KARVE ENERGY INC

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED

MARCH 31, 2021 AND MARCH 31, 2020

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

(Canadian $000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
ASSETS		
Current Assets		
Trade and other receivables (NOTE 4)	12,445	10,796
Prepaids and deposits (NOTE 5)	4,704	4,913
TOTAL CURRENT ASSETS	17,149	15,709
Property, plant and equipment (NOTE 7)	317,667	316,523
Exploration and evaluation (NOTE 7)	20,754	21,125
Right of use asset (NOTE 8)	-	82
Deferred income tax	6,578	5,335
TOTAL ASSETS	**362,148**	**358,774**
LIABILITIES		
Current Liabilities		
Trade and other payables (NOTE 6)	15,610	11,119
Operating loan (NOTE 10)	3,798	5,513
Derivative Liability (NOTE 16)	4,682	2,397
Lease liability (NOTE 9)	-	156
Decommissioning liability (NOTE 11)	2,324	2,502
TOTAL CURRENT LIABILITIES	**26,414**	**21,687**
Long term debt (NOTE 10)	56,396	53,374
Decommissioning liability (NOTE 11)	18,940	19,157
TOTAL LIABILITIES	**101,750**	**94,218**
SHAREHOLDERS' EQUITY		
Share capital (NOTE 12)	225,158	225,158
Contributed surplus (NOTE 12)	28,628	27,948
Accumulated earnings	6,612	11,450
TOTAL SHAREHOLDERS' EQUITY	**260,398**	**264,556**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**362,148**	**358,774**

COMMITMENTS (NOTE 15)
SUBSEQUENT EVENTS (NOTE 19)

The accompanying notes are an integral part of these financial statements.

Approved on behalf of the Board of Directors:

Signed "Donald A. Engle" *Signed "James C. Lough"*

Donald A. Engle
Chairman of the Board

James C. Lough
Director

CONSOLIDATED STATEMENTS OF NET LOSS AND COMPREHENSIVE LOSS (UNAUDITED)

(Canadian $000s, except per share amounts)	For the three months ended Mar. 31, 2021	Mar. 31, 2020
REVENUE		
Petroleum and natural gas sales (NOTE 18)	27,535	27,947
Royalties	(2,101)	(2,252)
NET REVENUE	25,434	25,695
Other income (NOTE 13)	1,573	1,645
(Loss) gain on financial derivative contracts (NOTE 16)	(6,046)	4,393
TOTAL REVENUE AND OTHER INCOME	20,961	31,733
EXPENSES		
Operating	11,090	11,127
Transportation	508	1,128
General and administration	2,520	1,715
Depletion, depreciation and amortization (NOTE 7, 8, & 11)	10,526	13,465
Financing (NOTE 10)	617	661
Accretion (NOTE 11)	596	384
Share-based compensation (NOTE 14)	680	1,580
Exploration and evaluation - expiries (NOTE 7)	507	915
NET (LOSS) INCOME BEFORE TAX EXPENSE	(6,083)	758
TAX EXPENSE		
Deferred income tax (recovery) expense	(1,245)	862
NET LOSS AND COMPREHENSIVE LOSS	(4,838)	(104)
LOSS PER SHARE ($) (NOTE 12)		
Basic	(0.03)	-
Diluted	(0.03)	-

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	For the three months ended	
(Canadian $000s)	Mar. 31, 2021	Mar. 31, 2020
SHARE CAPITAL		
BALANCE, BEGINNING AND END OF PERIOD	**225,158**	**225,158**
CONTRIBUTED SURPLUS		
Balance, beginning of period	27,948	22,224
Share-based compensation (NOTE 14)	680	1,580
BALANCE, END OF PERIOD	**28,628**	**23,804**
EARNINGS		
Balance, beginning of period	11,450	37,234
Net loss and comprehensive loss	(4,838)	(104)
BALANCE, END OF PERIOD	**6,612**	**37,130**

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Canadian $000s)	For the three months ended Mar. 31, 2021	Mar. 31, 2020
CASH PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net loss and comprehensive loss	(4,838)	(104)
ITEMS NOT AFFECTING CASH:		
Depletion, depreciation and amortization (NOTE 7, 8, & 11)	10,526	13,465
Accretion expense (NOTE 11)	596	384
Exploration and evaluation (NOTE 7)	507	915
Unrealized loss (gain) on foreign exchange	5	(103)
Share-based compensation (NOTE 14)	680	1,580
Unrealized loss on financial derivatives (NOTE 16)	2,285	(4,393)
Deferred income tax (recovery) expense	(1,245)	862
Non-cash financing expense (NOTE 10)	30	83
Decommissioning expenditures (NOTE 11)	(470)	(230)
FUNDS FLOW FROM OPERATIONS	**8,076**	**12,459**
Change in non-cash working capital (NOTE 18)	2,803	13,191
CASH FLOW FROM OPERATING ACTIVITIES	**10,879**	**25,650**
INVESTING ACTIVITIES		
Exploration and evaluation (NOTE 7)	(220)	(133)
Property, plant and equipment (NOTE 7)	(12,025)	(18,863)
Change in non-cash working capital (NOTE 18)	244	4,537
CASH FLOW USED FOR INVESTING ACTIVITIES	**(12,001)**	**(14,459)**
FINANCING ACTIVITIES		
Operating line (NOTE 10)	(1,714)	(5,956)
Financing lease expense (NOTE 9)	(164)	(138)
Long term debt (NOTE 10)	3,000	4,000
CASH FLOW FROM (USED FOR) FINANCING ACTIVITIES	**1,122**	**(2,094)**
Increase in cash and cash equivalents	-	9,097
Cash and cash equivalents, beginning of period	-	-
CASH AND CASH EQUIVALENTS, END OF PERIOD	**-**	**9,097**

The accompanying notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

These interim consolidated financial statements are as at March 31, 2021 and for the three months ended March 31, 2021 and 2020. Tabular amounts in thousands of Canadian dollars, unless otherwise stated. Amounts in text are in Canadian dollars unless otherwise stated.

1. REPORTING ENTITY

Karve Energy Inc. ("Karve" or the "Company") is a growth-oriented, private oil and natural gas company whose principal business activities are the acquisition, exploration and development of oil and gas properties in western Canada.

The Company was incorporated under the laws of the Province of Alberta on January 30, 2014, under the name "1799380 Alberta Ltd.". On June 16, 2014, the Company changed its name to "Bruin Oil & Gas Inc." ("Bruin") and on September 15, 2016, the Company changed its name to "Karve Energy Inc.". On July 15, 2019, the Company amalgamated with High Ground Energy Inc.

The consolidated financial statements of the Company are comprised of Karve and its wholly-owned subsidiary "DTC Energy Inc." which was incorporated under the laws of the Province of Alberta.

Karve's head office is located at Suite 1700, 205 5 Avenue SW, Calgary Alberta, T2P 2V7.

2. BASIS OF PRESENTATION

Statement of Compliance and Authorization

The consolidated financial statements (the "financial statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of financial statements. Certain comparative figures have been reclassified to conform to the current year presentation.

The financial statements were approved and authorized for issue by Karve's Board of Directors on May 12, 2021.

Basis of Measurement

These financial statements have been prepared on the historical cost basis, except for the revaluation to fair value of certain financial assets and financial liabilities, as required under IFRS. The financial statements are measured and presented in Canadian dollars as the functional currency of the Company.

All accounting policies and methods of computation followed in the preparation of these financial statements are consistent with those in the December 31, 2020 audited financial statements, except for income taxes. Income taxes for interim periods are accrued using the income tax rate that would be applicable to the expected annual net (loss) income.

Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the periods reported. Actual results may differ from such estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in NOTE 2 of the December 31, 2020 audited consolidated financial statements.

3. CHANGES IN ACCOUNTING POLICIES

Government Grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all conditions with the grant are met. Grants related to assets are recorded as a reduction to the asset's carrying value and are depreciated over the useful life of the asset. Claims under such government grant programs related to income are recorded as a deduction of the related expense.

4. TRADE AND OTHER RECEIVABLES

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Trade	11,329	9,695
Joint venture	1,609	1,637
GST	49	6
Allowance for doubtful accounts	(542)	(542)
TRADE AND OTHER RECEIVABLES	**12,445**	**10,796**

In determining the recoverability of receivables, the Company uses the ECL model and considers the age of the outstanding receivable and the credit worthiness of the counterparties. The Company recorded a provision of $542,000 at March 31, 2021 as it determined certain joint venture receivables were uncollectible using the ECL model (December 31, 2020 - $542,000).

Of the Company's accounts receivable at March 31, 2021, approximately 61% was receivable from two oil marketers (46% and 15%). At December 31, 2020, approximately 47% was receivable from two oil marketers (30% and 17%). Accounts receivable outstanding greater than ninety days at March 31, 2021 was $1.2 million (December 31, 2020 - $1.1 million).

5. PREPAIDS AND DEPOSITS

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Prepaids	4,606	4,815
Deposits	98	98
PREPAIDS AND DEPOSITS	**4,704**	**4,913**

6. TRADE AND OTHER PAYABLES

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Trade	9,222	7,146
Accrued	4,790	2,632
Royalties	712	677
GST	338	338
Joint venture	548	326
TRADE AND OTHER PAYABLES	**15,610**	**11,119**

7. CAPITAL ASSETS

The following table reconciles movement of Petroleum and natural gas ("P&NG") assets, corporate assets, and exploration and evaluation ("E&E") assets during the period:

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Petroleum and natural gas assets at cost	502,428	490,305
Corporate assets at cost	982	982
Property, plant and equipment at cost	503,410	491,287
Accumulated depletion and depreciation	(185,743)	(174,764)
PROPERTY, PLANT AND EQUIPMENT NET CARRYING AMOUNT	**317,667**	**316,523**

COST ($000s)	Petroleum and Natural Gas Assets	Corporate Assets	Total Property, Plant and Equipment	Exploration & Evalutation Assets
BALANCE AT DECEMBER 31, 2019	458,659	816	459,475	22,837
Additions	29,408	166	29,574	1,422
Transfers to (from) P&NG/E&E assets	290	-	290	(290)
Change in decommissioning provision (NOTE 11)	1,948	-	1,948	-
Expiries	-	-	-	(2,844)
BALANCE AT DECEMBER 31, 2020	**490,305**	**982**	**491,287**	**21,125**
Additions	12,025	-	12,025	220
Transfers to (from) P&NG/E&E assets	84	-	84	(84)
Change in decommissioning provision (NOTE 11)	14	-	14	-
Expiries	-	-	-	(507)
BALANCE AT MARCH 31, 2021	**502,428**	**982**	**503,410**	**20,754**
ACCUMULATED DD&A ($000s)				
BALANCE AT DECEMBER 31, 2019	124,314	280	124,594	-
Depletion, depreciation and amortization	49,987	183	50,170	-
BALANCE AT DECEMBER 31, 2020	**174,301**	**463**	**174,764**	**-**
Depletion, depreciation and amortization	10,931	48	10,979	-
BALANCE AT MARCH 31, 2021	**185,232**	**511**	**185,743**	**-**
NET CARRYING AMOUNT, DECEMBER 31, 2020	**316,004**	**519**	**316,523**	**21,125**
NET CARRYING AMOUNT, MARCH 31, 2021	**317,196**	**471**	**317,667**	**20,754**

Petroleum and Natural Gas Assets

At March 31, 2021, future development and production costs of $447.1 million (December 31, 2020 - $448.6 million) are included in costs subject to depletion.

General and administration costs capitalized by the Company during the three months ended March 31, 2021 were $215,000 (three months ended March 31, 2020 – $306,000).

The Company assessed for indicators of impairment and there were no indicators of impairment at March 31, 2021 or December 31, 2020.

As at March 31, 2020, the Company performed an impairment indicator assessment of its petroleum and natural gas assets and determined that there were impairment indicators based on the significant decrease in oil pricing during March 2020. Based on the reduction in oil pricing, the Company performed an impairment test and it was determined that the recoverable amount was greater than the carrying amount. The recoverable amount was determined based on fair value less costs of disposal (Level 3). The fair values were calculated based on discounted after-tax cash flows of proved and probable reserves using forecasted forward prices and cost estimates at March 31, 2020. Key assumptions used to determine the recoverable amount (future cash flows from reserves) include petroleum and natural gas prices, costs to develop and the discount rate. Discounted future cash flows are determined by applying a discount rate of 11%. The Company used internally prepared reserve estimates.

At March 31, 2020, future development and production costs of $377 million were included in costs subject to depletion.

The forward prices as at March 31, 2020 used to determine future cash flows from petroleum and natural gas reserves were:

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029 (1)
WTI crude oil (USD/bbl)	29.17	40.45	49.17	53.28	55.66	56.87	58.01	59.17	60.35	61.56
AECO natural gas ($/MMBtu)	1.74	2.20	2.38	2.45	2.53	2.60	2.66	2.72	2.79	2.85
Exchange Rate (CAD/USD) (2)	0.71	0.73	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

(1) Forecast benchmark commodity prices are assumed to increase by 2% in each year after 2029 to the end of the reserve life.

(2) Forecast exchange rate is assumed to remain at 0.75 CAD/USD each year after 2029 to the end of the reserve life.

As at March 31, 2020, a one percent increase in the assumed discount rate and/or a five percent decrease in forecast operating cash flows would result in the following pre-tax impairment expense being recognized:

($000s)	Impairment expense
1% increase in discount rate	19,048
5% decrease in cash flow	15,641
1% increase in discount rate and 5% decrease in cash flow	33,846

Exploration and Evaluation

Exploration and evaluation assets consist of the Company's undeveloped land, seismic, geological and geophysical costs and exploration projects that are pending the determination of technical feasibility.

The Company assessed for indicators of impairment and there were no indicators of impairment at March 31, 2021 or December 31, 2020.

8. RIGHT OF USE ASSETS

The following table reconciles the movement of right of use assets during the period:

($000s)	
Balance at December 31, 2020	738
Additions	-
BALANCE AT MARCH 31, 2021	**738**
ACCUMULATED DEPRECIATION AND AMORTIZATION	
Balance at December 31, 2020	(656)
Depreciation and amortization	(82)
BALANCE AT MARCH 31, 2021	(738)
NET CARRYING AMOUNT, MARCH 31, 2021	-

9. LEASE LIABILITY

The Company has lease liabilities for office space. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Lease liabilities were measured at a discounted value of lease payments using a weighted average incremental borrowing rate of 5% at January 1, 2019.

($000s)	
Balance at December 31, 2020	156
Interest expense	8
Lease payments	(164)
BALANCE AT MARCH 31, 2021	-

	As at Mar. 31, 2021	As at Dec. 31, 2020
Lease liability - current	-	156
Lease liability - long term	-	-
TOTAL LEASE LIABILITY AT MARCH 31, 2021	-	**156**

At March 31, 2021 the Company’s office lease expired bringing the lease liability and the right of use assets to $nil (NOTE 8). The Company has entered into a new office lease agreement effective April 1, 2021 to February 28, 2024.

10. OPERATING LOAN AND LONG TERM DEBT

The Company has secured bank credit facilities of $65.0 million, comprised of a $58.0 million Credit Facility and a $7.0 million operating loan. The full facility is conforming. The Credit Facility is a committed 364 days + 1 year and extendible upon agreement annually and shown as long term debt on the Company’s balance sheet. The operating loan is shown as a current liability. The

Credit Facility and operating loan incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75% and 4.75% depending on the type of borrowing and the Corporation's debt to EBITDA ratio. The Company is also subject to a standby fee of 0.6875% to 1.1875% based on the Corporation's debt to EBITDA ratio. The next annual review date is May 31, 2021.

As at March 31, 2021, $56.4 million (net of unamortized debt issue costs) (December 31, 2020 - $53.4 million) was drawn on the Credit Facility and $3.8 million (December 31, 2020 - $5.5 million) was drawn on the operating loan.

On September 2, 2020, the Corporation issued an irrevocable standby letter of credit in favor of the Saskatchewan - Ministry of Energy and Resources in the amount of $551,000, thereby reducing the available bank credit facility drawings by the same amount. This letter of credit represents a security deposit for the Corporation's Licensee Liability Rating ("LLR") with the Saskatchewan government and will be redetermined on September 2, 2021.

On June 19, 2020, the Corporation issued an irrevocable standby letter of credit in favor of a Nova Gas Transmission Ltd. in the amount of $230,000, thereby reducing the available bank credit facility drawings by the same amount. The letter of credit was increased to $340,000 on February 5, 2021. Subsequent to March 31, 2021, the letter of credit was further increased to $400,000. This letter of credit will be redetermined on June 19, 2021.

Long term debt and operating loan as at March 31, 2021 and December 31, 2020 is as follows:

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Credit Facility	56,500	53,500
Less: unamortized debt issue costs	(104)	(126)
LONG TERM DEBT	**56,396**	**53,374**
Operating loan	3,798	5,513
TOTAL BANK DEBT	**60,194**	**58,887**

Financing expense for the three months ended March 31, 2021 and March 31, 2020 is comprised of the following:

	For the three months ended	
($000s)	Mar. 31, 2021	Mar. 31, 2020
Credit facility interest and charges	565	552
Operating loan interest and charges	22	26
Amortization of debt issue costs	22	74
Interest on lease liability (NOTE 9)	8	9
FINANCING EXPENSES	**617**	**661**

For the three months ended March 31, 2021, the effective interest rate on the credit facility was 4.3% (three months ended March 31, 2020 – 3.9%).

11. DECOMMISSIONING LIABILITY

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company to abandon and reclaim the wells and facilities. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities and the discount rate applied in measuring the liability. The liability, the related asset and the expense are impacted by estimates with respect to the costs and timing of decommissioning.

The Company estimates its total undiscounted amount of cash flows required to settle its decommissioning liability is approximately $177.1 million ($101.3 million undiscounted, uninflated) (December 31, 2020 - $176.5 million and $101.0 million respectively), which will be incurred over the remaining life of the assets with the costs to be incurred between 2021 and 2065. The estimated future cash flows have been discounted using a credit adjusted rate of 11% (December 31, 2020 – 11%) and an inflation rate of 2% (December 31, 2020 – 2%). The change in estimate for the year ended December 31, 2020 relates to an increase to the credit adjusted discount rate and changes in timing of abandonment and reclamation expenses.

On May 1, 2020, the Alberta Department of Energy initiated the Site Rehabilitation Program ("SRP") whereby it will provide funding in the form of grant payments to the oil field services sector to abandon and/or reclaim upstream oil and gas infrastructure. The SRP will run from May 1, 2020 to March 31, 2022. Pursuant to the SRP, the Company was approved for up to $4.8 million in SRP funding. To date the Company has received $786,000 in SRP costs (December 31, 2020 - $251,000) resulting in a reduction of the decommissioning liability, with an off-setting credit to depletion, depreciation and amortization in the consolidated statement of loss and comprehensive loss.

The following table shows changes in the decommissioning liability:

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Balance, beginning of period	21,659	19,183
Decommissioning liabilities incurred during the period	14	176
Decommissioning liabilities settled during the period	(470)	(766)
Decommissioning liabilities settled during the period through SRP	(535)	(251)
Accretion expense during the period	596	1,545
Change in estimate	-	1,772
BALANCE, END OF PERIOD	**21,264**	**21,659**
Decommissioning liability - current	2,324	2,502
Decommissioning liability - long term	18,940	19,157
TOTAL DECOMMISSIONING LIABILITY - END OF PERIOD	**21,264**	**21,659**

12. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares.

Unlimited number of preferred shares, issuable in series.

b) Issued and Outstanding Common Shares

($000s except for share amounts)	Number	Amount
Common Shares		
Balance at December 31, 2018	137,269,270	216,208
Issued common shares	3,243,729	8,909
Issued on exercise of options and performance warrants	16,666	27
Allocation of contributed surplus - exercise of options	-	14
BALANCE AT DECEMBER 31, 2019 and DECEMBER 31, 2020 and MARCH 31, 2021	**140,529,665**	**225,158**

c) Contributed Surplus

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Balance, beginning of period	27,948	22,224
Share-based compensation - options	349	3,131
Share-based compensation - warrants	331	2,593
BALANCE, END OF PERIOD	**28,628**	**27,948**

d) Per Share Amounts

($000s except per share amounts)	For the three months ended Mar. 31, 2021	Mar. 31, 2020
Net loss for the period	(4,838)	(104)
Weighted average number of shares - basic	140,529,665	140,529,665
Dilutive impact of share-based compensation plans	-	-
Weighted average number of shares - diluted	**140,529,665**	**140,529,665**
Net loss per share - basic	**(0.03)**	**-**
Net loss per share - diluted	**(0.03)**	**-**

At March 31, 2021, 8,799,335 stock options and 12,560,000 performance warrants were excluded from the fully diluted calculation as they are anti-dilutive.

13. OTHER INCOME

The following table presents the composition of amounts included in Other Income in the consolidated statements of net loss and comprehensive loss:

	For the three months ended	
($000s)	Mar. 31, 2021	Mar. 31, 2020
Royalty income	873	723
Processing fee income	663	786
Other	37	136
TOTAL OTHER INCOME	**1,573**	**1,645**

Royalty income relates to freehold royalties, gross overriding royalties, royalties paid to the Company on fee title lands, and net profit interests.

Processing fee income relates to the Company processing third party oil and gas volumes through Karve owned and operated facilities.

Other income relates to road use income, seismic licensing income, and contract operating income.

14. SHARE-BASED COMPENSATION

The following table summarizes the Company's share-based compensation:

	For the three months ended	
($000s)	Mar. 31, 2021	Mar. 31, 2020
Share-based compensation - options	349	822
Share-based compensation - performance warrants	331	758
TOTAL SHARE-BASED COMPENSATION	**680**	**1,580**

a) Stock Options

Effective June 15, 2016, the Company adopted a new stock option plan under which officers, management, employees, directors and consultants of the Company are eligible to receive grants. Under the stock option plan, which was approved by the Board of Directors, the granted stock options vest to the grantee over a three-year period, the grantee has the right to exercise the stock options for seven years from the date of the grant and the stock options terminate 30 days following the termination of the grantee's employment. All stock options vest and may be exercisable in the event of a change of control or initial public offering. The maximum number of outstanding stock options under the plan is limited to 10% of the common shares outstanding. Stock option grants and the option exercise price are set by the Board of Directors at the time of grant. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for options outstanding was approved by the Board of Directors.

Share-based compensation expense related to stock options during the three months ended March 31, 2021 was $349,000 million (three months ended March 31, 2020 - $822,000).

The following table sets forth a reconciliation of the stock option plan activity from December 31, 2019 through to March 31, 2021:

	Number	Wtd. Avg. Exercise Price ($)
Balance at December 31, 2019	13,684,260	1.78
Granted	250,000	2.25
Forfeited	(86,000)	1.85
BALANCE AT DECEMBER 31, 2020	**13,848,260**	**1.79**
Granted	200,000	2.25
BALANCE AT MARCH 31, 2021	**14,048,260**	**1.79**

There were no stock options exercised during the three months ended March 31, 2021 and 10,914,351 stock options were exercisable at March 31, 2021. There were no stock options exercised during the year ended December 31, 2020. As at December 31, 2020 there were 10,814,351 options exercisable.

The range of exercise prices of the outstanding options and weighted average contractual life remaining as at March 31, 2021 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life Remaining	Number of options outstanding	Number of options exercisable
$0.85	2.21	2,320,976	2,320,976
$1.00 - $1.99	2.30	1,667,357	1,667,357
$2.00 - $3.00	4.37	10,059,927	6,926,018
	3.77	**14,048,260**	**10,914,351**

The fair value of each option granted or acquired is estimated on the date of grant or acquisition using the Black-Scholes option pricing model with the following weighted average assumptions:

	For the three months ended	
	Mar. 31, 2021	Mar. 31, 2020
Weighted average fair value of options granted	1.20	1.14
Risk-free Interest rate (%)	0.92%	0.78%
Expected life (years)	5.0	5.0
Estimated volatility of underlying common shares (%)	63%	60%
Weighted average grant date share price	2.25	2.25
Forfeiture rate	4%	4%
Expected dividend yield (%)	-	-

The expected volatility of the options granted is based on the historical volatility of publicly traded peer companies that in management's judgement have similar characteristics to the Company and are therefore a good indicator of the expected volatility of the Company.

b) Performance Warrants

There were no performance warrants issued by the Board of Directors during the three months ended March 31, 2021 (year ended December 31, 2020 – nil).

The performance warrants entitle the holder to purchase one common share of the Company and have the following vesting dates and exercise prices:

	2016 Issuance	**2017 Issuance**
Warrants granted	16,125,000	17,937,500
Issue date	$1.50	$3.00
First anniversary	$1.70	$3.40
Second anniversary	$1.90	$3.80
Third anniversary	$2.10	$4.20
Fourth anniversary	$2.30	$4.60

The right to exercise the performance warrants is subject to a performance event taking place which includes the occurrence of any of the following (i) the Company raising a minimum of $25.0 million through a private placement, excluding the securities issued as part of the recapitalization that occurred in June 2016 (ii) the occurrence of an initial public offering on a recognized Canadian or U.S. stock exchange, or (iii) a change of control. Only vested performance warrants based on the schedule above will become exercisable if the Company achieves performance event (i). In the event of performance event (ii) and (iii), all performance warrants outstanding which have not vested or become exercisable in accordance with their terms shall vest and become exercisable immediately. On November 6, 2019, an extension of 2 years to the expiry date (from 5 years to 7 years) for performance warrants was approved by the Board of Directors.

Share-based compensation expense related to performance warrants during the three months ended March 31, 2021 was $331,000 (three months ended March 31, 2020 - $758,000).

The following table sets forth a reconciliation of performance warrant activity from December 31, 2019 through to March 31, 2021:

	Number	Wtd. Avg. Exercise Price
BALANCE AT DECEMBER 31, 2019	32,129,500	2.87
Forfeited	(62,000)	3.80
BALANCE AT DECEMBER 31, 2020 & MARCH 31, 2021	**32,067,500**	**2.87**

There were no performance warrants exercised during the three months ended March 31, 2021 (year ended December 31, 2020 - nil) and 6,460,000 performance warrants were exercisable as at March 31, 2021 and December 31, 2020.

The range of exercise prices of the outstanding performance warrants and weighted average contractual life remaining as at March 31, 2021 were as follows:

Exercise Price Range	Wtd. Avg. Contractual Life Remaining	Number of warrants outstanding	Number of warrants exercisable
$1.50 to $2.99	2.31	15,700,000	6,460,000
$3.00 to $3.99	3.49	9,820,500	-
$4.00 to $4.60	3.49	6,547,000	-
	2.91	**32,067,500**	**6,460,000**

15. COMMITMENTS

Future minimum payments under operating leases and pipeline transportation agreements as at March 31, 2021 are as follows:

($000s)	2021	2022	Therafter	Total
Operating leases	68	-	-	68
Pipeline transportation	1,092	985	1,005	3,082
TOTAL COMMITMENTS	1,160	985	1,005	3,150

16. FINANCIAL INSTRUMENTS

The Company has exposure to credit, liquidity, interest, and foreign currency risk from its use of financial instruments. Further qualitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for identifying the principal risks of the Company and ensuring the policies and procedures are in place to appropriately manage these risks. Karve's management identifies, analyzes and monitors risks and considers the implication of the market condition in relation to the Company's activities.

a) Fair Value of Financial Instruments

Financial instruments comprise cash and cash equivalents, trade and other receivables, deposits, derivative assets (liabilities), trade and other payables, operating loan, and long term debt.

There are three levels of fair value by which a financial instrument can be classified:

Level 1 - Quoted prices in active markets for identical assets and liabilities such as traded securities on a registered exchange where there are a sufficient frequency and volume of transactions to provide ongoing pricing information.

Level 2 - Inputs other than quoted prices that are observable for the asset and liability either directly and indirectly such as quoted forward prices for commodities, time value and volatility factors which can be substantially observed or corroborated in the marketplace; and

Level 3 - Inputs that are not based on observable market data.

The fair values of the derivative contracts used for risk management as at March 31, 2021 were measured using level 2 observable inputs, including quoted prices received from financial institutions based on published forward price curves as at the measurement date, using the remaining contracted oil and natural gas volumes.

The fair value of cash and cash equivalents, trade and other receivables, deposits, and trade and other payables approximate their carrying amounts due to their short-term maturities. The fair value of the amounts drawn on the operating loan and long term debt is equal to its carrying amount as the facilities bear interest at floating rates and credit spreads that are indicative of market rates.

The following table summarizes Karve's financial instruments at March 31, 2021:

($000s)	Amortized cost	Total fair value
Assets		
Trade and other receivables	12,445	12,445
Deposits	98	98
	12,543	**12,543**
Liabilities		
Trade and other payables	15,610	15,610
Operating loan	3,798	3,798
Long term debt	56,396	56,396
	75,804	**75,804**

The following table summarizes Karve's financial instruments at December 31, 2020:

($000s)	Amortized cost	Total fair value
Assets		
Trade and other receivables	10,796	10,796
Deposits	98	98
	10,894	**10,894**
Liabilities		
Trade and other payables	11,119	11,119
Operating loan	5,513	5,513
Long term debt	53,374	53,374
	70,006	**70,006**

b) Risk Associated with Financial Assets and Liabilities

Commodity Price Risk

Due to the volatile nature of natural gas and oil commodity prices, the Company is exposed to adverse consequences if commodity prices decline. The Company is exposed to commodity price movements as part of its operations, particularly in relation to the prices received for its oil and gas production. Oil and gas is sensitive to numerous worldwide factors, many of which are beyond the Company's control. Changes in global supply and demand fundamentals in the oil and gas market and geopolitical events can significantly affect oil and gas prices. Consequently, these changes could also affect the value of the Company's properties, the level of spending for exploration and development and the ability to meet obligations as they come due. The Company's oil production is sold under short-term contracts, exposing it to the risk of near-term price movements depending on marketing conditions, it is the Company's policy to hedge a portion of its crude oil sales through the use of financial derivative contracts. The Company does not apply hedge accounting to these contracts.

At March 31, 2021, the Company had the following commodity contracts in place:

Type	Term	Basis [1]	Volume (Bbl/d)	Swap Price ($CAD/Bbl)[1]	Current Liability ($000s)
Fixed price swap	Jan. 1/21 - June 30/21	WTI	500	58.25	(726)
Fixed price swap	Jan. 1/21 - June 30/21	WTI	500	55.95	(830)
Fixed price swap	Jan. 1/21 - June 30/21	WTI	500	56.50	(806)
Fixed price swap	Jan. 1/21 - June 30/21	WTI	500	56.00	(829)
Fixed price swap	Jan. 1/21 - June 30/21	WTI	500	56.00	(829)
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE - 2021			**2,500**	**56.54**	**(4,020)**

(1) Nymex WTI monthly average in $CAD.

Type	Term	Basis	Volume (Bbl/d)	Swap Price ($USD/Bbl)	Current Liability ($000s)
Fixed price differential	Mar. 1/21 - Dec. 31/21	MSW	1,000	(4.85)	(493)
Fixed price differential	Apr. 1/21 - Dec. 31/21	MSW	500	(4.40)	(169)
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE - 2021			**1,500**	**(4.70)**	**(662)**

At March 31, 2021, the fair value of the financial derivative contracts was a current liability position of $4.7 million (December 31, 2020 - $2.4 million) resulting in an unrealized loss of $2.3 million for the three months ended March 31, 2021. The fair value, or mark-to-market value, of these contracts are based on the estimated amount that would have been received or paid to settle the contracts as at March 31, 2021 and may be different from what will eventually be realized. Assuming all other variables remain constant, a $5.00 USD increase in WTI would result in an unrealized loss of $3.4 million and a derivative liability of $5.8 million. A $5.00 USD decrease in WTI would result in an unrealized loss of $1.1 million or a derivative liability of $3.5 million.

Subsequent to March 31, 2021, the Company entered into the following derivative contract:

Type	Term	Basis [1]	Volume (Bbl/d)	Sold Put Price ($CAD/Bbl)
Put option	Jul. 1/21 - Dec. 31/21	WTI	1,000	60.00
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE			**1,000**	**60.00**

(1) Nymex WTI monthly average in $CAD.

The components of the (loss) gain on financial derivative contracts is as follows:

	For the three months ended	
($000s)	Mar. 31, 2021	Mar. 31, 2020
Unrealized (loss) gain on financial derivative contracts	(2,285)	4,393
Realized (loss) on financial derivative contracts	(3,761)	-
(LOSS) GAIN ON FINANCIAL DERIVATIVE CONTRACTS	**(6,046)**	**4,393**

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that bank debt is at a floating or short-term rate of interest in relation to interest expense on its long term debt and operating loan facility. The Credit Facility and operating loan incur interest based on the applicable Canadian prime rate or Banker's Acceptance rate plus between 1.75% and 4.75% depending on the type of borrowing and the Company's debt to EBITDA ratio, and is subject to an annual standby fee on the undrawn portion. As at March 31, 2021, $56.5 million (December 31, 2020 - $53.5 million) was drawn on the Credit facility ($56.4 million – net of amortized debt issue costs). Currently the Company has not entered into any agreements to manage this risk. An increase (decrease) in the interest rate by 1% would result in an increase (decrease) to net loss before tax of $136,000 for the three months ended March 31, 2021 (three months ended March 31, 2020 - $112,000).

Liquidity Risk

The Company's approach to managing liquidity risk is to have sufficient cash and/or credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of 12 months to identify any financing requirements. Liquidity is managed through daily and longer-term cash, debt, and equity management strategies. These include estimating future cash generated from operations based on reasonable production and pricing assumptions, estimating future discretionary and non-discretionary capital expenditures and assessing the amount of equity or debt financing available.

A contractual maturity analysis for the Company's financial liabilities as at March 31, 2021 is as follows:

($000s)	Within 1 year	1 to 5 years	Total
Trade and other payables	15,610	-	15,610
Operating loan	3,798	-	3,798
Long term debt	-	56,396	56,396
TOTAL	**19,408**	**56,396**	**75,804**

17. CAPITAL MANAGEMENT

a) Capital Base

In order to continue the Company's future exploration and development program, the Company must maintain a strong capital base to enable access to equity and debt markets. The Company continually monitors the risk/reward profile of its exploration and development projects and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. After considering these factors, revisions to the Company's capital budget is made upon the approval of the Board of Directors.

The Company considers shareholders' capital and net debt/adjusted positive working capital (excluding derivative assets and current portion decommissioning liability) as components of its capital base. The Company can access or increase capital through the issuance of shares, through bank borrowings (based on reserves) and by building cash reserves by reducing its capital expenditure program.

The following table represents the net capital of the Company:

($000s)	As at Mar. 31, 2021	As at Dec. 31, 2020
Shareholders' capital	260,398	264,556
Total current assets	17,149	15,709
Trade and other payables	(15,610)	(11,119)
Operating loan	(3,798)	(5,513)
Long term debt	(56,396)	(53,374)
NET DEBT	**(58,655)**	**(54,297)**
CAPITAL BASE	**201,743**	**210,259**

The Company monitors its capital based primarily on its Net debt to annualized funds flow ratio. Net debt and annualized funds flow are non-GAAP measures. Net debt is defined as long term debt plus any net working capital deficiency excluding derivative contract asset/liability, current portion of decommissioning liability, and current portion of lease liability. Annualized funds flow is calculated as cash flow from operations before changes in non-cash working capital for the Company's most recent quarter, multiplied by four. To facilitate the management and control its' capital base, the Company prepares annual operating and capital expenditure budgets. The budgets are updated when critical factors change. These include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and Company specific factors or assumptions such as the Company's drilling results and its production profile. The Company's Board of Directors approves the budget and changes thereto. At March 31, 2021, the Company had net debt of $58.7 million (December 31, 2020 – $54.3 million).

The Company's share capital is not subject to external restrictions, but the Company does have key covenants of the credit facilities that include standard business operating covenants. As at March 31, 2021, the Company is in compliance with all covenants.

The current challenging economic climate may lead to further adverse changes in cash flows, working capital levels and/or debt balances, which may also have a direct impact on the Company's operating results and financial position. These and other factors may adversely affect the Company's liquidity and the Company's ability to generate income and cash flows in the future. At March 31, 2021, the Company remains in compliance with all terms of our Credit Facility and based on current available information, management expects to comply with all terms during the subsequent 12-month period. However, in light of the current volatility in commodity prices and uncertainty regarding the timing for a recovery in such prices, pipeline and transportation capacity constraints, and the effects of the Coronavirus (COVID-19), preparation of financial forecasts is challenging.

18. SUPPLEMENTAL INFORMATION

The following table presents the composition of changes in non-cash working capital and the allocation to operating and investing activities:

	For the three months ended	
($000s)	Mar. 31, 2021	Mar. 31, 2020
CHANGES IN NON-CASH WORKING CAPITAL:		
Trade and other receivables (NOTE 4)	(1,653)	9,106
Prepaids and deposits (NOTE 5)	209	382
Trade and other payables (NOTE 6)	4,491	8,240
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**3,047**	**17,728**
CHANGES IN NON-CASH WORKING CAPITAL RELATED TO:		
Operating activities	2,803	13,191
Investing activities	244	4,537
Financing activities	-	-
TOTAL CHANGES IN NON-CASH WORKING CAPITAL	**3,047**	**17,728**

The following table presents the composition of petroleum & natural gas sales by product:

	For the three months ended	
($000s)	Mar 31, 2021	Mar 31, 2020
Crude oil	23,096	24,086
Natural gas liquids	993	859
Natural gas	3,446	3,002
TOTAL PETROLEUM AND NATURAL GAS SALES	**27,535**	**27,947**

19. SUBSEQUENT EVENTS

Subsequent to March 31, 2021, the Company entered into the following derivative contract:

Type	Term	Basis [1]	Volume (Bbl/d)	Sold Put Price ($CAD/Bbl)
Put option	Jul. 1/21 - Dec. 31/21	WTI	1,000	60.00
TOTAL VOLUME AND WEIGHTED AVERAGE PRICE			**1,000**	**60.00**

(1) Nymex WTI monthly average in $CAD.