4,177** |

Southern Energy Corporation (Delaware), one of the wholly-owned subsidiaries of Southern, held the existing senior secured term loan ("Credit Facility") at December 31, 2023. The Credit Facility is comprised of Tranche A of $5.5 million that was advanced at closing on April 30, 2021 and Tranche B of $31.5 million with an availability until December 31, 2026. Effective February 28, 2024, interest on the Credit Facility is 15% per annum (previously 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 December 31, 2026. As at December 31, 2023, Southern had $17.9 million drawn on the Credit Facility and $10.0 million available from Tranche B.

Effective September 29, 2023, Southern entered into the fifth amendment to the Credit Facility (the "Fifth Amendment"). The Fifth Amendment included an increase of $2.0 million to Tranche B of the Credit Facility, bringing the total Tranche B commitment to $31.5 million, and an extension of the commitment period for Tranche B until August 31, 2025. The amendment also extended the principal amortization period by an additional twelve months, reset the DSCR (as defined below) covenant calculation to an annualized basis beginning in Q4 2023, reduced the DSCR (as defined below) in Q3 2023 to 1.20:1, reverting back to 1.25:1 in Q4 2023 and all future periods, and allowed for repayment and reborrowing under the Tranche B facility.

Subsequent to December 31, 2023, Southern entered into the sixth amendment to the Credit Facility (the "Sixth Amendment"), effective February 28, 2024. The Sixth Amendment includes an extension of the maturity of the Credit Facility to December 31, 2026, resets the DSCR (as defined below) covenant calculation to an annualized basis beginning in Q1 2024, reduces the repayments based on a FCF grid (as described below) and increases the fixed per annum coupon from 12% to 15% per annum. The amendment also pauses the monthly repayment of the principal amount outstanding (as described below) for the period from February 1, 2024 to September 30, 2024.

Quarterly positive free cash flow ("FCF") (as described below) repayments are based on a FCF grid whereby quarterly repayments are X% of the preceding quarter where X is equal to 30% (previously 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 15% (previously 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 24 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, 2023 and December 31, 2022:

| **Financial covenant** | **Limit** | **As at Dec 31, 2023** | **As at Dec 31, 2022** |
|---|---|---|---|
| Asset Coverage ratio | Minimum 2.00 | 2.48 | 9.77 |
| Debt Service Coverage ratio | Minimum 1.25 | 0.43 | 3.87 |

On December 19, 2023, Southern obtained a waiver for the DSCR (as defined below) for the fiscal quarter ending December 31, 2023.

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, 2023, Southern was in compliance with the ACR and had obtained a waiver for the DSCR.

## 7. Convertible Debentures

| | Number of Convertible Debentures | Liability Component ($000s) | Equity Component ($000s) |
|---|---|---|---|
| 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** |
| Accretion of discount | - | 80 | - |
| Effect of foreign exchange rate changes | - | 75 | - |
| **Balance at December 31, 2023** | **4,286** | **$ 3,196** | **$ 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 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.

On January 2, 2024, the accrued interest payment due on December 31, 2023, was settled in-kind through the issuance of 779,273 new Common Shares. The number of Common Shares issued is equal to the amount of interest, divided by the volume weighted average trading price per Common Share for the 20 consecutive trading days ending on the fifth trading day preceding December 31, 2023.

At December 31, 2023, the Debentures were classified as a current liability as they have a maturity date of June 30, 2024. The fair value of the Debentures at December 31, 2023 was $3.2 million.

## 8. 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.

Amounts in thousands of U.S. Dollars, except for per share amounts

The following table reflects the Company's outstanding Common Shares at December 31, 2023 and 2022:

| | Number of Shares | Share Capital |
|---|---|---|
| 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** |
| November issuance of Common Shares by Fundraising | 26,630,000 | 5,001 |
| Issuance of Common Shares to satisfy unit warrant exercise | 1,031,250 | 310 |
| Share issuance costs | - | (818) |
| **Balance as at December 31, 2023** | **165,718,160** | **$ 79,764** |

On November 9, 2023, Southern closed an equity financing raising aggregate gross proceeds of $5.0 million through the issuance of a total of 26,630,000 new Common Shares (the "Fundraising"). The Fundraising consisted of gross proceeds of $2.8 million through a placing of 15,853,097 new Common Shares at a price of 15.5 pence per Common Share, $2.2 million pursuant to a prospectus offering of 10,712,387 new Common Shares at a price of CAD$0.26 per Common Share and the remaining $0.01 million pursuant to a subscription offering of 64,516 new Common Shares at a price of 15.5 pence 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 new Common Shares (the "2022 Offering"), of which $17.5 million was raised pursuant to a bought deal prospectus offering of 26,060,000 new 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 20,311,927 new Common Shares at a price of 54.5 pence per Common Share.

*Warrants*

In connection with the Fifth Amendment, the Company extended the term of the outstanding Common Share purchase warrants ("Bonus Warrants") previously issued to the lender from April 30, 2024 until August 31, 2025. There are 3,906,250 remaining Bonus Warrants with an exercise price of CAD$0.40.

The performance-based Common Share purchase warrants issued in connection with the non-brokered private placement completed on December 19, 2018, expired on December 19, 2023.

The Common Share purchase warrants issued in connection with the non-brokered private placement completed on May 3, 2021, expired on December 31, 2023.

*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.

The following table reflects the Company's outstanding common stock options at December 31, 2023 and 2022:

| | Number of stock options | Weighted average exercise price (CAD) |
|---|---|---|
| Balance at December 31, 2022 | 7,628,125 | $ 0.87 |
| Granted | 60,000 | 0.39 |
| Forfeited | (573,750) | 0.87 |
| **Balance at December 31, 2023** | **7,114,375** | **$ 0.86** |

The forfeiture of 573,750 stock options in 2023 are related to the retirement of three directors.

The following table summarizes information regarding stock options outstanding as at December 31, 2023:

| 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) |
|---|---|---|---|---|---|
| **$0.39 - $1.01** | **7,114** | **2.6** | **$0.86** | **5,846** | **$0.83** |

Southern recognized $0.7 million of share-based compensation expense relating to stock options during 2023 ($1.0 million in 2022).

*Share Award Incentive Plan*

On June 6, 2023, Southern issued 1.3 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. On June 15, 2023, 59,950 RSAs were forfeited due to the retirement of two directors and on November 29, 2023, 19,984 RSAs were forfeited due to the retirement of a director.

On September 12, 2022, Southern issued 2.5 million restricted share awards ("RSAs") under its Share Award Incentive Plan.

Amounts in thousands of U.S. Dollars, except for per share amounts

The following table reflects the Company's outstanding RSAs at December 31, 2023 and 2022:

| | Number of RSAs |
|---|---|
| Balance at December 31, 2022 | 2,495,700 |
| Granted - June 6, 2023 | 1,345,800 |
| Forfeited | (79,934) |
| Released upon cash settlement | (811,909) |
| **Balance at December 31, 2023** | **2,949,657** |

Southern recognized $0.1 million of share-based compensation expense relating to the RSAs during 2023 ($0.3 million in 2022).

## 9. Earnings (Loss) Per Share

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

| | 2023 | 2022 |
|---|---|---|
| Net (loss) earnings | $ (46,817) | $ 9,299 |
| Basic - weighted average Common Shares outstanding | 142,746,621 | 108,144,191 |
| Dilutive effect of warrants, options and convertible debentures | - | 14,828,197 |
| Diluted – weighted average Common Shares outstanding | 142,746,621 | 122,972,388 |
| Net (loss) earnings per share, basic | $ (0.33) | $ 0.09 |
| Net (loss) earnings per share, diluted | $ (0.33) | $ 0.08 |

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, 2023, all dilutive securities are excluded as they are anti-dilutive. For the year ended December 31, 2022, 4.0 million Common Shares on exercise of stock options were excluded.

Amounts in thousands of U.S. Dollars, except for per share amounts

## 10. 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, 2023 | 2022 |
|---|---|---|
| Net (loss) earnings before tax | $ (46,817) | $ 9,299 |
| Statutory income tax rate | 23.0% | 23.0% |
| Expected income (recovery) tax | (10,768) | 2,139 |
| | | |
| Effect on income tax of: | | |
| Tax rate changes – current year movement | 985 | (179) |
| Unrecognized deferred tax asset | 9,585 | (2,189) |
| Other | 198 | 229 |
| **Deferred tax expense (recovery)** | **$ -** | **$ -** |

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Property and equipment and exploration | $ (33,620) | $ (35,352) |
| ROU asset | (105) | (214) |
| Decommissioning provisions | 8,917 | 6,587 |
| Unamortized share issuance costs | 2,696 | 2,710 |
| Lease obligation | 121 | 126 |
| Convertible debenture – debt portion | (137) | (293) |
| Convertible debenture – equity portion | (71) | (71) |
| Interest liability | 2,665 | - |
| Derivative (asset) liability | (2,478) | (621) |
| Unrealized Foreign Exchange | 135 | (384) |
| Non-capital losses | 87,381 | 44,193 |
| **Total** | **$ 65,504** | **$ 16,681** |

Canadian non-capital tax losses of approximately $11.1 million at December 31, 2023 (December 31, 2022 – $13.3 million) will expire in future years ranging from 2032 – 2042. US net operating losses of approximately $76.2 million at December 31, 2023 (approximately $32.3 million at December 31, 2022) can be carried forward unlimited years.

Amounts in thousands of U.S. Dollars, except for per share amounts

## 11. Financial Instruments and Financial Risk Management

### *Financial Derivative Contracts*

Southern utilizes crude oil and natural gas derivative contracts to mitigate its exposure to commodity price risk associated with future crude 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, 2023:

| Natural Gas | Volume | Pricing |
|---|---|---|
| *Fixed Price Swap* | | |
| January 1, 2024 – December 31, 2025 | 1,000 MMBtu/d | NYMEX – HH $3.880/MMBtu |
| April 1, 2024 – October 31, 2024 | 1,500 MMBtu/d | NYMEX – HH $3.208/MMBtu |
| April 1, 2024 – October 31, 2024 | 1,500 MMBtu/d | NYMEX – HH $3.420/MMBtu |
| April 1, 2025 – October 31, 2025 | 1,500 MMBtu/d | NYMEX – HH $3.420/MMBtu |
| | | |
| *Costless Collar* | | |
| January 1, 2024 – March 31, 2024 | 2,000 MMBtu/d | NYMEX – HH $3.00 - $3.98/MMBtu |
| January 1, 2024 – March 31, 2024 | 1,000 MMBtu/d | NYMEX – HH $3.00 - $4.60/MMBtu |
| November 1, 2024 – March 31, 2025 | 1,000 MMBtu/d | NYMEX – HH $3.50 - $5.20/MMBtu |

Subsequent to December 31, 2023, Southern monetized the above fixed price swap derivative contracts to take advantage of the positive unrealized gain position, realizing net proceeds of $1.1 million.

In addition, subsequent to December 31, 2023, Southern entered into the following commodity derivative contracts:

| Natural Gas | Volume | Pricing |
|---|---|---|
| *Fixed Price Swap* | | |
| May 1, 2024 – December 31, 2026 | 5,000 MMBtu/d | NYMEX – HH $3.400/MMBtu |

Amounts in thousands of U.S. 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, 2023 and 2022 are presented below. The classification within the fair value hierarchy for these financial instruments is Level 2.

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Comprised of: | | |
| Current derivative asset | $ 1,022 | $ 17 |
| Current derivative liability | (10) | - |
| Non-current derivative asset | 235 | - |
| Non-current derivative liability | (37) | - |
| **Net fair value of contracts, end of year** | **$ 1,210** | **$ 17** |

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Realized (gain) loss on derivatives | $ (317) | $ 7,238 |
| Unrealized (gain) on derivatives | (1,193) | (603) |
| **(Gain) loss on derivative instruments** | **$ (1,510)** | **$ 6,635** |

***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.

Amounts in thousands of U.S. Dollars, except for per share amounts

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, 2023 or 2022.

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Accrued receivables | $ 1,819 | $ 3,480 |
| Accounts receivable – joint venture | 315 | 259 |
| **Total accounts receivable and other** | **$ 2,134** | **$ 3,739** |

| | | |
|---|---|---|
| 0 to 30 days | $ 1,983 | $ 3,579 |
| 31 to 60 days | 59 | 15 |
| 61 to 90 days | 27 | 8 |
| Greater than 90 days | 65 | 137 |
| **Total accounts receivable** | **$ 2,134** | **$ 3,739** |

***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. At December 31, 2023, Southern was in breach of its DSCR financial covenant on its senior secured term loan, however the Company has obtained a waiver through December 31, 2023. There is no assurance that covenants will continue to be waived. If financial covenants are not met and the Company is unable to obtain waivers, the debt may become due on demand. This uncertainty may cast doubt with respect to the ability of the Southern to continue as a going concern.

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 petroleum and natural gas assets and excess equipment inventory along with alternative sources of financing. After examining the economic factors that could cause liquidity risk, the Company believes it will have sufficient liquidity to support its operations and meet its financial obligations for at least twelve months. The consolidated financial statements have been prepared on a going concern basis, which presumes that Southern will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The consolidated financial statements do not reflect adjustments and classification of assets, liabilities, revenues and expenses which would be necessary if the Company were unable to continue as a going concern.

Amounts in thousands of U.S. Dollars, except for per share amounts

The Company has the following financial liabilities:

| | Year ended December 31, | |
|---|---|---|
| | **2023** | **2022** |
| Accrued payables | $ 2,461 | $ 5,169 |
| Accounts payables – trade | 3,074 | 5,979 |
| Royalties payables | 6,362 | 5,073 |
| Convertible debentures (face value) | 3,241 | 3,164 |
| Long-term debt (excluding unamortized transaction costs) | 17,864 | 4,800 |
| **Total** | **$ 33,002** | **$ 24,185** |

### *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, 2023, a 10% change in future commodity prices applied against these contracts would have approximately a $0.5 million impact on net income.

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.

## 12. Royalties Payable

As at December 31, 2023, Southern had $6.4 million ($5.1 million at December 31, 2022) 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 6,500 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.

## 13. Petroleum 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.

Amounts in thousands of U.S. Dollars, except for per share amounts

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| **Commodity sales from production, by product** | | |
| Crude oil | $ 3,242 | $ 3,988 |
| Natural gas liquids | 180 | 287 |
| Natural gas | 15,891 | 40,942 |
| **Total Petroleum and Natural Gas Sales** | **$ 19,313** | **$ 45,217** |

## 14. Financing

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| Credit facility interest | $ 1,708 | $ 689 |
| Convertible debentures interest | 254 | 369 |
| Interest income | (195) | (90) |
| Accretion | 766 | 558 |
| Interest on lease obligations | 22 | 36 |
| **Total Financing Expenses** | **$ 2,555** | **$ 1,562** |

## 15. Supplemental Cash Flow Information

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

| | Year ended December 31, 2023 | 2022 |
|---|---|---|
| **Source (use) of cash:** | | |
| Accounts receivable and other | $ 1,605 | $ (1,207) |
| Prepaid expenses and deposits | 4,443 | (5,110) |
| Accounts payables | (5,612) | 7,780 |
| Royalties payable | 1,289 | 593 |
| Foreign exchange | 207 | (80) |
| **Changes in non-cash working capital** | **$ 1,932** | **$ 1,976** |
| | | |
| **Related to:** | | |
| Operating activities | $ 521 | $ 1,524 |
| Investing activities | 1,789 | 591 |
| Financing activities | (378) | (139) |
| | **$ 1,932** | **$ 1,976** |
| | | |
| Interest paid, net | **$ 2,419** | **$ 1,101** |
| Income taxes paid | **$ -** | **$ -** |

Amounts in thousands of U.S. Dollars, except for per share amounts

## 16. 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.

## 17. Commitments

The following table lists the Company's contractual obligations and commitments as at December 31, 2023:

| | Total | 2024 | 2025 | 2026 | Thereafter |
|---|---|---|---|---|---|
| Long-term debt(1) | $ 17,864 | $ 4,985 | $ 12,879 | $ - | $ - |
| Convertible debentures(2) | 3,241 | 3,241 | - | - | - |
| Lease obligations(3) | 128 | 128 | - | - | - |
| **Total** | **$ 21,233** | **$ 8,354** | **$ 12,879** | **$ -** | **$ -** |

Notes:

(1) Long-term debt consists of the Credit Facility – see note 6 – Long-term Debt for more information

(2) Debentures have a maturity date of June 30, 2024.

(3) The lease obligations relate to the Canadian office lease that is accounted for under IFRS 16. The office lease expires on November 30, 2024

Amounts in thousands of U.S. Dollars, except for per share amounts

## 18. Related Party Disclosures

There were no related party transactions in 2023 or 2022.

*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, 2023 and 2022:

| | Year ended December 31, 2023 | Year ended December 31, 2022 |
|---|---|---|
| Salaries, incentives and short term benefits | $ 633 | $ 525 |
| Directors' fees | 131 | 169 |
| Share based compensation | 408 | 660 |
| **Total** | **$ 1,172** | **$ 1,354** |

*Directors' Remuneration*

| | Cash compensation 2023 | Cash compensation 2022 | Share – based compensation 2023 | Share – based compensation 2022 |
|---|---|---|---|---|
| Ian Atkinson | $ 221 | $ 181 | $ 120 | $ 162 |
| Bruce Beynon | 30 | 27 | 20 | 31 |
| Paul Baay(1) | 11 | 10 | 10 | 26 |
| Michael Kohut(1) | 14 | 25 | 11 | 31 |
| Tamara MacDonald | 24 | 19 | 20 | 31 |
| Andrew McCreath(2) | 21 | 19 | 20 | 31 |
| John Joseph Nally | 21 | 19 | 20 | 30 |
| C. Neil Smith | 28 | 25 | 20 | 31 |
| R. Steven Smith | 28 | 25 | 20 | 31 |
| **Total** | **$ 398** | **$ 350** | **$ 261** | **$ 404** |

Notes:

(1) On June 15, 2023, Paul Baay and Michael Kohut retired from the board of directors of Southern

(2) On November 29, 2023 Andrew McCreath retired from the board of directors of Southern