



Condensed Interim Consolidated Financial Statements

**For the three and nine months ended
September 30, 2023
(unaudited)**

Lycos Energy Inc.

Condensed Interim Consolidated Statements of Financial Position

(unaudited)

(in thousands)

	Notes	September 30, 2023	December 31, 2022
Assets			
Current assets			
Cash		\$ -	\$ 59,628
Accounts receivable	15	12,872	4,998
Due from related party		-	426
Financial derivative	15	199	-
Prepaid expenses and deposits		2,015	968
Total current assets		15,086	66,020
Exploration and evaluation assets	6	2,646	755
Property, plant and equipment	4 & 7	200,318	64,797
Investment in associate	4 & 5	-	3,676
Total assets		\$ 218,050	\$ 135,248
Liabilities and Shareholders' Equity			
Current liabilities			
Accounts payable and accrued liabilities	15	\$ 33,981	\$ 9,141
Current portion of lease obligations	9	137	44
Current portion of decommissioning liabilities	8	1,500	1,000
Financial derivative	15	876	-
Bank debt	16	9,784	-
Total current liabilities		46,278	10,185
Lease obligations	9	305	-
Decommissioning liabilities	8	30,353	16,662
Deferred income tax		4,076	-
Total liabilities		81,012	26,847
Shareholders' equity			
Share capital	10	179,568	177,032
Contributed surplus		9,508	6,954
Deficit		(52,038)	(75,585)
Total shareholders' equity		137,038	108,401
Total liabilities and shareholders' equity		\$ 218,050	\$ 135,248

Commitments (note 17)

Subsequent events (note 19)

See accompanying notes to the condensed interim consolidated financial statements

Lycos Energy Inc.

Condensed Interim Consolidated Statements of Income and Comprehensive Income

(unaudited)

(in thousands, except per share data)

	Notes	Three Months Ended September 30, 2022 Adjusted (Note 20)		Nine Months Ended September 30, 2022 Adjusted (Note 20)	
		2023		2023	
Revenue					
Petroleum and natural gas sales	12	\$ 28,310	\$ 11,575	\$ 65,945	\$ 32,092
Royalties		(3,411)	(1,579)	(7,484)	(4,073)
Petroleum and natural gas sales, net of royalties		24,899	9,996	58,461	28,019
Other income		53	160	556	421
Realized loss on financial derivatives	15	(594)	-	(502)	-
Unrealized loss on financial derivatives	15	(688)	-	(677)	-
Total revenue and other income		23,670	10,156	57,838	28,440
Expenses					
Operating		7,681	5,751	19,980	14,392
Blending and transportation		4,547	2,016	14,730	5,819
General and administrative		1,209	844	3,201	1,671
Stock-based compensation	11	567	-	1,560	-
Transaction costs	18	649	-	1,525	-
Finance expense	13	347	140	808	350
Depletion and depreciation	7	5,639	2,125	14,745	4,885
Impairment reversal		-	(19,589)	-	(19,589)
Gain on disposition		-	(99)	-	(296)
		20,639	(8,812)	56,549	7,232
Net income before investment in associate		\$ 3,031	\$ 18,968	\$ 1,289	\$ 21,208
Gain on CDLP Acquisition	4 & 5	-	-	11,382	-
Share of profit (loss) of investment in associate	5	-	(2,634)	35	(1,901)
Loss related to Class D distribution		-	(688)	-	(688)
Income (loss) from investment in associate		\$ -	\$ (3,322)	\$ 11,417	\$ (2,589)
Income before income taxes		3,031	15,646	12,706	18,619
Deferred income tax expense (recovery)		1,332	-	(10,841)	-
Net income and comprehensive income		\$ 1,699	\$ 15,646	\$ 23,547	\$ 18,619
Net income per share					
Basic	10	\$ 0.04	\$ 1.59	\$ 0.59	\$ 1.90
Diluted	10	\$ 0.04	\$ 1.59	\$ 0.56	\$ 1.90

See accompanying notes to the condensed interim consolidated financial statements

Lycos Energy Inc.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

(in thousands, except share amounts)

	Notes	Number of Common Shares	Share Capital	Contributed Surplus	Deficit	Shareholders' Equity
Balance, December 31, 2021 ⁽¹⁾	10	9,812,325	\$ 113,332	\$ 6,954	\$ (79,256)	\$ 41,030
Net income		-	-	-	18,619	18,619
Balance, September 30, 2022 ⁽¹⁾		9,812,325	\$ 113,332	\$ 6,954	\$ (60,637)	\$ 59,649
Balance, December 31, 2022 ⁽¹⁾	10	39,768,500	\$ 177,032	\$ 6,954	\$ (75,585)	\$ 108,401
Stock-based compensation	11	-	-	2,554	-	2,554
Issued pursuant to acquisition	4 & 10	635,640	2,536	-	-	2,536
Net income		-	-	-	23,547	23,547
Balance, September 30, 2023	10	40,404,140	\$ 179,568	\$ 9,508	\$ (52,038)	\$ 137,038

⁽¹⁾ The number of common shares has been adjusted retrospectively to reflect the 8:1 share consolidation that was approved by Lycos' shareholders on June 14, 2023 and effected on September 1, 2023 (note 10).

See accompanying notes to the condensed interim consolidated financial statements

Lycos Energy Inc.

Condensed Interim Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

		Three Months Ended		Nine Months Ended	
	Notes	September 30,	2022	September 30,	2022
		2023		2023	
Operating Activities					
Net income		\$ 1,699	\$ 15,646	\$ 23,547	\$ 18,619
Adjustments for:					
Unrealized loss on financial derivatives	15	688	-	677	-
Finance expense	13	347	140	808	350
Interest expense	13	(95)	-	(152)	(5)
Depletion and depreciation	7	5,639	2,125	14,745	4,885
Impairment reversal		-	(19,589)	-	(19,589)
Stock-based compensation	11	567	-	1,560	-
Gain on disposition		-	(99)	-	(296)
Other income		-	(156)	-	(396)
Gain on CDLP Acquisition	4 & 5	-	-	(11,382)	-
Share of profit (loss) of investment in associate	5	-	2,634	(35)	1,901
Loss related to Class D distribution		-	688	-	688
Deferred income tax expense (recovery)		1,332	-	(10,841)	-
Decommissioning expenditures	8	(899)	(20)	(1,363)	(20)
Change in non-cash operating working capital	14	(1,744)	1,795	(5,656)	(1,655)
Cash flow from operating activities		7,534	3,164	11,908	4,482
Financing Activities					
Payments on lease obligations	9	(54)	(8)	(118)	(107)
Bank debt	16	9,784	-	9,784	-
Cash flow from (used in) financing activities		9,730	(8)	9,666	(107)
Investing Activities					
Capital expenditures - exploration and evaluation	6	(2,331)	(3)	(3,242)	(92)
Capital expenditures - property, plant and equipment	7	(18,549)	(3,019)	(41,234)	(4,510)
Acquisition through business combination, net of cash acquired	4	(6,110)	-	(54,886)	-
Proceeds on disposition		-	98	-	316
Change in non-cash investing working capital	14	8,763	939	18,160	1,333
Cash flow used in investing activities		(18,227)	(1,985)	(81,202)	(2,953)
Change in cash		(963)	1,171	(59,628)	1,422
Cash, beginning of period		963	494	59,628	243
Cash, end of period		\$ -	\$ 1,665	\$ -	\$ 1,665

See accompanying notes to the condensed interim consolidated financial statements.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2023, and 2022

(Tabular amounts in thousands)

1. Corporate information

Lycos Energy Inc. (“Lycos” or the “Company”) is a Canadian resource company engaged in the exploration for and development of petroleum and natural gas production in western Canada. The consolidated financial statements (the “financial statements”) of the Company are comprised of the accounts of Lycos, Chronos Duvernay LP, Chronos Duvernay GP Ltd., Chronos Duvernay Ltd., Chronos Duvernay MIS Ltd. and Chronos Duvernay Sub Co. Ltd., which are incorporated in Canada. Lycos is a public company existing under the Alberta Business Corporations Act with common shares listed on the TSX Venture Exchange (“TSXV”) under the symbol “LCX”.

On December 12, 2022, Lycos (formerly Samoth Oilfield Inc. or “Samoth”) and Chronos Resources Ltd. (formerly “Chronos”) completed an amalgamation (the “Transaction”) pursuant to a Definitive Agreement dated November 7, 2022, between Samoth and Chronos. The amalgamation was treated as a reverse takeover transaction (“RTO”) for accounting purposes. In accordance with IFRS 3, Samoth did not meet the definition of a business for accounting purposes. Therefore, the RTO does not constitute a business combination, but instead a share-based payment to acquire Samoth’s listing status, with Chronos being the continuing entity from an accounting perspective.

On February 28, 2023, Lycos purchased its partner’s equity interest in the Company’s limited partnership (“the CDLP Acquisition”). The purchase price consisted of \$50.0 million cash and the grant of a 2.345% gross overriding royalty (“GORR”) to the former partner on any newly drilled wells on the acquired lands. The strategic CDLP Acquisition provides the Company with 100% working interest in certain lands and heavy oil producing wells in Lloydminster, Alberta (see note 4).

On May 1, 2023, Lycos amalgamated with the Company’s limited partnership by way of a vertical amalgamation with Chronos Duvernay GP Ltd., Chronos Duvernay Ltd., Chronos Duvernay MIS Ltd. and Chronos Duvernay Sub Co. Ltd.

On June 14, 2023, the shareholders of Lycos approved a consolidation of common shares (the “Consolidation”) on the basis of a ratio eight (8) pre-consolidation common shares for each one (1) post-consolidation common share. The Consolidation was effective on September 1, 2023. As a result, the number of common shares has been adjusted retrospectively to reflect the 8:1 share consolidation (see notes 10 and 11).

On September 1, 2023, Lycos completed the acquisition (the “Wyatt Acquisition”) of Wyatt Resources Ltd. (“Wyatt”), a privately held, heavy oil producer in the Greater Lloydminster area of Alberta. The purchase price consisted of \$6.3 million in cash, net of closing adjustments, and subject to change, and the issuance of 635,640 post-consolidation common shares valued at \$2.5 million (based on the closing price of Lycos’ common shares of \$3.99 per share on the TSXV on September 1, 2023). Following the completion of the Wyatt Acquisition and the Consolidation, Lycos now has 40,404,140 shares issued and outstanding (see notes 4 and 10).

Lycos principal place of business is located at 1900, 215 – 2nd Street S.W., Calgary, Alberta and its registered office is located at 4300 Bankers Hall West, 888-3rd Street S.W. Calgary, Alberta.

2. Basis of preparation

Statement of compliance

These unaudited condensed interim financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting as issued by the International Accounting Standards Board (“IASB”). The unaudited condensed interim financial statements do not include all information required for annual financial statements and should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2022.

These unaudited condensed interim financial statements have been prepared following the same accounting policies as the Company’s audited financial statements for the year ended December 31, 2022.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2023, and 2022

(Tabular amounts in thousands)

The timely preparation of these financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in the audited financial statements for the year ended December 31, 2022.

These unaudited condensed interim financial statements were approved and authorized for issue by the Board of Directors on November 22, 2023.

3. Significant accounting policies

Except as described below, these Condensed Interim Consolidated Financial Statements as at September 30, 2023 have been prepared following the same accounting policies as the consolidated financial statements as at December 31, 2022.

Business combinations

The acquisition method of accounting is used to account for acquisitions of entities or assets that meet the definition of a business under IFRS. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued, and liabilities incurred or assumed at the date of acquisition.

The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Transaction costs are expensed as incurred.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognized in the Condensed Interim Consolidated Statement of Income and Comprehensive Income.

Acquisition-related costs are recognized in earnings as incurred. Identifiable assets acquired, liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess cost of acquisition over the fair value of the identifiable assets and liabilities acquired and contingent liabilities for which a provision is provided is recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets of the entities acquired, the difference is recognized as a bargain purchase gain in the Condensed Interim Consolidated Statement of Income and Comprehensive Income. Operational results of the business acquired are included in earnings from the closing date of acquisition.

4. Business combination

a) Wyatt acquisition

On September 1, 2023, Lycos completed the acquisition (the "Wyatt Acquisition") of Wyatt Resources Ltd. ("Wyatt"), a privately held, heavy oil producer. The purchase price consisted of \$6.3 million in cash and the issuance of 635,640 post-consolidation (5,085,120 pre-consolidation) common shares valued at \$2.5 million (based on the closing price of Lycos' common shares of \$3.99 per share on the TSXV on September 1, 2023). Lycos and Wyatt were amalgamated on September 1, 2023.

The acquisition complements Lycos' existing heavy oil asset base in the Greater Lloydminster areas of Wildmere and Frog Lake area. The operations from the acquisition have been included in the results of Lycos commencing September 1, 2023.

Lycos incurred transaction costs of \$0.3 million on the acquisition which were expensed through the Condensed Interim Consolidated Statements of Income and Comprehensive Income.

The Company assessed the acquisition and determined it constitutes a business combination in accordance with IFRS 3. The table below summarizes the identifiable assets acquired and liabilities assumed.

The purchase price, based on management's estimates of fair values, is as follows:

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2023, and 2022

(Tabular amounts in thousands)

Consideration	Note		
Cash		\$	6,267
Common shares	10		2,536
Total consideration paid		\$	8,803
Fair value of net assets acquired	Notes		
Property, plant and equipment	7	\$	12,638
Exploration and evaluation assets	6		1,818
Deferred income tax liability			(2,295)
Decommissioning liabilities ⁽¹⁾	8		(2,564)
Working capital ⁽²⁾	14		(794)
Fair value of net assets acquired		\$	8,803

⁽¹⁾ The decommissioning liabilities acquired in the business combination were initially recognized using a credit adjusted risk free discount rate in calculating fair value. They were subsequently revalued using the risk-free rate resulting in a change in estimate with the offset recorded to property, plant and equipment (note 8).

⁽²⁾ Includes \$0.2 million of cash.

The estimated acquisition date fair value attributed to the property, plant and equipment was derived from the estimate of proved and probable oil and gas reserves and the related cash flows prepared at March 31, 2023 by independent third-party reserve evaluators and internally updated to reflect activity up to September 1, 2023 discounted at rates that range from 15%-30%. Petroleum and natural gas revenue of \$1.7 million and net income of \$0.6 million are included in the Consolidated Statement of Income and Comprehensive Income for the Wyatt acquisition since the closing date of September 1, 2023.

Changes in the provisional measurements of assets and liabilities acquired may be recorded as part of the purchase price allocation as new information is obtained, until the final measurements are determined no later than 12 months after the acquisition date. Fair value is estimated using the latest available information as at the date of the financial statements. As a result, these preliminary allocations may change.

If the Wyatt acquisition had occurred on January 1, 2023, the Company's pro forma results of petroleum and natural gas revenue and net income and comprehensive income for the period ended September 30, 2023, are estimated to have been as follows:

For the period ended September 30, 2023	As stated	Wyatt prior to September 1, 2023	Pro forma
Petroleum and natural gas revenue	\$ 65,945	\$ 8,266	\$ 74,211
Net income and comprehensive income	\$ 23,547	\$ 936	\$ 24,483

b) CDLP acquisition

On February 28, 2023, Lycos purchased its partner's equity interest in the Company's limited partnership, Chronos Duvernay LP ("the CDLP Acquisition"). The purchase price consisted of \$50.0 million cash and the grant of a 2.345% gross overriding royalty ("GORR") to the former partner on any newly drilled wells on the acquired lands. The cash consideration was funded by existing cash on hand.

This transaction was accounted for as a business combination through a step acquisition in accordance with IFRS 3. Accordingly, the Company remeasured its investment in CDLP immediately before the acquisition date. The fair value of net assets acquired was estimated at \$67.5 million (or \$14.8 million for the Company's 21.85% share in CDLP), resulting in a gain of \$11.4 million when compared to the carrying value of the investment of \$3.7 million (including the \$0.3 million unrecognized portion of transaction costs). Lycos and CDLP were subsequently amalgamated on May 1, 2023.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2023, and 2022

(Tabular amounts in thousands)

The acquisition complements Lycos' existing heavy oil asset base in the Lloydminster area. The operations from the acquisition have been included in the results of Lycos commencing February 28, 2023.

Lycos incurred transaction costs of \$0.8 million on the acquisition which were expensed through the Condensed Interim Consolidated Statements of Income and Comprehensive Income.

The Company assessed the acquisition and determined it constitutes a business combination in accordance with IFRS 3. The table below summarizes the identifiable assets acquired and liabilities assumed.

The purchase price, based on management's estimates of fair values, is as follows:

Consideration	Note		
Cash		\$	50,000
Investment in associate	5		15,093
Total consideration paid		\$	65,093
Fair value of net assets acquired		Notes	
Property, plant and equipment ⁽¹⁾	7	\$	87,111
Deferred income tax liability			(12,622)
Decommissioning liabilities ⁽²⁾	8		(7,730)
Working capital ⁽³⁾	14		(1,666)
Fair value of net assets acquired		\$	65,093

⁽¹⁾ 100% of the fair value of property, plant and equipment and deferred income tax liability in CDLP was \$90,344 thousand and \$13,430 thousand respectively. The private equity firm retained a 2.345% gross overriding royalty ("GORR") on any newly drilled wells on acquired lands, resulting in acquired property, plant and equipment and deferred income tax liability of \$87,111 thousand and \$12,622 thousand respectively. During the period ended September 30, 2023, the GORR was recategorized from a liability to property, plant and equipment with a resulting decrease in deferred income tax liability.

⁽²⁾ The decommissioning liabilities acquired in the business combination were initially recognized using a credit adjusted risk free discount rate in calculating fair value. They were subsequently revalued using the risk-free rate resulting in a change in estimate with the offset recorded to property, plant and equipment (note 8).

⁽³⁾ Includes \$1.2 million of cash.

The fair value of acquired property, plant and equipment was determined based on internally prepared estimates of proved and probable petroleum and natural gas reserves discounted at rates that range from 12%-40%. Petroleum and natural gas revenue of \$10.3 million and net income of \$1.5 million are included in the Consolidated Statement of Income and Comprehensive Income for the CDLP acquisition since the closing date of February 28, 2023.

Changes in the provisional measurements of assets and liabilities acquired may be recorded as part of the purchase price allocation as new information is obtained, until the final measurements are determined no later than 12 months after the acquisition date. Fair value is estimated using the latest available information as at the date of the financial statements. As a result, these preliminary allocations may change.

If the CDLP acquisition had occurred on January 1, 2023, the Company's pro forma results of petroleum and natural gas revenue and net income and comprehensive income for the period ended September 30, 2023, are estimated to have been as follows:

For the period ended September 30, 2023	CDLP prior to February 28, 2023 ⁽¹⁾			Pro forma
	As stated			
Petroleum and natural gas revenue	\$ 65,945	\$	4,858	\$ 70,803
Net income and comprehensive income	\$ 23,547	\$	126	\$ 23,673

⁽¹⁾ The net income and comprehensive income were offset by two months of share of profit in CDLP.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

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(Tabular amounts in thousands)

5. Investment in associate

On June 14, 2018, the Company entered into a partnership and financing arrangement with a private equity firm for the development of the Company's land base in the East Duvernay Shale Basin in Alberta, and subsequently the Lloydminster area of Alberta. At closing, Chronos contributed undeveloped Duvernay properties into Chronos Duvernay LP ("the Partnership") and the private equity firm contributed cash, each in return for an equity investment in the Partnership.

The financing arrangement was comprised of an equity line of credit pursuant to which the private equity firm may invest, on a capital call basis, from time to time, up to \$100 million in consideration of additional equity of the Partnership.

The cash contributed by the private equity firm on closing represented the first capital contribution under the initial tranche of capital to be invested under the equity line of credit. Exploration and development activities on the East Duvernay Shale Basin assets are to be funded with the cash contributed by the private equity firm under the equity line of credit.

In 2018, the Company shared joint control with the private equity firm and the resulting joint arrangement was classified as a Joint Venture under IFRS 11 and was required to be accounted for using the equity method of accounting. The investment was initially recorded at the cost of the undeveloped land disposed and related expenses and the subsequent carrying amount was increased or decreased by the Company's share of Consolidated Statement of Income and Comprehensive Income.

In 2019, the private equity firm contributed additional cash in exchange for additional equity, which reduced Chronos working interest in the Partnership to lower than 50 percent. As such, the Company was reduced from joint control to significant influence over the investment and continued using the equity method of accounting.

In 2023 and 2022, the private equity firm did not contribute any additional cash in exchange for additional equity interest in the Partnership.

On February 28, 2023, Lycos acquired the remaining 78.15% interest in the Partnership (see note 4).

Summarized below is the financial information of Chronos Duvernay LP.

	Note	February 28, 2023	December 31, 2022
Current assets		\$ 3,659	\$ 3,801
Non-current assets		90,344	29,092
Current liabilities		(5,325)	(5,882)
Non-current liabilities		(21,160)	(11,750)
Net assets		\$ 67,518	\$ 15,261
Share of associate (percentage)		21.85%	21.85%
Share of net assets		\$ 14,752	\$ 3,335
Unrecognized portion of transaction costs ⁽¹⁾		341	341
Investment in associate before acquisition		15,093	3,676
Derecognition of investment in associate	4	(15,093)	-
Investment in associate		\$ -	\$ 3,676

⁽¹⁾ The amount represented transaction costs incurred in 2018 and 2019 on the financing of the Partnership that are not included in the net assets of the associate.

Lycos Energy Inc.

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(Tabular amounts in thousands)

Results of Operations for the Period Ended	February 28, 2023	December 31, 2022
Revenues	\$ 4,858	\$ 24,125
Expenses	(3,624)	(30,325)
Depletion	(1,073)	(4,451)
Net income (loss)	\$ 161	\$ (10,651)
Share of investment in associate (weighted average percentage)	21.85%	21.8%
Share of profit (loss) of investment in associate	\$ 35	\$ (2,327)

The Company's carrying amount of the investment in associate is as follows:

Investment in associate, December 31, 2021	Note	\$ 6,931
Share of net loss from investment in associate		(2,327)
Adjustment related to Class D unit distribution ⁽¹⁾		(928)
Investment in associate, December 31, 2022		\$ 3,676
Share of net income from investment in associate		35
Gain on previously held investment in associate recognized in Consolidated Statement of Income and Comprehensive Income		11,382
Derecognition of investment in associate	4	(15,093)
Investment in associate, February 28, 2023		\$ -

⁽¹⁾ During 2022, the Partnership paid a distribution of \$4.2 million to the class D unitholders which are held with the private equity firm.

6. Exploration and evaluation assets

The following table reconciles the movements of the Company's Exploration and evaluation ("E&E") assets for the periods:

	Notes	September 30, 2023	December 31, 2022
Balance, beginning of period		\$ 755	\$ 755
Additions		3,242	-
Acquisitions through business combination	4	1,818	-
Transfers to PP&E	7	(3,169)	-
Balance, end of period		\$ 2,646	\$ 755

E&E assets consist of the Company's undeveloped land and exploration projects which are pending the determination of proved and probable petroleum and natural gas reserves. Additions represent the Company's share of the cost of E&E assets.

At September 30, 2023, \$2.6 million (December 31, 2022 - \$0.8 million) remained in E&E assets. The Company does not amortize its E&E assets.

Impairment

The Company concluded there are no indicators of impairment for its E&E assets as at September 30, 2023.

7. Property, plant and equipment

A reconciliation of the carrying value of property, plant and equipment as at September 30, 2023 and December 31, 2022 is set out below:

Lycos Energy Inc.

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(Tabular amounts in thousands)

Cost	Notes	Total property, plant and equipment
Balance, December 31, 2021		\$ 113,993
Additions		10,091
Disposal of right-of-use asset		(499)
Changes in decommissioning liabilities	8	(3,000)
Balance, December 31, 2022		\$ 120,585
Additions		41,234
Transfer from E&E	6	3,169
Acquisitions through business combination	4	99,749
Right of use assets	9	519
Disposal of right-of-use asset		(131)
Disposal of decommissioning liabilities	8	(172)
Changes in decommissioning liabilities	8	4,813
Capitalized stock-based compensation	11	994
Balance, September 30, 2023		\$ 270,760
Accumulated depletion, depreciation and impairment		
Balance, December 31, 2021		\$ 58,675
Depletion and depreciation		6,386
Impairment reversal		(8,922)
Disposal of right-of-use asset		(351)
Balance, December 31, 2022		\$ 55,788
Depletion and depreciation		14,745
Disposal of right-of-use asset		(91)
Balance, September 30, 2023		\$ 70,442
Net carrying value:		
December 31, 2022		\$ 64,797
September 30, 2023		\$ 200,318

The Company capitalized \$1.5 million (December 31, 2022 - \$0.7 million) of general and administrative costs and \$1.0 million (December 31, 2022 - \$nil) of stock-based compensation for the period ended September 30, 2023.

Impairment

The Company concluded there are no indicators of impairment or impairment reversal for its CGUs as at September 30, 2023.

8. Decommissioning liabilities

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. The Company estimates the total future undiscounted and uninflated amount of cash flows required to settle its decommissioning liabilities for September 30, 2023, is approximately \$38.6 million (December 31, 2021 - \$20.6 million). These payments are expected to be made over the next 20 to 40 years. A risk-free rate of 3.81% (December 31, 2022 - 3.28%) and an inflation rate of 1.75% (December 31, 2022 - 2.09%) was used to calculate the decommissioning liabilities.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

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(Tabular amounts in thousands)

	Notes	September 30, 2023	December 31, 2022
Balance, beginning of period		\$ 17,662	\$ 20,716
Change in estimates ⁽¹⁾		(1,888)	(3,272)
Additions		746	101
Disposals	7	(172)	-
Decommissioning expenditures	15	(1,363)	(28)
Liabilitied acquired on Wyatt acquisition, CDLP acquisition and RTO ⁽²⁾	4	10,294	92
Revaluation of liabilities incurred ⁽³⁾		5,955	79
Liabilities settled by government grants		-	(503)
Accretion	13	619	477
Balance, end of period		\$ 31,853	\$ 17,662
Expected to be incurred within one year		\$ 1,500	\$ 1,000
Expected to be incurred beyond one year		\$ 30,353	\$ 16,662

⁽¹⁾ The change in estimates in 2023 is due to a change in estimated abandonment and remediation cost of \$0.7 million (December 31, 2022 - \$0.2 million) and change in discount and inflation rates totalling \$1.2 million (December 31, 2022 - \$(3.1) million).

⁽²⁾ The amount represents the decommissioning liability incurred in the Wyatt acquisition of \$2.6 million (note 4), the CDLP acquisition of \$7.7 million (note 4) in 2023, and the RTO of \$0.1 million in 2022.

⁽³⁾ The decommissioning liabilities acquired in the Wyatt and CDLP acquisitions (note 4) and assumed in the RTO were initially recognized using a credit-adjusted risk-free discount rate in calculating fair value. They were subsequently revalued using the risk-free rate resulting in a change in estimate with the offset recorded in property, plant, and equipment.

9. Lease obligations

	Notes	September 30, 2023	December 31, 2022
Balance, beginning of period		\$ 44	\$ 182
Additions	7	519	-
Disposal		(40)	(87)
Interest expense	13	37	2
Payments		(118)	(53)
Balance, end of period		\$ 442	\$ 44
Current		137	44
Non-current		305	-
		\$ 442	\$ 44

On November 24, 2022, Lycos entered into a head office sublease agreement for a period of two years and eight months resulting in the recognition of a \$0.2 million right-of-use asset and lease obligation. The Company took possession on January 1, 2023. The Company is obligated to pay basic rent of approximately \$94 thousand per year. In addition, during the period ended September 30, 2023, the Company has recognized \$0.3 million in the right-of-use asset and lease obligation related to field trucks.

10. Share capital

(a) Authorized

The Company's authorized share capital consists of an unlimited number of common voting shares and an unlimited number of preferred shares, issuable in series.

(b) Issued and outstanding common shares

The following table summarizes the Company's issued and outstanding common shares for the periods:

Lycos Energy Inc.

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(Tabular amounts in thousands)

	Note	September 30, 2023		December 31, 2022	
		Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of period ⁽¹⁾		39,768,500	\$ 177,032	9,812,325	\$ 113,332
Shares issued as part of the Wyatt acquisition ⁽¹⁾	4	635,640	2,536	-	-
Shares issued as part of subscription receipt private placement ⁽¹⁾		-	-	23,660,751	53,000
Shares issued as part of unit private placement ⁽¹⁾		-	-	5,357,143	12,000
Shares issued as part of subscription receipt unit private placement - advisory fee ⁽¹⁾		-	-	349,108	782
Acquired on reverse takeover ⁽¹⁾		-	-	589,173	1,320
Share issue costs		-	-	-	(3,402)
Balance, end of period⁽¹⁾		40,404,140	\$ 179,568	39,768,500	\$ 177,032

⁽¹⁾ The number of common shares has been adjusted retrospectively to reflect the 8:1 share consolidation that was approved by Lycos' shareholders on June 14, 2023 and effected on September 1, 2023.

On June 14, 2023, the shareholders of Lycos approved a consolidation of common shares on the basis of a ratio eight (8) pre-consolidation common shares for each one (1) post-consolidation common share. The Consolidation was effective on September 1, 2023. As a result, the number of common shares has been adjusted retrospectively to reflect the 8:1 share consolidation.

Warrants

	Number of Warrants	
	September 30, 2023	December 31, 2022
Balance, beginning of period ⁽¹⁾	5,706,250	-
Issued	-	5,706,250
Balance, end of period	5,706,250	5,706,250

⁽¹⁾ The number of warrants has been adjusted retrospectively to reflect the 8:1 share consolidation that was approved by Lycos' shareholders on June 14, 2023 and effected on September 1, 2023.

On June 14, 2023, the shareholders of Lycos approved a consolidation of common shares on the basis of a ratio eight (8) pre-consolidation common shares for each one (1) post-consolidation common share. The Consolidation was effective on September 1, 2023. As a result, the number of warrants has been adjusted retrospectively to reflect the 8:1 share consolidation.

On December 12, 2022, the Company issued 5,706,250 warrants in connection with the RTO transaction in 2022 which were recorded in share capital.

	Warrants outstanding			Warrants exercisable		
	Number outstanding	Weighted average exercise price	Weighted average life remaining (years)	Number outstanding	Weighted average exercise price	Weighted average life remaining (years)
Balance, end of period	5,706,250	\$ 2.24	4.3	5,706,250	\$ 2.24	4.3

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements
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(Tabular amounts in thousands)

(c) Per share amounts

The following table summarizes the shares used in calculating net income per share:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Weighted average number of shares - basic	39,975,774	9,812,325	39,838,351	9,812,325
Effect of dilutive securities	2,167,111	-	2,288,409	-
Weighted average number of shares - diluted	42,142,885	9,812,325	42,126,760	9,812,325

In computing diluted per share amounts for the three and nine months ended September 30, 2023, 5,706,250 (three and nine months ended September 30, 2022 – nil) warrants were included in the calculation and 2,134,375 (three and nine months ended September 30, 2022 – nil) stock options (note 11) were excluded from the calculation as their effect was anti-dilutive.

11. Stock-based compensation

The Company established a share option plan for its directors, officers, employees, and certain consultants under which the Company may grant options to acquire a maximum number of common shares equal to 10% of the total issued and outstanding common shares of the Company.

As at September 30, 2023, Lycos granted stock options to certain employees, directors, and officers. The stock options expire five years from the date of grant and vest as to one-third on each of the first, second and third anniversary of the grant date. The following table summarizes the granted stock options:

	Number of Options ⁽¹⁾	Exercise price
January 25, 2023	1,991,875	\$ 4.40
May 15, 2023	142,500	\$ 3.60
August 24, 2023	51,250	\$ 3.68
Total options granted in period	2,185,625	

⁽¹⁾ On June 14, 2023, the shareholders of Lycos approved a consolidation of common shares on the basis of a ratio eight (8) pre-consolidation common shares for each one (1) post-consolidation common share. The Consolidation was effective on September 1, 2023. As a result, the number of stock options has been adjusted retrospectively to reflect the 8:1 share consolidation (note 10).

There were no options granted in 2022. The total fair value of each option granted during the period ended September 30, 2023, was estimated on the date of grant using the Black-Scholes pricing model with weighted average assumptions as follows:

	Nine months ended September 30, 2023
Weighted average fair value of options granted	\$ 2.55
Average risk-free interest rate	3.58%
Average expected life years	5
Average expected volatility ⁽¹⁾	79.43%

⁽²⁾ During the period ended September 30, 2023, the expected volatility was estimated based on a peer group historical volatility.

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Notes to Unaudited Condensed Interim Consolidated Financial Statements

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(Tabular amounts in thousands)

The following table summarizes the changes in the outstanding stock options for the periods:

	Nine months ended September 30, 2023		Year ended December 31, 2022	
	Number of Options ⁽¹⁾	Weighted average exercise price	Number of Options	Weighted average exercise price
Options outstanding, beginning of period	-	\$ -	-	\$ -
Granted	2,185,625	\$ 4.33	-	\$ -
Forfeited	(51,250)	\$ 4.40	-	\$ -
Options outstanding, end of period	2,134,375	\$ 4.33	-	\$ -

⁽¹⁾ The number of stock options has been adjusted retrospectively to reflect the 8:1 share consolidation that was approved by Lycos' shareholders on June 14, 2023 and effected on September 1, 2023.

The range of exercise price of stock options outstanding and exercisable as at September 30, 2023, is as follows:

Outstanding options			
Exercise price	Number of Options Outstanding	Weighted average remaining term (years)	Weighted average exercise price
\$ 3.60 - \$ 4.40	2,134,375	4.4	\$ 4.33

At September 30, 2023, there are no exercisable options.

During the three and nine months ended September 30, 2023, the Company recorded gross stock-based compensation expense of \$1.0 million and \$2.6 million, respectively (three and nine months ended September 30, 2022 - \$nil million), and capitalized stock-based compensation expense of \$0.4 million and \$1.0 million, respectively (three and nine months ended September 30, 2022 - \$nil million).

12. Revenue

The Company sells its production pursuant to fixed or variable-price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contracts, the Company is required to deliver a fixed or variable volume of crude oil, condensate, natural gas or natural gas liquids to the customer. Revenue is recognized when a unit of production is delivered to the customer.

The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

Crude oil and natural gas are sold under contracts of varying terms of up to one year. Revenues are typically collected on the 25th day of the month following production.

The following table summarizes the Company's petroleum and natural gas sales, all of which are from revenue with contracts with customers:

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

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(Tabular amounts in thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022		2022	
	Adjusted		Adjusted	
	2023	(Note 20)	2023	(Note 20)
Crude oil	\$ 28,154	\$ 11,148	\$ 65,077	\$ 30,945
Natural gas	29	18	82	79
Petroleum and natural gas revenues	28,183	11,166	65,159	31,024
Processing income	127	409	786	1,068
Total petroleum and natural gas sales	\$ 28,310	\$ 11,575	\$ 65,945	\$ 32,092

Included in accounts receivable as at September 30, 2023, is \$11.0 million (December 31, 2022 - \$3.7 million) of accrued crude oil and natural gas sales related to September 2023 production.

13. Finance expense

	Notes	Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2023	2022	2023	2022
Accretion on decommissioning liabilities	8	\$ 237	\$ 139	\$ 619	\$ 341
Interest expense		95	-	152	5
Interest on lease obligations	9	15	1	37	4
		\$ 347	\$ 140	\$ 808	\$ 350

14. Supplementary cash flow information

The following table details the changes in non-cash working capital.

	Note	Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2023	2022	2023	2022
Accounts receivable		\$ (5,387)	(444)	\$ (7,874)	(2,452)
Due from related party		-	50	426	81
Prepaid expenses and deposits		(502)	(30)	(1,047)	(547)
Accounts payable and accrued liabilities		13,859	3,158	24,840	2,596
Working capital assumed on CDLP acquisition and Wyatt acquisition ⁽¹⁾	4	(951)	-	(3,841)	-
		\$ 7,019	\$ 2,734	\$ 12,504	\$ (322)
Relating to:					
Operating activities		\$ (1,744)	\$ 1,795	\$ (5,656)	\$ (1,655)
Investing activities		8,763	939	18,160	1,333
		\$ 7,019	\$ 2,734	\$ 12,504	\$ (322)

⁽¹⁾ The amount represents the working capital excluding the cash acquired on the CDLP acquisition and Wyatt acquisition (note 4) that has been excluded from the changes in non-cash working capital.

15. Financial instruments and risk management

The Company has exposure to credit and liquidity risks from its financial assets and liabilities and exposure to market risks relating to commodity prices, interest rates and foreign exchange rates. This note presents information about the Company's exposure to these risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital.

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(Tabular amounts in thousands)

Further quantitative disclosures are included throughout these Condensed Interim Consolidated Financial Statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Market risk

Market risk is the risk that changes in market prices, such as commodity prices for crude oil and natural gas, foreign exchange rates and interest rates will affect the Company's valuation of financial instruments, the debt levels of the Company, as well as its income and cash flow from operations.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while maximizing the Company's returns. All such transactions are conducted in accordance with the Company's risk management policy that has been approved by the Board of Directors.

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by the relationship between the Canadian and United States dollar and also world economic events that dictate the levels of supply and demand. The Company may utilize both financial derivatives and physical delivery contracts to manage commodity price risks in accordance with the Company's expected sale requirements.

Fixed price physical delivery contracts that were entered into by the Company continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements which meets 'own use exemption'. These contracts are accounted for as executory contracts and are not considered financial instruments; therefore, no asset or liability has been recognized in the financial statements.

As at September 30, 2023, the Company had the following fixed price physical sales contract:

Index	Type	Term	Volume	Price/Unit
WCS	Fixed	October 1, 2023 to December 31, 2023	9,000 bbl/month	US \$45.25

As at September 30, 2023, the Company had the following financial derivative commodity contracts:

Index	Type	Term	Volume	Price/Unit	Mark-to Market Asset (Liability)
WCS	Fixed	October 1, 2023 to October 31, 2023	500 bbl/d	CAD \$91.60	\$ (47)
WCS	Fixed	October 1, 2023 to December 31, 2023	250 bbl/d	CAD \$80.15	\$ (332)
WCS	Fixed	October 1, 2023 to December 31, 2023	300 bbl/d	CAD \$84.80	\$ (272)
WCS	Fixed	November 1, 2023 to November 31, 2023	500 bbl/d	CAD \$91.05	\$ (23)
WCS	Differential	January 1, 2024 to December 31, 2024	250 bbl/d	CAD (\$20.00)	\$ 199
WTI	Fixed	January 1, 2024 to March 31, 2024	250 bbl/d	CAD \$106.50	\$ (151)
WTI	Fixed	January 1, 2024 to March 31, 2024	250 bbl/d	CAD \$111.55	\$ (39)
WTI	Fixed	April 1, 2024 to June 30, 2024	250 bbl/d	CAD \$109.05	\$ (12)

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(Tabular amounts in thousands)

The following table summarizes the Company's financial derivative gains on commodity contracts for the periods:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Loss on financial derivatives:				
Realized losses	\$ (594)	\$ -	\$ (502)	\$ -
Unrealized losses	(688)	-	(677)	-
Loss on financial derivatives	\$ (1,282)	\$ -	\$ (1,179)	\$ -

The following table summarizes the fair value as at September 30, 2023, and the change in fair value for the nine months ended September 30, 2023:

	September 30,	December 31,
	2023	2022
Net financial derivative receivable/liabilities, beginning of period	\$ -	-
Unrealized loss change in fair value	(677)	-
Net financial derivative receivable/liabilities, end of period	\$ (677)	-

Interest rate risk

The Company is exposed to interest rate risk on cash balances to the extent of changes in market interest rates. As at September 30, 2023, the Company had no interest rate swap or derivative contracts in place.

Foreign exchange risk

Foreign exchange risk arises from changes in foreign exchange rates that may affect the fair value or future cash flows of the Company's financial assets or liabilities. The Company is exposed to foreign exchange risk in relation to its crude oil sales. As at September 30, 2023, the Company had no foreign exchange swap or derivative contracts in place and mitigates the risk by entering into commodity contracts in Canadian dollars.

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 and arises principally from the Company's receivables from purchasers of the Company's petroleum and natural gas and counterparties to cash joint venture partners and the counterparties to risk management contracts.

As at September 30, 2023, the Company's receivables consisted of \$11.0 million from petroleum and natural gas purchasers, \$1.5 million from other receivables and \$0.4 million due from the government for goods and services tax. The Company's cash is deposited in high yield saving accounts with financial institutions and are subject to counterparty credit risk. The Company mitigates this risk by only transacting with investment grade financial institutions with high credit ratings.

Receivables from purchasers of the Company's petroleum and natural gas are normally collected on the 25th day of the month following shipment. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large, credit worthy petroleum marketers. At September 30, 2023, there was \$12.9 million (December 31, 2022 - \$5.0 million) of accounts receivable. Subsequent to September 30, 2023, approximately \$11.2 million has been collected and the remaining balance is expected to be collected.

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Financial derivative contracts are only entered into with credit worthy institutions. Joint venture receivables are typically collected within one to four months of the joint venture bill being issued to the partner.

The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to commencement of the joint venture project and smaller partners are cash called to pay for their share of costs in advance of a project commencing. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection.

To offset this risk, the Company often has the ability to withhold production from joint venture partners in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company has calculated the expected credit losses using the simplified approach which permits the use of the lifetime expected loss provision. To assess the expected credit loss, the Company uses historical information and forward-looking information. No loss provision was recorded for the three and nine months ended September 30, 2023. Historically, there was no indication that amounts were non-collectable thus, an allowance for doubtful accounts was not set up.

As at September 30, 2023, and December 31, 2022 the Company's accounts receivables are aged as follows:

Period ended	Total Receivables		< 90 Days		Past Due	
September 30, 2023	\$	12,872	\$	12,214	\$	658
		100%		95%		5%
December 31, 2022	\$	4,998	\$	4,327	\$	671
		100%		87%		13%

Fair value of financial instruments

The Company classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

The Company's exposure under its financial instruments is limited to financial assets and liabilities, all of which are included in these financial statements. The carrying value of cash, accounts receivable, and accounts payable and accrued liabilities included in the Consolidated Statement of Financial Position approximate fair value due to the short-term nature of those instruments or the indexed rate of interest.

The fair value of financial derivatives is based on models that use published information with respect to volatility, prices, and interest rates. The fair value of financial derivatives is determined by discounting the difference between the contracted prices and published forward price curves as at the date of the statement of financial position, using the remaining contracted oil and gas volumes and a risk-free interest rate (based on published government rates). The Company's financial derivative asset/liability is considered Level 2 in the fair value hierarchy.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company manages liquidity risk through cash and debt management strategies to mitigate the likelihood of encountering difficulties in meeting its financial obligations. Such strategies include an actively managed operating and capital expenditure budgeting process, authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures, and the Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company entered into a credit facility in the first quarter of 2023 to further strengthen its liquidity (discussed below).

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The Company's objectives when managing capital are to i) deploy capital to provide an appropriate return on investment to its shareholders; ii) maintain financial flexibility in order to preserve the Company's ability to meet financial obligations; and iii) maintain a capital structure that provides financial flexibility to execute strategic acquisitions. To aid in managing the capital structure, the Company monitors adjusted funds flow from operations and adjusted working capital (net debt) and (see note 15(i) and note 15(ii)).

The Company's strategy is designed to maintain a flexible capital structure consistent with the objectives as stated above and to respond to changes in economic conditions and the risk characteristics of the underlying crude oil assets. Key indicators of changing economic conditions include adjusted working capital (net debt) and adjusted funds flow from operations. Lycos considers its capital structure to include shareholders' equity and working capital (net debt). In order to maintain or adjust its capital structure, the Company may from time to time issue new common shares, seek debt financing and adjust its capital spending to manage working capital.

The following are the contractual maturities of financial obligations and associated interest payments as at September 30, 2023:

	Less than 1 year	1 to 2 years	Thereafter	Total
Accounts payable and accrued liabilities	\$ 33,981	\$ -	\$ -	\$ 33,981
Lease obligations	\$ 137	\$ 303	\$ 2	\$ 442

Capital management

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including changes in economic conditions and resulting changes in capital markets, the current and forecasted net debt levels, the forecasted commodity prices and resulting cash flow from operations and adjusted funds flow from operations, adjusted working capital (net debt), and capital expenditures.

The Company prepares annual capital expenditure budgets and longer term plans, which are continually monitored and updated as necessary depending on varying factors including current and forecast commodity prices, earning and expiry commitments, weather and access restrictions, and project investment risk return profile. The annual and updated budgets are approved by the Board of Directors. The Company will adjust its capital structure through issuance of shares and make adjustments to capital spending to balance the capital structure. The Board of Directors does not establish quantitative return on capital targets for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

Adjusted funds flow from operations, adjusted working capital (net debt), and total capital expenditures are not standardized measures and therefore may not be comparable with the calculation of similar measures of other entities.

i) Adjusted funds flow from operations:

Management considers adjusted funds flow from operations to be a key measure to assess the performance of the Company's oil and gas properties and the Company's ability to fund future capital investment. Adjusted funds flow from operations is an indicator of operating performance as it varies in response to production levels and management of costs.

Changes in non-cash working capital, decommissioning costs incurred and transaction costs vary from period to period and Management believes that excluding the impact of these provides a useful measure of Lycos' ability to generate the funds necessary to manage the capital needs of the Company.

Lycos Energy Inc.

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(Tabular amounts in thousands)

	Notes	Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2023	2022	2023	2022
Cash flow from operating activities		\$ 7,534	\$ 3,164	\$ 11,908	\$ 4,482
Change in non-cash working capital		1,744	(1,795)	5,656	1,655
Funds flow from operations		9,278	1,369	17,564	6,137
Decommissioning costs incurred	8	899	20	1,363	20
Transaction costs	18	649	-	1,525	-
Adjusted funds flow from operations		\$ 10,826	\$ 1,389	\$ 20,452	\$ 6,157

ii) Adjusted working capital (net debt):

Management considers adjusted working capital (net debt) to be a key measure to assess the Company's liquidity and capital management. The Company believes its presentation of adjusted working capital (net debt) is a useful supplemental measure because Management maintains the flexibility to adjust its decommissioning expenditures to manage working capital requirements and financial derivative assets/liabilities are subject to volatility prior to settlement and are included in Lycos' reported adjusted funds flow from operations in the production month that they are realized.

	September 30, 2023	December 31, 2022
Working capital ⁽¹⁾	\$ (31,192)	\$ 55,835
Current portion of decommissioning liabilities	1,500	1,000
Financial derivative receivable	(199)	-
Financial derivative liabilities	876	-
Adjusted working capital (net debt)	\$ (29,015)	\$ 56,835

⁽¹⁾ Includes bank debt.

iii) Capital expenditures:

Management considers capital expenditures to be a key measure to assess the Company's capital investment in exploration and production activity, as well as property acquisitions and dispositions:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Net cash used in investing activities	\$ 18,227	\$ 1,985	\$ 81,202	\$ 2,953
Change in non-cash working capital	8,763	939	18,160	1,333
Capital expenditures	\$ 26,990	\$ 2,924	\$ 99,362	\$ 4,286

16. Bank debt

As at September 30, 2023, the Company had an uncommitted demand revolving credit facility of \$35.0 million with the National Bank of Canada ("the Lender"). The next borrowing base review is expected to be completed on or about November 30, 2023.

The credit facilities are secured by a demand debenture in the amount of \$100.0 million. The Company is subject to a financial covenant, whereby the Company's ratio of adjusted working capital, including any undrawn availability under the revolving facility as a current asset, shall not be less than 1.00:1.00. Repayments of principal are not required until the Lender demands, provided that the borrowings do not exceed the authorized credit facility and the Company is compliant with all covenants. As at September 30, 2023, the Company was compliant with all covenants. Lycos incurred transaction costs of \$99 thousand on the credit facility which were expensed through the Condensed Interim Consolidated Statements of Income and Comprehensive Income.

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(Tabular amounts in thousands)

17. Commitments

Future minimum payments relating to variable office rent payments, which are a non-lease component of the Company's head office sublease, as at September 30, 2023 are as follows:

	September 30, 2023
Less than 1 year	\$ 528
1-2 years	768
Total commitments	\$ 1,296

The variable office rent payments will be recorded to general and administrative expenses in the period in which incurred.

18. Transaction costs

The following table presents the Company's transaction costs:

		Three Months Ended		Nine Months Ended	
	Note	September 30,		September 30,	
		2023	2022	2023	2022
Transaction costs related to acquisitions ⁽¹⁾	4	\$ 649	\$ -	\$ 1,426	\$ -
Transaction costs related to credit facilities		-	-	99	-
		\$ 649	\$ -	\$ 1,525	\$ -

⁽¹⁾ The amount represents the transaction cost on the CDLP acquisition of \$0.8 million (note 4), Wyatt acquisition of \$0.3 million (note 4) and DCEL acquisition of \$0.3 million (note 19).

19. Subsequent events

1) Durham Creek Exploration Ltd. ("DCEL") Acquisition

On October 16, 2023, the Company closed the previously announced acquisition of DCEL. Lycos acquired all the issued and outstanding common shares of DCEL for \$12.5 million in cash and 2,816,907 common shares of Lycos.

Concurrent with the DCEL Acquisition, Lycos completed a bought-deal financing including the exercise of the over-allotment option (the "Offering") of 9,860,100 Lycos common shares at a price of \$3.55 per common share for gross proceeds of approximately \$35.0 million. A portion of the net proceeds from the Offering were used to fund the cash purchase price of the DCEL Acquisition.

Given the transaction closed on October 16, 2023, as at the date of our condensed interim consolidated financial statements we do not have sufficient information to determine fair values and complete the purchase price allocation or the proforma financial information disclosures.

2) Acquisition of Alberta Mannville Lands

On October 11th, 2023, Lycos completed the acquisition of Mannville lands in Alberta. Total consideration for the assets was approximately \$3.5 million in cash, before closing adjustments.

3) On October 30th, 2023, Lycos granted 1,626,250 stock options to certain employees, directors and officers. The stock options expire five years from the date of grant and are exercisable at a price of \$3.75 per common share. The options vest as to one-third on each of the first, second and third anniversary of the grant date.

Lycos Energy Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2023, and 2022

(Tabular amounts in thousands)

20. Adjustment of the Condensed Interim Consolidated Financial Statements

The Company has adjusted petroleum and natural gas sales, operating expenses and blending and transportation expenses to record certain transactions gross that had previously been recorded net. The adjustment is not a result of any change to the Company's operations or the Company's business. For any and all of the periods adjusted there is no impact on the overall cash position, cash flow from operating, investing or financing activities on the Condensed Interim Consolidated Statement of Cash Flows, or any of the inputs used to determine the Company's recoverable reserves. See the table below for a reconciliation of the impact of the adjustment to the Condensed Interim Consolidated Statement of Income and Comprehensive Income.

(\$ in thousands)	Three months ended			Nine months ended		
	September 30, 2022			September 30, 2022		
	Previously Reported	Adjustment	Adjusted	Previously Reported	Adjustment	Adjusted
Petroleum and natural gas sales	9,212	2,363	11,575	25,396	6,696	32,092
Operating expense	5,341	410	5,751	13,324	1,068	14,392
Blending and transportation expense	63	1,953	2,016	191	5,628	5,819
Net income and comprehensive income	15,646	-	15,646	18,619	-	18,619
Net income per share amounts:						
Basic & diluted	\$ 1.59	\$ -	\$ 1.59	\$ 1.90	\$ -	\$ 1.90