UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

(Amendment No. 1)

**CURRENT REPORT PURSUANT TO
SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

Date of report (Date of earliest event reported): April 3, 2023

VITAL ENERGY, INC.

(Exact name of registrant as specified in charter)

Delaware	**001-35380**	**45-3007926**
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification No.)

521 E. Second Street	**Suite 1000**	
Tulsa	**Oklahoma**	**74120**
(Address of principal executive offices)		(Zip code)

Registrant's telephone number, including area code: **(918) 513-4570**

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common stock, $0.01 par value	**VTLE**	**New York Stock Exchange**

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Explanatory Note

As previously disclosed in its Current Report on Form 8-K filed with the Securities and Exchange Commission on April 3, 2023 (the "Original Form 8-K"), on April 3, 2023 (the "Closing Date"), Vital Energy, Inc. (the "Company") completed the acquisition of oil and gas properties in the Midland Basin, including approximately 11,200 net acres located in Upton and Reagan Counties, and related assets and contracts (the "Driftwood Acquisition") from Driftwood Energy Operating, LLC for aggregate consideration of approximately (i) $120.4 million in cash, after closing price adjustments, and (ii) 1,578,948 shares of the Company's common stock, par value $0.01 per share.

This Amendment to Current Report on Form 8-K is being filed to amend and supplement the Original Form 8-K, the sole purpose of which is to provide the financial statements and pro forma financial information required by Item 9.01, which were excluded from the Original Form 8-K and are filed as exhibits hereto and are incorporated herein by reference. All other items in the Original Form 8-K remain the same.

Item 9.01. Financial Statements and Exhibits.

(a) Financial statements of business to be acquired.

The audited annual consolidated financial statements of Driftwood Energy Partners, LLC and its wholly-owned subsidiaries, Driftwood Energy Operating, LLC, Driftwood Energy Management, LLC and Driftwood Energy Intermediate, LLC (collectively, "Driftwood"), which comprise the balance sheets as of December 31, 2022 and 2021, the related statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements, are filed as Exhibit 99.1 hereto and incorporated by reference herein.

The unaudited quarterly consolidated financial statements of Driftwood, which comprise the balance sheet as of March 31, 2023, the related statements of operations, members' equity, and cash flows for the three-month periods ended March 31, 2023 and 2022, and the related notes to the consolidated financial statements, are filed as Exhibit 99.2 hereto and incorporated by reference herein.

(b) Pro forma financial information.

The unaudited pro forma condensed combined financial information of the Company, which comprises the balance sheet as of March 31, 2023, the related statements of operations for the three-month period ended March 31, 2023 and year ended December 31, 2022, and the related notes thereto, is filed as Exhibit 99.3 hereto and incorporated by reference herein.

(d) Exhibits.

Exhibit Number	Description
23.1	Consent of Weaver and Tidwell, L.L.P.
23.2	Consent of Netherland, Sewell & Associates, Inc.
99.1	Audited consolidated financial statements of Driftwood as of December 31, 2022 and 2021 and for the years then ended.
99.2	Unaudited consolidated financial statements of Driftwood as of March 31, 2023 and for the three-month periods ended March 31, 2023 and March 31, 2022.
99.3	Unaudited pro forma condensed combined financial information of Vital Energy, Inc. as of March 31, 2023 and for the three-month period ended March 31, 2023 and year ended December 31, 2022.
99.4	Reserves report of Netherland, Sewell & Associates, Inc. with respect to Driftwood as of December 31, 2022.
104	Cover Page Interactive Data File (formatted as Inline XBRL).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

VITAL ENERGY, INC.

Date: June 15, 2023	By:	/s/ Bryan J. Lemmerman
		Bryan J. Lemmerman
		Senior Vice President and Chief Financial Officer

EXHIBIT 23.1

Consent of Independent Auditors

We consent to the incorporation by reference in Vital Energy, Inc.'s Registration Statements on Form S-3 (File Nos. 333-257799, 333-260479, 333-263752 and 333-271095) and Form S-8 (File Nos. 333-178828, 333-211610, 333-231593 and 333-256431) of our report dated June 7, 2023, relating to the consolidated financial statements of Driftwood Energy Partners, LLC for the years ended December 31, 2022 and 2021 appearing in this Current Report on Form 8-K/A of Vital Energy, Inc.

/s/ Weaver and Tidwell, L.L.P.

Dallas, Texas
June 15, 2023

Weaver and Tidwell, L.L.P.
2300 North Field Street, Suite 1000 | Dallas, Texas 75201
Main: 972.490.1970
CPAs AND ADVISORS | WEAVER.COM

EXHIBIT 23.2

NETHERLAND, SEWELL & ASSOCIATES, INC.

CONSENT OF INDEPENDENT PETROLEUM ENGINEERS AND GEOLOGISTS

We hereby consent to the references to our firm, in the context in which they appear, and to the references to and the filing and incorporation by reference of our letter as of December 31, 2022, prepared for Driftwood Energy Management, LLC, included in or made part of this Report on Form 8-K/A of Vital Energy, Inc.

NETHERLAND, SEWELL & ASSOCIATES, INC.

By: /s/ Eric J. Stevens
Eric J. Stevens, P.E.
President and Chief Operating Officer

Dallas, Texas
June 15, 2023

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2022 and 2021
with Report of Independent Auditors

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2022 and 2021

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weaver
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Independent Auditor's Report

To the Members of
Driftwood Energy Partners, LLC

Opinion

We have audited the consolidated financial statements of Driftwood Energy Partners, LLC and its subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Subsequent Event

As discussed in note J to the consolidated financial statements, on February 14, 2023, the Company entered into an agreement to sell the assets of a subsidiary, Driftwood Energy Operating, LLC. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the consolidated financial statements are issued (or when applicable, one year after the date that the consolidated financial statements are available to be issued).

The Members of
Driftwood Energy Partners, LLC

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

/s/ Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL, L.L.P.

Dallas, Texas
March 20, 2023, except as to the addition of Supplemental Oil and Gas Reserves Information (Unaudited), which is as of June 7, 2023.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED BALANCE SHEETS

	December 31, 2022	December 31, 2021
Assets		
Current assets:		
Cash and cash equivalents	$ 8,576,210	$ 7,649,558
Accounts receivable	9,694,573	11,669,064
Prepaid expenses and other current assets	402,630	274,100
Total current assets	18,673,413	19,592,722
Oil and natural gas properties (successful efforts accounting):		
Proved oil and natural gas properties	219,202,498	120,577,266
Unproved oil and natural gas properties	10,251,491	24,157,148
Accumulated depletion	(27,417,060)	(16,421,225)
Total oil and natural gas properties, net	202,036,929	128,313,189
Other non-current assets:		
Other property and equipment, net	—	2,256
Other non-current assets	964,834	133,924
Total other non-current assets	964,834	136,180
Total assets	$ 221,675,176	$ 148,042,091
Liabilities and Members' Equity		
Current liabilities:		
Accounts payable	$ 3,823,430	$ 6,856,924
Accrued expenses	412,505	1,601,321
Revenue payable	5,985,736	1,513,764
Current derivative liability	5,621,893	8,142,455
Current portion of asset retirement obligations	254,976	48,581
Total current liabilities	16,098,540	18,163,045
Non-current liabilities:		
Line-of-credit	77,161,685	37,045,231
Deferred rent liability	—	11,340
Derivative liability	1,569,291	3,257,215
Asset retirement obligations	511,436	581,336
Total non-current liabilities	79,242,412	40,895,122
Members' equity		
Members' equity	126,810,557	89,460,257
Members receivables	(476,333)	(476,333)
Total members' equity	126,334,224	88,983,924
Total liabilities and members' equity	$ 221,675,176	$ 148,042,091

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,	
	2022	2021
Revenues:		
Oil and natural gas sales, net	$ 85,685,089	$ 31,803,060
Operating Expenses:		
Lease operating	10,453,123	4,093,421
Production and ad valorem taxes	4,757,208	1,900,530
Depletion expense	11,017,204	4,978,958
Depreciation expense	2,314	2,032
Accretion expense	42,190	45,652
General and administrative	3,333,317	3,487,090
Impairment of oil and natural gas properties	1,005,033	3,190,663
Exploration	143,257	53,540
Total operating expenses	30,753,646	17,751,886
Operating Income	54,931,443	14,051,174
Other Income (Expenses):		
Unrealized gain (loss) on derivatives	4,208,486	(11,930,795)
Realized loss on derivatives	(18,855,309)	(3,821,893)
Interest expense	(2,934,320)	(1,272,987)
Other income	—	5,500,000
Loss on sale of assets	—	(6,386,920)
Total other expense	(17,581,143)	(17,912,595)
Net Income (Loss)	$ 37,350,300	$ (3,861,421)

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY

Years Ended December 31, 2022 and 2021

	Members' Equity	Member Receivables	Total
Balance at December 31, 2020	$ 93,321,678	$ (476,333)	$ 92,845,345
Net loss	(3,861,421)	—	(3,861,421)
Balance at December 31, 2021	89,460,257	(476,333)	88,983,924
Net income	37,350,300	—	37,350,300
Balance at December 31, 2022	$ 126,810,557	$ (476,333)	$ 126,334,224

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2022	Years Ended December 31, 2021
Operating Activities		
Net income (loss)	$ 37,350,300	$ (3,861,421)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion expense	11,017,204	4,978,958
Depreciation, amortization and accretion expense	44,504	47,684
Amortization of debt issuance costs	190,023	75,806
Impairment of oil and natural gas properties	1,005,033	3,190,663
Interest (PIK)	566,454	592,231
Deferred rent liability	(11,340)	(13,224)
Loss on sale of assets	—	(6,386,920)
Change in derivative commodity contracts	(4,208,486)	11,930,795
Changes in operating assets and liabilities:		
Accounts receivable	1,987,401	(9,644,653)
Prepaids	(141,440)	(155,226)
Accounts payable	2,602,504	712,463
Accrued expenses	(420,880)	136,548
Revenue payable	4,386,192	82,156
Net cash provided by operating activities	54,367,469	1,685,860
Investing Activities		
Acquisition/development of oil and natural gas properties	(94,093,617)	(19,562,265)
Additions to other property and equipment	-	(2,226)
Proceeds from sale of proved properties	2,123,733	6,120,347
Net cash used in investing activities	(91,969,884)	(13,444,144)
Financing Activities		
Proceeds from line-of-credit	57,000,000	30,000,000
Repayment of line-of-credit	(17,450,000)	(13,000,000)
Debt issuance costs	(1,020,934)	(10,129)
Net cash provided by financing activities	38,529,066	16,989,871
Net increase in cash and cash equivalents	926,652	5,231,587
Cash and cash equivalents at beginning of year	7,649,558	2,414,971
Cash and cash equivalents at end of year	$ 8,576,209	$ 7,646,558
Supplemental Disclosure of Cash Flow Information		
Cash paid during the year for interest	$ 2,085,294	$ 482,274
Non-cash Transactions:		
Additions/revisions to asset retirement obligations	$ 346,984	$ 82,389
Additions to oil and natural gas properties in accounts payable and accrued liabilities	$ 634,405	$ 6,952,557

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022, and 2021

A. Nature of Business

Driftwood Energy Partners, LLC (the "Company"), is engaged in the exploration and development of oil and natural gas properties. The Company was organized as a Delaware Limited Liability Company ("LLC") on September 27, 2017. The Company has three wholly owned subsidiaries Driftwood Energy Operating, LLC ("Operating"), Driftwood Energy Management, LLC ("Management"), and Driftwood Energy Intermediate, LLC ("Intermediate"). The Company's offices are in Dallas, Texas.

B. Summary of Significant Accounting Policies

A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

Basis of Accounting and Principles of Consolidation

The accounts are maintained, and the consolidated financials have been prepared using the accrual basis of accounting in accordance with generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of Operating, Management, and Intermediate. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect certain reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates and assumptions.

Cash and Cash Equivalents

The Company considers all highly-liquid investments with an original maturity of three months or less to be cash equivalents. The Company had no cash equivalents as of December 31, 2022 and 2021.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consists principally of cash. The Company maintains deposits in one financial institution, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses related to amounts in excess of FDIC limits.

Substantially all of the Company's accounts receivable is due from either purchasers of crude oil and natural gas or participants in crude oil and natural gas wells which the Company serves as the operator. Generally, operators of crude oil and natural gas properties have the right to offset future revenues against unpaid charges related to operate wells. The Company's receivables from purchasers are generally unsecured; however, credit losses to date have been minimal.

B. Summary of Significant Accounting Policies - continued

Concentrations of Credit Risk - continued

Oil and gas sales to six purchasers totaled approximately 100% of gross oil and natural gas revenues for both years ended December 31, 2022, and 2021, respectively. Accounts receivable from these six purchasers was 100% of the Company's accounts receivable as of December 31, 2022 and 2021, respectively.

Due to the nature of the markets for oil and natural gas, the Company does not believe the loss of any one purchaser would have a material adverse impact on the Company's financial position, results of operations, or cash flows for any significant period of time.

Accounts Receivable

Accounts receivable are stated at amounts management expects to collect from outstanding balances. The Company's accounts receivable are due from purchasers of oil and natural gas and amounts due from other interest holders. Oil and natural gas sales receivables related to these operations are generally unsecured. Receivables are considered past due if full payment is not received by the contractual due date. Past due accounts are generally written off against the allowance for doubtful accounts only after all collection attempts have been exhausted. As of December 31, 2022, and 2021 no credit losses had occurred and an allowance for doubtful accounts was not recorded.

Oil and Natural Gas Properties

The Company follows the successful efforts accounting method for its oil and natural gas properties. Under this method, costs of acquiring properties, costs of drilling successful exploration wells, and development costs are capitalized. The costs of exploratory wells are initially capitalized pending a determination of whether proved reserves have been found. At the completion of drilling activities, the costs of exploratory wells remain capitalized if a determination is made that proved reserves have been found. If no proved reserves have been found, the costs of each of the related exploratory wells are charged to expense. In some cases, a determination of proved reserves cannot be made at the completion of drilling, requiring additional testing, and evaluation of the wells. The Company's policy is to expense the costs of such exploratory wells if a determination of proved reserves has not been made within a twelve-month period after drilling is complete. Exploration costs such as geological, geophysical, and seismic costs are expensed as incurred, unless such costs relate to seismic surveys to further develop a proven area and then, those costs are capitalized.

Capitalized costs are depleted on a composite unit-of-production method based on proved oil and natural gas reserves on a field level basis.

The partial sale of a proved property within an existing field is accounted for as a normal retirement and no net gain or loss on divestiture activity is recognized as long as the treatment does not significantly affect the units-of-production depletion rate. The sale of a partial interest in an individual proved property is accounted for as a recovery of cost. A net gain or loss on divestiture activity is recognized in the accompanying statements of operations for all other sales of proved properties.

B. Summary of Significant Accounting Policies - continued

Oil and Natural Gas Properties – continued

The costs of unproved properties are excluded from depletion until the properties are evaluated. All unevaluated properties are reviewed by management on an annual basis to determine whether or not proved reserves have been assigned to the properties or if impairment has occurred. The Company recognized impairments of approximately $1.0 million and $3.2 million for the years ended December 31, 2022, and 2021 respectively.

The Company reviews its proved oil and natural gas properties for impairment whenever events or changes in circumstances indicate that the carrying amounts of such properties may not be recoverable. The determination of recoverability is made based upon estimated undiscounted future net cash flows. The amount of impairment loss, if any, is determined by comparing the fair value, as determined by a discounted cash flow analysis, with the carrying value of the related asset.

The Company can capitalize certain internal overhead and interest costs directly attributable to acquisition, exploration and development activities. Capitalized costs may not include any costs related to production, lease operating expense or similar activities. The Company did not capitalize any internal overhead or interest costs in 2022 and 2021.

Other Property and Equipment

Other property and equipment are carried at cost. Major renewals and improvements are capitalized while expenditures for maintenance and repairs are expensed as incurred. The Company's other property and equipment policy requires all items under $2,000 to be expensed. Upon sale or abandonment, the cost of the equipment and related accumulated depreciation are removed from the accounts and any gain or loss is recognized. Depreciation is calculated using the straight-line method over the estimated useful lives ranging between three and five years.

The Company evaluates other property and equipment for potential impairment whenever indicators of impairment are present. Circumstances that could indicate potential impairment include significant adverse changes in industry trends and the economic outlook, legal actions, regulatory changes, and significant declines in utilization rates.

If it is determined that other property and equipment are potentially impaired, we perform an impairment evaluation by estimating the future undiscounted net cash flow from the use and eventual disposition of other property and equipment grouped at the lowest level at which cash flows can be identified. If the sum of the future undiscounted net cash flows is less than the net book value of the property, an impairment loss is recognized for the excess, if any, of the assets' net book values over their estimated discounted fair values. As of December 31, 2022 and 2021, no impairment expense was recorded.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses include amounts payable from expenses incurred directly by the Company.

B. Summary of Significant Accounting Policies - continued

Asset Retirement Obligations

The Company recognizes an asset retirement obligation for legal obligations associated with the retirement of the Company's oil and natural gas properties. Oil and natural gas producing companies incur such a liability upon acquiring or drilling a well. An asset retirement obligation ("ARO") is recorded as a liability at its estimated present value at the asset's inception, with an offsetting increase to producing properties in the accompanying balance sheets which is depreciated on a unit–of– production basis. Periodic accretion of the discount on asset retirement obligations is recorded as an expense in the accompanying statement of operations. See further discussion of AROs at Note E.

Member Receivable

Member receivables consist of notes receivable from the management members of the Company. These notes are classified as receivables within equity, as these notes represent a capital contribution to the Company. See Note G for further information.

Revenue Recognition

On January 1, 2019, the Company adopted ASU No. 2014–09, Revenue from Contracts with Customers ("Topic 606"), which supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, Revenue Recognition. The Financial Accounting Standards Board ("FASB") has also issued several amendments (ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20) clarifying different aspects of Topic 606. The Company implemented this standard using the modified retrospective method applied to contracts for the year ended December 31, 2019.

Oil, natural gas and natural gas liquids revenues are recognized upon the transfer of control of the products to a purchaser. Transfer of control typically occurs when the products are delivered to the purchaser, title or risk of loss has transferred and collectability of the revenue is reasonably assured. Revenue is recognized net of royalties due to third parties in an amount that reflects the consideration the Company expects to receive in exchange for those products. The Company's oil production is primarily sold under market-sensitive contracts that are typically priced at a differential to a market index price or at purchaser posted prices for the producing area. For oil contracts, the Company generally records sales based on the net amount received. The Company's natural gas production is primarily sold under market-sensitive contracts that are typically priced at a differential to the published natural gas index price for the producing area due to the natural gas quality and the proximity to major consuming markets. For natural gas contracts, the Company generally records sales at the wellhead or inlet of the gas processing plant as revenues net of transportation, gathering and processing expenses if the processor is the customer and there is no redelivery of commodities to the Company at the tailgate of the plant.

B. Summary of Significant Accounting Policies - continued

Revenue Recognition – continued

As a result of Topic 606 adoption, there were no significant changes to the timing of revenue recognized for sales of production.

Contract Balances

Customers are invoiced once the Company's performance obligations have been satisfied. Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 days. There are no significant judgments that significantly affect the amount or timing of revenue from contracts with customers. Accordingly, the Company's oil and natural gas sales contacts do not give rise to material contract assets or contract liabilities. Accounts receivable from the sales of oil and natural gas are primarily from purchasers and from exploration and production companies that own interests in properties operated on behalf of the Company.

Performance Obligations

The Company applies the optional exemptions in Topic 606 and does not disclose consideration for remaining performance obligations with an original expected duration of one year or less or for variable consideration related to unsatisfied performance obligations.

Derivatives

The Company uses various financial instruments for non-trading purposes to manage and reduce price volatility and other market risks associated with its oil and natural gas production. These arrangements are structured to reduce the Company's exposure to commodity price decreases, but they can also limit the benefit the Company might otherwise receive from commodity price increases. The Company's risk management activity is generally accomplished through over-the-counter commodity derivative contracts with large financial institutions. The Company applies the provisions of the "Derivatives and Hedging" topic of the Accounting Standards Codification ("ASC"), which requires each derivative instrument to be recorded in the accompanying consolidated balance sheets at fair value.

If a derivative has not been designated as a hedge or does not otherwise qualify for hedge accounting, it must be adjusted to fair value through earnings. The Company elected not to designate its current portfolio of commodity derivative contracts as hedges for accounting purposes. Therefore, changes in fair value of these derivative instruments are recognized in earnings in the accompanying consolidated statements of operations.

At December 31, 2022, the Company's derivatives were composed of the following:

B. Summary of Significant Accounting Policies - continued

Derivatives – continued

Commodity price	**Volume (Bbl/MMBTU)**	**Strike**
Swaps (crude oil)		
Jan – Mar 2023	7,008	$44.45
Jan – Dec 2024	75,950	63.75
Swaps (natural gas)		
Mar – Dec 2023	127,100	2.46
Jan – Dec 2024	263,900	3.39
Jan – Dec 2024	298,700	(1.10)
Jan – Dec 2024	191,800	3.15
Call Options (crude oil)		
Jan – Dec 2023	417,908	35.00 – 93.50
Jan – Dec 2024	217,350	50.00 – 89.50
Call Options (natural gas)		
Feb – Dec 2023	200,000	2.00 – 3.01
WTI Diff Spread (crude oil)		
Feb – Dec 2023	651,818	0.32
Jan – Dec 2024	293,300	0.22
WTI Diff Spread (natural gas)		
Jan – Dec 2023	2,026,881	(1.76) – (0.31)
Jan – Dec 2024	933,292	(1.00)

B. Summary of Significant Accounting Policies - continued

Derivatives – continued

At December 31, 2021, the Company's derivatives were composed of the following:

Commodity price	Volume (Bbl/MMBTU)	Strike
Swaps (crude oil)		
Jan – Mar 2022	18,000	$51.00
Apr – Dec 2022	42,270	54.40
Jan – Mar 2022	550	40.75
Feb – Apr 2022	82,700	67.10
Jan – Mar 2023	7,008	44.45
Jan – Dec 2024	75,950	63.75
Swaps (natural gas)		
Apr – Jun 2022	24,000	2.34
Feb – May 2022	125,200	4.06
Mar – Dec 2023	127,100	2.46
Jan – Dec 2024	191,800	3.15
Call Options (crude oil)		
Jan – Dec 2022	453,387	30.00 – 83.10
Jan – Dec 2023	327,608	35.00 – 84.30
Jan – Mar 2024	75,950	50.00 – 84.00
Call Options (natural gas)		
Jan – Dec 2022	319,600	2.00 – 3.24
Jan – Mar 2023	232,000	2.00 – 3.01
WTI Diff Spread (crude oil)		
Jan – Dec 2022	315,472	0.00 – 0.95
Jan – Dec 2023	219,116	0.00
Jan – Dec 2024	151,900	0.22
WAHA Diff Spread (natural gas)		
Jan – Dec 2022	571,786	(0.66) – (0.31)
Jan – Mar 2023	31,862	(0.31)

Fair Value Measurement

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a three-tier hierarchy that is used to identify assets and liabilities measured at fair value. The hierarchy

B. Summary of Significant Accounting Policies - continued

Fair Value Measurement – continued

focuses on the inputs used to measure fair value and requires that the lowest level input be used. The three levels defined are as follows:

- Level 1 — observable inputs that are based upon quoted market prices for identical assets or liabilities within active markets.
- Level 2 — observable inputs other than Level 1 that are based upon quoted market prices for similar assets or liabilities, based upon quoted prices within inactive markets, or inputs other than quoted market prices that are observable through market data for substantially the full term of the asset or liability.
- Level 3 — inputs that are unobservable for the particular asset or liability due to little or no market activity and are significant to the fair value of the asset or liability. These inputs reflect assumptions that market participants would use when valuing the particular asset or liability.

The Company's derivatives consist of over–the–counter ("OTC") contracts which are not traded on a public exchange. As the fair value of these derivatives is based on inputs using market prices obtained from independent brokers or determined using quantitative models that use as their basis readily observable market parameters that are actively quoted and can be validated through external sources, including third party pricing services, brokers and market transactions, the Company has categorized these derivatives as Level 2. The Company values these derivatives using the income approach using inputs such as the forward curve for commodity prices based on quoted market prices and prospective volatility factors related to changes in the forward curves. The Company's estimates of fair value have been determined at discrete points in time based on relevant market data.

The following table presents assets that are measured at fair value on a recurring basis as of December 31, 2021 and 2020:

	December 31, 2022			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets (Liabilities)				
Oil and natural gas commodity contracts	$ —	$ (7,191,184)	$ —	$ (7,191,184)

	December 31, 2021			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets (Liabilities)				
Oil and natural gas commodity contracts	$ —	$ (11,399,670)	$ —	$ (11,399,670)

B. Summary of Significant Accounting Policies - continued

Fair Value Measurement – continued

Our other financial instruments consist primarily of the cash and cash equivalents, trade and other receivables, accounts payable and accrued expenses. The carrying value of our trade and other receivables, accounts payable and accrued expenses approximates fair value due to their highly liquid nature, short term maturity, or competitive rates assigned to these financial statements.

Income Taxes

The Company is organized as a limited liability company and taxed as a partnership for federal income tax purposes. As a result, income or losses are taxable or deductible to the members rather than at the Company level; accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements. In certain instances, the Company is subject to state taxes on income arising in or derived from the state tax jurisdictions in which it operates.

State income tax positions are evaluated in a two-step process. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the more likely than not threshold, it is then measured to determine the amount of expense to record in the consolidated financial statements. The tax expense recorded would equal the largest amount of expense related to the outcome that is 50% or greater likely to occur. The Company classifies any potential accrued interest recognized on an underpayment of income taxes as interest expense and classifies any statutory penalties recognized on a tax position taken as operating expense.

Management of the Company has not taken a tax position that, if challenged, would be expected to have a material effect on the consolidated financial statements as of or for the years ended December 31, 2022 and 2021. The Company did not incur any penalties or interest related to its state tax returns during the years ended December 31, 2022 and 2021.

Under the new centralized partnership audit rules effective for tax years beginning after 2017, the Internal Revenue Service (“IRS”) assesses and collects underpayments of tax from the partnership instead of from each partner. The partnership may be able to pass the adjustments through to its partners by making a push-out election or, if eligible, by electing out of the centralized partnership audit rules.

The collection of tax from the partnership is only an administrative convenience for the IRS to collect any underpayment of income taxes including interest and penalties. Income taxes on partnership income, regardless of who pays the tax or when the tax is paid, is attributed to the partners. Any payment made by the partnership as a result of an IRS examination will be treated as a distribution from the partnership to the partners in the consolidated financial statements.

General and Administrative Expenses

General and administrative expenses include corporate expenses, accounting, legal and insurance.

B. Summary of Significant Accounting Policies - continued

Recent Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-02, Leases. This update applies to any entity that enters into a lease, with some specified scope exemptions. Under this update, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. Entities will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.

The Company has only 1 real estate lease which qualifies under ASC 842. This lease is expiring in 2024. The Company has entered into a transaction to divest its assets of Driftwood Energy Operating, LLC on February 14, 2023 and intend to terminate this lease in 2023. The Company has evaluated that impact of this standard is immaterial on the financials and decided not to implement it.

C. Oil and Natural Gas Properties

The Company's oil and natural gas properties consist of the following as of December 31, 2022 and 2021:

	2022	2021
Proved oil and natural gas properties	$ 219,202,498	$ 120,577,266
Unproved oil and natural gas properties	10,251,491	24,157,148
Accumulated depletion and impairment	(27,417,060)	(16,421,225)
Oil and natural gas properties, net	$ 202,036,929	$ 128,313,189

D. Other Property and Equipment

Other property and equipment consisted of the following as of December 31, 2022 and 2021:

	2022	2021
Office equipment	$ 6,505	$ 6,505
Office furniture	6,361	6,361
IT- Hardware	45,500	45,500
Less accumulated depreciation	(58,366)	(56,110)
Other property and equipment, net	$ —	$ 2,256

E. Asset Retirement Obligations

Changes in the Company's asset retirement obligations for the years ended December 31, 2022 and 2021 are as follows:

	2022	2021
Asset retirement obligations at beginning of year	$ 629,918	$ 745,131
Additions during the year	122,767	82,389
Revisions	224,217	
Liabilities settled	(252,680)	(243,254)
Accretion of discount	42,190	45,652
Asset retirement obligations at end of year	$ 766,412	$ 629,918

F. Line of Credit

The Company has a reserve-based lending facility with certain financial institutions with aggregate commitments totaling $100 million. The Company had an outstanding balance on the facility of
$58,000,000 and $18,450,000 as of December 31, 2022, and 2021, respectively. The borrowing base is periodically redetermined based on the proved oil and gas properties of the Company. The borrowing base for the facility was $95 million as of December 31, 2022. The credit agreement is secured against a first lien on the Company's oil and natural gas properties and other assets. Balances outstanding under the credit agreement bear interest at Eurodollar-based rate plus a margin ranging from 3.00% to 4.00%. The rate as of December 31, 2022 and 2021 was 5.53% and 4.87%, respectively. Principal and any accrued interest is due at maturity in April 2026. The line of credit is subject to restrictive debt covenants as defined in the credit agreement.

In January 2021, the Company also entered into a promissory note with a total borrowing capacity of
$30 million. The note has no recourse to the Company's oil and natural gas properties and other assets. The company had an outstanding balance on the promissory note of $19,161,685 and $18,595,231 as of December 31, 2022 and 2021, respectively. Balances outstanding under the credit agreement bear interest at BSBY rate. The Company treats interest for this promissory note as paid-in-kind interest.

The Company has capitalized debt issuance costs of approximately $1,381,624, at December 31, 2022 and amortizes the debt issuance costs monthly, which is included in interest expense on the consolidated statements of operations.

Amortization expense for the year ended December 31, 2022 was approximately $202,407. Amortization expense for each of the succeeding years is as follows:

F. Line of Credit - continued

2023	$	293,250
2024		276,805
2025		276,805
2026		92,268
	$	939,128

G. Members' Equity and Incentive Units

The equity of the Company is 100% owned by CEC Driftwood Holdings, LLC and certain members of management and employees of the Company. The equity members have made equity commitments to the Company pursuant to the Company's limited liability company agreement. The balance of prior contributions of equity from equity members and receivables owed from equity members is included within Members' equity on the consolidated balance sheets.

Series C Units

The Company's limited liability company agreement provides for the issuance of Incentive Units. The Incentive Units entitle the holder to participate in the net profits and cumulative returns of the Company, but are subject to various performance criteria and vesting requirements, as defined in the Company's limited liability company agreement.

The Company implemented the provisions of FASB ASC Topic 710, *Compensation – General*, due to the issuance of these management incentive units. The Incentive Units are designed as a profits interest, and the Incentive Unit holders are entitled to an increased share of the distributable cash flow generated by the Company in the event that certain performance hurdles are met. The Incentive Units are accounted for consistent with requirements of ASC Topic 710 due to the payouts being consistent with profit sharing of the Company based on substantive terms of the instruments. Due to the nature of the Incentive Units, no value is attributed and no expense recognized at the date of issuance.

H. Transactions

In July 2022, the Company divested one well in Upton County for $2.1 million. This property was acquired in a package when the Company purchased certain unproved properties. Therefore, no cost basis was assigned to the sold property. As such, no gain or loss was recognized.

In November 2022, the Company entered into a transaction where it divested all its interests in certain Upton County wells for no consideration. These wells were acquired in a package with unproved properties and no basis was assigned to sold properties. As such, no gain or loss was recognized.

In 2021, the Company divested some of its properties in Upton County. The Company recognized $6.39 million loss as a result of these transactions which is included in Loss on sale of assets on the statements of operations.

I. Commitments and Contingencies

Environmental Remediation

Various federal, state, and local laws and regulations covering the discharge of materials into the environment, or otherwise relating to the protection of the environment, may affect the Company's operations and the costs of its oil and natural gas exploration, development, and production operations. The Company does not anticipate that it will be required in the near future to expend significant amounts in relation to the consolidated financial statements taken as a whole by reason of environmental laws and regulations, and appropriately no reserves have been recorded.

Legal Contingencies

In the course of its business affairs and operations, the Company is subject to possible loss contingencies arising from federal, state and local environmental, health and safety laws and regulations and third-party litigation. As of December 31, 2022, there are no matters which, in the opinion of management, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Operating Leases

The Company leases a building under a non-cancelable operating lease that expires in 2024.

Future fiscal year minimum payments under the non-cancelable operating lease consisted of the following at December 31, 2022:

2023	$	111,592
2024		47,825
Total minimum lease payments	$	159,417

When the Company enters into an operating lease that contains a period where there are free or reduced rents, or rent increases throughout the lease term, the Company recognizes rent expense on a straight- line basis over the term of the lease. Deferred rent as of December 31, 2022 and 2021 was approximately $0 and $11,340, respectively. Rent expense for the years December 31, 2022 and 2021 was approximately $147,000 and $147,000, respectively, and is included in general and administrative expense in the accompanying consolidated statements of operations.

I. Commitments and Contingencies – continued

Risk and Uncertainties

The Company's revenue, profitability, and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, which depend on numerous factors beyond its control such as overall oil and natural gas production and inventories in relevant markets, economic conditions, the global political environment, regulatory developments, and competition from other energy sources. Oil and natural gas prices historically have been volatile and may be subject to significant fluctuations in the future.

J. Subsequent Events

In preparing the accompanying consolidated financial statements, management has evaluated all subsequent events and transactions for potential recognition or disclosure through March 20, 2023 the date the consolidated financial statements were available for issuance.

On February 14, 2023, the Company entered into a purchase and sale agreement to sell the assets of Driftwood Energy Operating, LLC. The deal is expected to close on April 3, 2023, contingent upon certain closing conditions and obligations of the buyer and seller as defined in the purchase and sale agreement.

Supplemental Oil and Gas Reserve Information (Unaudited)

Proved Oil and Gas Reserve Quantities

Netherland, Sewell & Associates ("NSAI"), the Company's independent reserve engineers, estimated 100% of the Company's proved reserves as of December 31, 2022. In accordance with SEC regulations, the reserves as of December 31, 2022 were estimated using the Realized Prices, which reflect adjustments to the Benchmark Prices for quality, certain transportation fees, geographical differentials, marketing bonuses or deductions and other factors affecting the price received at the delivery point. The Company's reserves are reported in three streams: oil, NGL and natural gas.

The SEC has defined proved reserves as the estimated quantities of oil, NGL and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. The process of estimating oil, NGL and natural gas reserves is complex, requiring significant decisions in the evaluation of available geological, geophysical, engineering and economic data. The data for a given property may also change substantially over time as a result of numerous factors, including additional development activity, evolving production history and a continual reassessment of the viability of production under changing economic conditions. As a result, material revisions to existing reserve estimates occur from time to time. Although every reasonable effort is made to ensure that reserve estimates reported represent the most accurate assessments possible, the subjective decisions and variances in available data for various properties increase the likelihood of significant changes in these estimates.

Supplemental Oil and Gas Reserve Information (Unaudited) – continued

Proved Oil and Gas Reserve Quantities

The following table disclosed changes in the estimated quantities of proved reserves for 2022:

Proved developed and undeveloped reserves:	**Oil (MBbls)**	**Natural Gas (MMcf)**	**Natural Gas Liquids (MMcf)**	**Total (MBoe)**
Beginning of year - January 1, 2022	13,006	18,289	4,436	20,489
Revisions of previous estimates	(2,699)	5,474	1,723	(63)
Extensions and discoveries	6,789	11,756	3,390	12,139
Divestitures of reserves	(1,009)	(1,885)	(464)	(1,786)
Production	(773)	(1,100)	(580)	(1,536)
End of year - December 31, 2022	15,314	32,535	8,506	29,242
Proved developed reserves:				
Beginning of year	3,553	7,442	1,768	6,561
End of year	7,321	17,340	4,503	14,714
Proved undeveloped reserves:				
Beginning of year	9,453	10,847	2,668	13,929
End of year	7,993	15,195	4,003	14,528

For the year ending December 31, 2022, the Company's negative revision of 63 MBoe of previously estimated quantities consisted in performance revisions of proved developed producing wells.

For the year ending December 31, 2022, extensions and discoveries of 12,139 MBoe consisted of the conversion of non-proved undeveloped horizontal locations to proved developed reserves and new horizontal proved undeveloped locations added offsetting recently drilled proved developed producing wells.

Standardized Measure of Discounted Cash Flows

The standardized measure of discounted future net cash flows does not purport to be, nor should it be interpreted to present, the fair value of the oil, NGL and natural gas reserves of the property. An estimate of fair value would take into account, among other things, the value of proved properties and consideration of expected future economic and operating conditions.

Supplemental Oil and Gas Reserve Information (Unaudited) – continued

The estimates of future cash flows and future production and development costs as of December 31, 2022 are based on the Realized Prices, which reflect adjustments to the Benchmark Prices for quality, certain transportation fees, geographical differentials, marketing or deductions and other factors affecting the price received at the delivery point. All Realized Prices are held flat over the forecast period for all reserve categories in calculating the discounted future net cash flows. In accordance with SEC regulations, the proved reserves were anticipated to be economically producible from the “as of date” forward based on existing economic conditions, including prices and costs at which economic producibility from a reservoir was determined. These costs, held flat over the forecast period, include development costs, operating costs, ad valorem and production taxes and abandonment costs after salvage. Future income tax expenses are computed using the appropriate year-end statutory tax rates applied to the future pretax net cash flows from proved oil, NGL and natural gas reserves, less the tax basis of the Company's oil and natural gas properties. The estimated future net cash flows are then discounted at a rate of 10%.

The following prices were used in the calculation of proved reserves and the standardized measure of discounted future net cash flows for the year ended December 31, 2022:

	Benchmark Prices
	2022
Oil (per Bbl)	$94.14
Natural gas (per Mcf)	$6.54

	Realized Prices
	2022
Oil (per Bbl)	$92.98
Natural gas (per Mcf)	$4.37
Natural gas liquids (per Bbl)	$31.88

The following table presents the standardized measure of future net cash flows related to estimated proved oil and natural gas reserves together with changes therein:

		2022
Future cash inflows	$	1,837,188,400
Future production costs		(412,611,900)
Future development costs		(178,013,400)
Future income tax expense		(9,645,239)
Future net cash flows		1,236,917,861
10% discount for estimated timing of cash flows		(641,525,849)
Standardized measure of future discounted cash flows	$	595,392,012

Supplemental Oil and Gas Reserve Information (Unaudited) – continued

It is not intended that the FASB's standardized measure of discounted future net cash flows represent the fair market value of the Company's proved reserves. The Company cautions that the disclosures shown are based on estimates of proved reserve quantities and future production schedules which are inherently imprecise and subject to revision, and the 10% discount rate is arbitrary. In addition, prices and costs as of the measurement date are used in the determinations, and no value may be assigned to probable or possible reserves.

The following table presents the changes in the standardized measure of discounted future net cash flows related to the proved oil and gas reserves of the Company for the year ended December 31, 2022:

Standardized measure of discounted future net cash flows:		**2022**
Beginning of year - January 1, 2022	$	336,163,640
Changes in the year resulting from:		
Sales, less production costs		(70,473,905)
Revisions of previous quantity estimates		(1,308,684)
Extensions, discoveries and other additions		264,981,300
Divestiture of reserves		(26,278,600)
Net change in prices and production costs		78,622,921
Net change in estimated future development costs		(16,791,528)
Previously estimated development costs incurred		15,246,100
Net change in taxes		(2,019,228)
Accretion of discount		33,887,270
Timing difference and other		(16,637,274)
End of year - December 31, 2022	$	595,392,012

Estimates of economically recoverable oil, NGL and natural gas reserves and of future net cash flows are based upon a number of variable factors and assumptions, all of which are, to some degree, subjective and may vary considerably from actual results. Therefore, actual production, revenues, development and operating expenditures may not occur as estimated. The reserve data are estimates only, are subject to many uncertainties and are based on data gained from production histories and on assumptions as to geologic formations and other matters. Actual quantities of oil, NGL and natural gas may differ materially from the amounts estimated.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED FINANCIAL STATEMENTS

Quarter Ended March 31, 2023 and 2022 and Year Ended December 2022

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED FINANCIAL STATEMENTS

Quarter Ended March 31, 2023 and 2022 and Year Ended December 2022

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DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED BALANCE SHEETS

	March 31, 2023 (unaudited)	December 31, 2022
Assets		
Current assets:		
Cash and cash equivalents	$ 2,491,520	$ 8,576,210
Accounts receivable	6,802,861	9,694,573
Prepaid expenses and other current assets	3,961,665	402,630
Total current assets	13,256,046	18,673,413
Oil and natural gas properties (successful efforts accounting):		
Proved oil and natural gas properties	203,956,269	219,202,498
Unproved oil and natural gas properties	10,252,217	10,251,491
Accumulated depletion	(26,975,789)	(27,417,060)
Total oil and natural gas properties, net	187,232,697	202,036,929
Other non-current assets:		
Other non-current assets	879,161	964,834
Total other non-current assets	879,161	964,834
Total assets	$ 201,367,904	$ 221,675,176
Liabilities and Members' Equity		
Current liabilities:		
Accounts payable	$ 3,545,058	$ 3,823,430
Accrued expenses	225,187	412,505
Revenue payable	3,048,152	5,985,736
Current derivative liability	1,808,856	5,621,893
Current portion of asset retirement obligations	254,976	254,976
Total current liabilities	8,882,229	16,098,540
Non-current liabilities:		
Line-of-credit	49,460,685	77,161,685
Derivative liability	499,750	1,569,291
Asset retirement obligations	515,785	511,436
Total non-current liabilities	50,476,220	79,242,412
Members' equity		
Members' equity	142,485,788	126,810,557
Members receivables	(476,333)	(476,333)
Total members' equity	142,009,455	126,334,224
Total liabilities and members' equity	$ 201,367,904	$ 221,675,176

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	For the Three Months Ended March 31,	
	2023	2022
Revenues:		
Oil Sales	$ 20,171,226	$ 6,323,409
Gas Sales	1,182,389	563,681
NGL Sales	2,426,831	952,443
Oil and natural gas sales, net	$ 23,780,446	$ 7,839,533
Operating Expenses:		
Lease operating	3,396,241	861,126
Gathering & Processing	726,500	192,066
Production and ad valorem taxes	998,390	403,007
Depletion expense	5,069,339	868,853
Depreciation expense	—	456
Accretion expense	11,746	10,483
General and administrative	883,995	712,430
Exploration	116,194	—
Total operating expenses	11,202,405	3,048,421
Operating Income	12,578,041	4,791,112
Other Income (Expenses):		
Unrealized gain (loss) on derivatives	4,882,579	(17,592,203)
Realized loss on derivatives	(1,916,020)	(2,512,453)
Interest expense	(1,170,104)	(391,871)
Gain on sale of assets	1,300,734	—
Total other expense	3,097,189	(20,496,527)
Net Income (Loss)	$ 15,675,230	$ (15,705,415)

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY (unaudited)

For the Three Months Ended March 31, 2023 and March 31, 2022

	Members' Equity		Member Receivables		Total	
Balance at December 31, 2022	$	126,810,557	$	(476,333)	$	126,334,224
Net income	$	15,675,230		-		15,675,230
Balance at March 31, 2023	$	142,485,788	$	(476,333)	$	142,009,455
Balance at December 31, 2021	$	89,460,257	$	(476,333)	$	88,983,924
Net loss	$	(15,705,415)		-	$	(15,705,415)
Balance at March 31, 2022	$	73,754,842	$	(476,333)	$	73,278,509

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	For the Three Months Ended March 31, 2023	2022
Operating Activities		
Net income (loss)	$ 15,675,230	$ (15,705,415)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion expense	5,069,339	868,853
Depreciation, amortization and accretion expense	11,746	10,882
Amortization of debt issuance costs	190,023	19,132
Interest (PIK)	—	138,816
Deferred rent liability	—	(3,844)
Gain on sale of assets	(1,300,734)	—
Change in derivative commodity contracts	(4,882,578)	17,592,203
Changes in operating assets and liabilities:		
Accounts receivable	2,891,712	3,751,937
Prepaids	(3,559,035)	86,698
Accounts payable	(1,201,488)	6,429,414
Accrued expenses	(74,595)	(546,555)
Revenue payable	(2,937,584)	5,780,221
Net cash provided by operating activities	9,882,037	18,422,341
Investing Activities		
Acquisition/development of oil and natural gas properties	(2,435,570)	(15,214,658)
Proceeds from sale of proved properties	14,274,194	—
Net cash provided by (used in) investing activities	11,838,623	(15,214,658)
Financing Activities		
Repayment of line-of-credit	(27,701,000)	(7,450,000)
Debt issuance costs	(104,350)	—
Net cash used in financing activities	(27,805,350)	(7,450,000)
Net increase in cash and cash equivalents	(6,084,690)	(4,242,317)
Cash and cash equivalents at beginning of period	8,576,210	7,649,558
Cash and cash equivalents at end of period	$ 2,491,520	$ 3,407,241
Supplemental Disclosure of Cash Flow Information		
Cash paid during the year for interest	$ 1,037,674	$ 353,218
Non-cash Transactions:		
Additions to oil and natural gas properties in accounts payable and accrued liabilities	$ (810,393)	$ (7,987,979)

See accompanying notes to consolidated financial statements.

DRIFTWOOD ENERGY PARTNERS, LLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. Nature of Business

Driftwood Energy Partners, LLC (the "Company"), is engaged in the exploration and development of oil and natural gas properties. The Company was organized as a Delaware Limited Liability Company ("LLC") on September 27, 2017. The Company has three wholly owned subsidiaries Driftwood Energy Operating, LLC ("Operating"), Driftwood Energy Management, LLC ("Management"), and Driftwood Energy Intermediate, LLC ("Intermediate"). The Company's offices are in Dallas, Texas.

B. Summary of Significant Accounting Policies

A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

Basis of Accounting and Principles of Consolidation

The accounts are maintained, and the consolidated financials have been prepared using the accrual basis of accounting in accordance with generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of Operating, Management, and Intermediate. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect certain reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates and assumptions.

Cash and Cash Equivalents

The Company considers all highly-liquid investments with an original maturity of three months or less to be cash equivalents. The Company had no cash equivalents as of March 31, 2023 and December 2022.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consists principally of cash. The Company maintains deposits in one financial institution, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses related to amounts in excess of FDIC limits.

Substantially all of the Company's accounts receivable is due from either purchasers of crude oil and natural gas or participants in crude oil and natural gas wells which the Company serves as the operator. Generally, operators of crude oil and natural gas properties have the right to offset future revenues against unpaid charges related to operate wells. The Company's receivables from purchasers are generally unsecured; however, credit losses to date have been minimal.

B. Summary of Significant Accounting Policies - continued

Concentrations of Credit Risk – continued

Oil and gas sales to six purchasers totaled approximately 100% of gross oil and natural gas revenues for quarter ended March 31, 2023, and year ended December 2022. Accounts receivable from these six purchasers was 100% of the Company's accounts receivable as of March 31, 2023, and December 31, 2022.

Due to the nature of the markets for oil and natural gas, the Company does not believe the loss of any one purchaser would have a material adverse impact on the Company's financial position, results of operations, or cash flows for any significant period of time.

Accounts Receivable

Accounts receivable are stated at amounts management expects to collect from outstanding balances. The Company's accounts receivable are due from purchasers of oil and natural gas and amounts due from other interest holders. Oil and natural gas sales receivables related to these operations are generally unsecured. Receivables are considered past due if full payment is not received by the contractual due date. Past due accounts are generally written off against the allowance for doubtful accounts only after all collection attempts have been exhausted. As of March 31, 2023 and December 31, 2022, no credit losses had occurred and an allowance for doubtful accounts was not recorded.

Oil and Natural Gas Properties

The Company follows the successful efforts accounting method for its oil and natural gas properties. Under this method, costs of acquiring properties, costs of drilling successful exploration wells, and development costs are capitalized. The costs of exploratory wells are initially capitalized pending a determination of whether proved reserves have been found. At the completion of drilling activities, the costs of exploratory wells remain capitalized if a determination is made that proved reserves have been found. If no proved reserves have been found, the costs of each of the related exploratory wells are charged to expense. In some cases, a determination of proved reserves cannot be made at the completion of drilling, requiring additional testing, and evaluation of the wells. The Company's policy is to expense the costs of such exploratory wells if a determination of proved reserves has not been made within a twelve-month period after drilling is complete. Exploration costs such as geological, geophysical, and seismic costs are expensed as incurred, unless such costs relate to seismic surveys to further develop a proven area and then, those costs are capitalized.

Capitalized costs are depleted on a composite unit-of-production method based on proved oil and natural gas reserves on a field level basis.

The partial sale of a proved property within an existing field is accounted for as a normal retirement and no net gain or loss on divestiture activity is recognized as long as the treatment does not significantly affect the units-of-production depletion rate. The sale of a partial interest in an individual proved property is accounted for as a recovery of cost. A net gain or loss on divestiture activity is recognized in the accompanying statements of operations for all other sales of proved properties.

B. Summary of Significant Accounting Policies - continued

Oil and Natural Gas Properties – continued

The costs of unproved properties are excluded from depletion until the properties are evaluated. All unevaluated properties are reviewed by management on an annual basis to determine whether or not proved reserves have been assigned to the properties or if impairment has occurred. There was no impairment as of March 31, 2023 and 2022.

The Company reviews its proved oil and natural gas properties for impairment whenever events or changes in circumstances indicate that the carrying amounts of such properties may not be recoverable. The determination of recoverability is made based upon estimated undiscounted future net cash flows. The amount of impairment loss, if any, is determined by comparing the fair value, as determined by a discounted cash flow analysis, with the carrying value of the related asset.

The Company can capitalize certain internal overhead and interest costs directly attributable to acquisition, exploration and development activities. Capitalized costs may not include any costs related to production, lease operating expense or similar activities. The Company did not capitalize any internal overhead or interest costs during the three months ended March 31, 2023 and 2022.

Other Property and Equipment

Other property and equipment are carried at cost. Major renewals and improvements are capitalized while expenditures for maintenance and repairs are expensed as incurred. The Company's other property and equipment policy requires all items under $2,000 to be expensed. Upon sale or abandonment, the cost of the equipment and related accumulated depreciation are removed from the accounts and any gain or loss is recognized. Depreciation is calculated using the straight-line method over the estimated useful lives ranging between three and five years.

The Company evaluates other property and equipment for potential impairment whenever indicators of impairment are present. Circumstances that could indicate potential impairment include significant adverse changes in industry trends and the economic outlook, legal actions, regulatory changes, and significant declines in utilization rates.

If it is determined that other property and equipment are potentially impaired, we perform an impairment evaluation by estimating the future undiscounted net cash flow from the use and eventual disposition of other property and equipment grouped at the lowest level at which cash flows can be identified. If the sum of the future undiscounted net cash flows is less than the net book value of the property, an impairment loss is recognized for the excess, if any, of the assets' net book values over their estimated discounted fair values. As of March 31, 2023 and December 31, 2022 no impairment expense was recorded.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses include amounts payable from expenses incurred directly by the Company.

B. Summary of Significant Accounting Policies - continued

Asset Retirement Obligations

The Company recognizes an asset retirement obligation for legal obligations associated with the retirement of the Company's oil and natural gas properties. Oil and natural gas producing companies incur such a liability upon acquiring or drilling a well. An asset retirement obligation ("ARO") is recorded as a liability at its estimated present value at the asset's inception, with an offsetting increase to producing properties in the accompanying balance sheets which is depreciated on a unit–of– production basis. Periodic accretion of the discount on asset retirement obligations is recorded as an expense in the accompanying statement of operations. See further discussion of AROs at Note E.

Member Receivable

Member receivables consist of notes receivable from the management members of the Company. These notes are classified as receivables within equity, as these notes represent a capital contribution to the Company. See Note G for further information.

Revenue Recognition

On January 1, 2019, the Company adopted ASU No. 2014–09, Revenue from Contracts with Customers ("Topic 606"), which supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, Revenue Recognition. The Financial Accounting Standards Board ("FASB") has also issued several amendments (ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20) clarifying different aspects of Topic 606. The Company implemented this standard using the modified retrospective method applied to contracts for the year ended December 31, 2019.

Oil, natural gas and natural gas liquids revenues are recognized upon the transfer of control of the products to a purchaser. Transfer of control typically occurs when the products are delivered to the purchaser, title or risk of loss has transferred and collectability of the revenue is reasonably assured. Revenue is recognized net of royalties due to third parties in an amount that reflects the consideration the Company expects to receive in exchange for those products. The Company's oil production is primarily sold under market-sensitive contracts that are typically priced at a differential to a market index price or at purchaser posted prices for the producing area. For oil contracts, the Company generally records sales based on the net amount received. The Company's natural gas production is primarily sold under market-sensitive contracts that are typically priced at a differential to the published natural gas index price for the producing area due to the natural gas quality and the proximity to major consuming markets. For natural gas contracts, the Company generally records sales at the wellhead or inlet of the gas processing plant as revenues net of transportation, gathering and processing expenses if the processor is the customer and there is no redelivery of commodities to the Company at the tailgate of the plant.

B. Summary of Significant Accounting Policies - continued

Revenue Recognition – continued

As a result of Topic 606 adoption, there were no significant changes to the timing of revenue recognized for sales of production.

Contract Balances

Customers are invoiced once the Company's performance obligations have been satisfied. Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 days. There are no significant judgments that significantly affect the amount or timing of revenue from contracts with customers. Accordingly, the Company's oil and natural gas sales contacts do not give rise to material contract assets or contract liabilities. Accounts receivable from the sales of oil and natural gas are primarily from purchasers and from exploration and production companies that own interests in properties operated on behalf of the Company.

Performance Obligations

The Company applies the optional exemptions in Topic 606 and does not disclose consideration for remaining performance obligations with an original expected duration of one year or less or for variable consideration related to unsatisfied performance obligations.

Derivatives

The Company uses various financial instruments for non-trading purposes to manage and reduce price volatility and other market risks associated with its oil and natural gas production. These arrangements are structured to reduce the Company's exposure to commodity price decreases, but they can also limit the benefit the Company might otherwise receive from commodity price increases. The Company's risk management activity is generally accomplished through over-the-counter commodity derivative contracts with large financial institutions. The Company applies the provisions of the "Derivatives and Hedging" topic of the Accounting Standards Codification ("ASC"), which requires each derivative instrument to be recorded in the accompanying consolidated balance sheets at fair value.

If a derivative has not been designated as a hedge or does not otherwise qualify for hedge accounting, it must be adjusted to fair value through earnings. The Company elected not to designate its current portfolio of commodity derivative contracts as hedges for accounting purposes. Therefore, changes in fair value of these derivative instruments are recognized in earnings in the accompanying consolidated statements of operations.

At March 31, 2023, the Company's derivatives were composed of the following:

B. Summary of Significant Accounting Policies - continued

Derivatives - continued

Commodity price	**Volume (Bbl/MMBTU)**	**Strike**
Swaps (crude oil)		
Jan – Dec 2024	75,950	$63.75
Swaps (natural gas)		
Apr – Dec 2023	120,500	2.46
Jan – Dec 2024	191,800	3.15
Jan – Dec 2024	263,900	3.39
Call Options (crude oil)		
Jan – Dec 2023	336,700	40.00 – 99.00
Jan – Dec 2024	217,700	50.00 – 89.50
Call Options (natural gas)		
Apr – Dec 2023	140,500	2.00 – 12.00
Jan – Dec 2024	298,300	4.00 – 7.37
Basis Swaps (crude oil)		
Apr – Dec 2023	528,700	73.55 – 79.48
Jan – Dec 2024	293,300	69.34 - 74.20
Basis Swaps (natural gas)		
Apr – Dec 2023	1,388,996	0.06 – 3.72
Jan – Dec 2024	1,231,992	2.24 – 4.41

B. Summary of Significant Accounting Policies – continued

Derivatives – continued

At December 31, 2022, the Company's derivatives were composed of the following:

Commodity price	**Volume (Bbl/MMBTU)**	**Strike**
Swaps (crude oil)		
Jan – Mar 2023	7,008	$44.45
Jan – Dec 2024	75,950	63.75
Swaps (natural gas)		
Mar – Dec 2023	127,100	2.46
Jan – Dec 2024	263,900	3.39
Jan – Dec 2024	298,700	(1.10)
Jan – Dec 2024	191,800	3.15
Call Options (crude oil)		
Jan – Dec 2023	417,908	35.00 – 93.50
Jan – Dec 2024	217,350	50.00 – 89.50
Call Options (natural gas)		
Feb – Dec 2023	200,000	2.00 – 3.01
WTI Diff Spread (crude oil)		
Feb – Dec 2023	651,818	0.32
Jan – Dec 2024	293,300	0.22
WTI Diff Spread (natural gas)		
Jan – Dec 2023	2,026,881	(1.76) – (0.31)
Jan – Dec 2024	933,292	(1.00)

Fair Value Measurement

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a three-tier hierarchy that is used to identify assets and liabilities measured at fair value. The hierarchy

B. Summary of Significant Accounting Policies - continued

Fair Value Measurement – continued

focuses on the inputs used to measure fair value and requires that the lowest level input be used. The three levels defined are as follows:

- Level 1 — observable inputs that are based upon quoted market prices for identical assets or liabilities within active markets.
- Level 2 — observable inputs other than Level 1 that are based upon quoted market prices for similar assets or liabilities, based upon quoted prices within inactive markets, or inputs other than quoted market prices that are observable through market data for substantially the full term of the asset or liability.
- Level 3 — inputs that are unobservable for the particular asset or liability due to little or no market activity and are significant to the fair value of the asset or liability. These inputs reflect assumptions that market participants would use when valuing the particular asset or liability.

The Company's derivatives consist of over–the–counter ("OTC") contracts which are not traded on a public exchange. As the fair value of these derivatives is based on inputs using market prices obtained from independent brokers or determined using quantitative models that use as their basis readily observable market parameters that are actively quoted and can be validated through external sources, including third party pricing services, brokers and market transactions, the Company has categorized these derivatives as Level 2. The Company values these derivatives using the income approach using inputs such as the forward curve for commodity prices based on quoted market prices and prospective volatility factors related to changes in the forward curves. The Company's estimates of fair value have been determined at discrete points in time based on relevant market data.

The following table presents assets that are measured at fair value on a recurring basis as of March 31, 2023 and December 31, 2022:

	March 31, 2023			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets (Liabilities)				
Oil and natural gas commodity contracts	$ —	$ (2,308,606)	$ —	$ (2,308,606)

	December 31, 2022			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets (Liabilities)				
Oil and natural gas commodity contracts	$ —	$ (7,191,184)	$ —	$ (7,191,184)

B. Summary of Significant Accounting Policies - continued

Fair Value Measurement – continued

Our other financial instruments consist primarily of the cash and cash equivalents, trade and other receivables, accounts payable and accrued expenses. The carrying value of our trade and other receivables, accounts payable and accrued expenses approximates fair value due to their highly liquid nature, short term maturity, or competitive rates assigned to these financial statements.

Income Taxes

The Company is organized as a limited liability company and taxed as a partnership for federal income tax purposes. As a result, income or losses are taxable or deductible to the members rather than at the Company level; accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements. In certain instances, the Company is subject to state taxes on income arising in or derived from the state tax jurisdictions in which it operates.

State income tax positions are evaluated in a two-step process. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the more likely than not threshold, it is then measured to determine the amount of expense to record in the consolidated financial statements. The tax expense recorded would equal the largest amount of expense related to the outcome that is 50% or greater likely to occur. The Company classifies any potential accrued interest recognized on an underpayment of income taxes as interest expense and classifies any statutory penalties recognized on a tax position taken as operating expense.

Management of the Company has not taken a tax position that, if challenged, would be expected to have a material effect on the consolidated financial statements as of or for the quarter ended March 31, 2023 and 2022 and year ended December 31, 2022. The Company did not incur any penalties or interest related to its state tax returns during the quarter ended March 31, 2023 and 2022 and year ended December 31, 2022.

Under the new centralized partnership audit rules effective for tax years beginning after 2017, the Internal Revenue Service (“IRS”) assesses and collects underpayments of tax from the partnership instead of from each partner. The partnership may be able to pass the adjustments through to its partners by making a push-out election or, if eligible, by electing out of the centralized partnership audit rules.

The collection of tax from the partnership is only an administrative convenience for the IRS to collect any underpayment of income taxes including interest and penalties. Income taxes on partnership income, regardless of who pays the tax or when the tax is paid, is attributed to the partners. Any payment made by the partnership as a result of an IRS examination will be treated as a distribution from the partnership to the partners in the consolidated financial statements.

General and Administrative Expenses

General and administrative expenses include corporate expenses, accounting, legal and insurance.

B. Summary of Significant Accounting Policies - continued

Recent Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-02, Leases. This update applies to any entity that enters into a lease, with some specified scope exemptions. Under this update, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. Entities will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.

The Company has only 1 real estate lease which qualifies under ASC 842. This lease is expiring in 2024. The Company has entered into a transaction to divest its assets of Driftwood Energy Operating, LLC on February 14, 2023 and intend to terminate this lease in 2023. The Company has evaluated that impact of this standard is immaterial on the financials and decided not to implement it.

C. Oil and Natural Gas Properties

The Company's oil and natural gas properties consist of the following as of March 31, 2023 and December 31, 2022:

	2023	2022
Proved oil and natural gas properties	$ 203,956,269	$ 219,202,498
Unproved oil and natural gas properties	10,252,217	10,251,491
Accumulated depletion and impairment	(26,795,789)	(27,417,060)
Oil and natural gas properties, net	$ 187,232,697	$ 202,036,929

D. Other Property and Equipment

Other property and equipment consisted of the following as of March 31, 2023 and December 31, 2022:

	2023	2022
Office equipment	$ 6,505	$ 6,505
Office furniture	6,361	6,361
IT- Hardware	45,500	45,500
Less accumulated depreciation	(58,366)	(58,366)
Other property and equipment, net	$ —	$ —

E. Asset Retirement Obligations

Changes in the Company's asset retirement obligations for the quarter ended March 31, 2023 and year ended December 31, 2022 are as follows:

	2023	2022
Asset retirement obligations at beginning of year	$ 766,412	$ 629,918
Additions during the year	—	122,767
Revisions	—	224,217
Liabilities settled	(7,397)	(252,680)
Accretion of discount	11,746	42,190
Asset retirement obligations at end of year	$ 770,761	$ 66,412

F. Line of Credit

The Company has a reserve-based lending facility with certain financial institutions with aggregate commitments totaling $100 million. The Company had an outstanding balance of $29,990,836 and $58,000,000 as of March 31, 2023 and December 31, 2022. The borrowing base is periodically redetermined based on the proved oil and gas properties of the Company. The credit agreement is secured against a first lien on the Company's oil and natural gas properties and other assets. Balances outstanding under the credit agreement bear interest at Eurodollar-based rate plus a margin ranging from 3.00% to 4.00%. The rate as of March 31, 2023 and December 31, 2022 was 1.97% and 5.53%, respectively. Principal and any accrued interest is due at maturity in April 2026. The line of credit is subject to restrictive debt covenants as defined in the credit agreement.

In January 2021, the Company also entered into a promissory note with a total borrowing capacity of $30 million. The note has no recourse to the Company's oil and natural gas properties and other assets. The company has an outstanding balance of $19,469,849 and $19,161,685 as of March 31, 2023 and December 31, 2022. Balances outstanding under the credit agreement bear interest at BSBY rate. The Company treats interest for this promissory note as paid-in-kind interest.

The Company has capitalized debt issuance costs of approximately $1,381,624, at March 31, 2023 and amortizes the debt issuance costs monthly, which is included in interest expense on the consolidated statements of operations.

Amortization expense for the three months ended March 31, 2023 and 2022 was approximately $88,298 and $19,132, respectively. Amortization expense for each of the succeeding years is as follows:

F. Line of Credit - continued

2023	$	280,092
2024		276,805
2025		276,805
2026		92,268
	$	925,970

G. Members' Equity and Incentive Units

The equity of the Company is 100% owned by CEC Driftwood Holdings, LLC and certain members of management and employees of the Company. The equity members have made equity commitments to the Company pursuant to the Company's limited liability company agreement. The balance of prior contributions of equity from equity members and receivables owed from equity members is included within Members' equity on the consolidated balance sheets.

Series C Units

The Company's limited partnership agreement provides for the issuance of Incentive Units. The Incentive Units entitle the holder to participate in the net profits and cumulative returns of the Company, but are subject to various performance criteria and vesting requirements, as defined in the Company's limited liability company agreement.

The Company implemented the provisions of FASB ASC Topic 710, *Compensation – General*, due to the issuance of these management incentive units. The Incentive Units are designed as a profits interest, and the Incentive Unit holders are entitled to an increased share of the distributable cash flow generated by the Company in the event that certain performance hurdles are met. The Incentive Units are accounted for consistent with requirements of ASC Topic 710 due to the payouts being consistent with profit sharing of the Company based on substantive terms of the instruments. Due to the nature of the Incentive Units, no value is attributed and no expense recognized at the date of issuance.

H. Transactions

In January 2023, the Company divested two wells in Upton County for $14.27 million. The Company recognized $1.64 million gain as a result of this transaction which is included in Gain on sale of assets on the statements of operations.

I. Commitments and Contingencies

Environmental Remediation

Various federal, state, and local laws and regulations covering the discharge of materials into the environment, or otherwise relating to the protection of the environment, may affect the Company's operations and the costs of its oil and natural gas exploration, development, and production operations.

I. Commitments and Contingencies - continued

The Company does not anticipate that it will be required in the near future to expend significant amounts in relation to the consolidated financial statements taken as a whole by reason of environmental laws and regulations, and appropriately no reserves have been recorded.

Legal Contingencies

In the course of its business affairs and operations, the Company is subject to possible loss contingencies arising from federal, state and local environmental, health and safety laws and regulations and third-party litigation. As of March 31, 2023, there are no matters which, in the opinion of management, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Operating Leases

The Company leases a building under a non-cancelable operating lease that expires in 2024.

Future fiscal year minimum payments under the non-cancelable operating lease consisted of the following at March 31, 2023:

2023	$	84,810
2024		47,825
Total minimum lease payments	$	132,635

When the Company enters into an operating lease that contains a period where there are free or reduced rents, or rent increases throughout the lease term, the Company recognizes rent expense on a straight- line basis over the term of the lease. Deferred rent as of March 31, 2023 and December 31, 2022 was $0. Rent expense for the three months ended March 31, 2023 and year ended December 31, 2022 was approximately $38,255 and $147,000, respectively, and is included in general and administrative expense in the accompanying consolidated statements of operations.

Risk and Uncertainties

The Company's revenue, profitability, and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, which depend on numerous factors beyond its control such as overall oil and natural gas production and inventories in relevant markets, economic conditions, the global political environment, regulatory developments, and competition from other energy sources. Oil and natural gas prices historically have been volatile and may be subject to significant fluctuations in the future.

J. Subsequent Events

In preparing the accompanying consolidated financial statements, management has evaluated all subsequent events and transactions for potential recognition or disclosure through May 31, 2023 the date the consolidated financial statements were available for issuance.

On February 14, 2023, the Company entered into a purchase and sale agreement to sell the assets of Driftwood Energy Operating, LLC. This transaction was closed on April 3, 2023. At closing, the Company received $104.0 million in cash and 1,578,948 shares of purchaser’s common stock. From the cash proceeds, $49.7 million was used to pay down the remaining outstanding balances on the Company’s lines of credit, $52.6 million was used to pay an equity distribution to the members in accordance with the Company’s limited liability company agreement, and $1.7 million was retained to for general corporate purposes. At closing, the purchaser also funded a remaining balance of $16.4 million to an escrow account, which may be released to the Company over the subsequent twelve months, subject to the terms of the purchase and sale agreement.

Vital Energy, Inc.
Unaudited pro forma condensed combined financial information

On February 14, 2023, Vital Energy, Inc., a Delaware corporation ("Vital" or the "Company"), as buyer, and Driftwood Energy Operating, LLC, a Delaware limited liability company, as seller, entered into a purchase and sale agreement (the "Purchase Agreement"). Pursuant to the Purchase Agreement, Vital acquired certain oil and gas properties in the Midland Basin, including approximately 11,200 net acres located in Upton and Reagan Counties and related assets and contracts (the "Driftwood Acquisition"). On April 3, 2023, Vital completed the Driftwood Acquisition pursuant to the Purchase Agreement.

The fair value of consideration paid to the seller on the close date of April 3, 2023 was $210.2 million, of which $120.4 million was paid in cash, and the remainder was in the form of stock consideration consisting of 1,578,948 shares of Vital common stock, based on the price of the Company's common stock on April 3, 2023. The cash portion of the purchase price was funded by $120.0 million in borrowings under the Company's senior secured credit facility, with the remaining portion funded with cash on hand. In addition, Vital will assume revenue suspense of $0.5 million, as well as derivative liabilities of $4.3 million and asset retirement obligations of $1.0 million, both based upon fair value as of April 3, 2023.

The Driftwood Acquisition will be accounted for as an asset acquisition in accordance with Accounting Standards Codification Topic 805, Business Combinations ("ASC 805"). The fair value of the consideration paid by Vital and the allocation of that amount to the underlying assets acquired is recorded on a relative fair value basis. Additionally, costs directly related to the Driftwood Acquisition are capitalized as a component of the purchase price. The unaudited pro forma condensed combined financial statements presented herein have been prepared to reflect the transaction accounting adjustments to Vital's historical condensed consolidated financial information in order to account for the Driftwood Acquisition and include the assumption of liabilities as set forth in the Purchase Agreement.

The Unaudited Pro Forma Condensed Combined Balance Sheet as of March 31, 2023 gives effect to the Driftwood Acquisition as if it had been completed on March 31, 2023. The Unaudited Pro Forma Condensed Combined Statements of Operations for the three months ended March 31, 2023 and the year ended December 31, 2022 give effect to the Driftwood Acquisition as if it had been completed on January 1, 2022. Assumptions and estimates underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with the unaudited pro forma condensed combined financial statements.

The unaudited pro forma condensed combined financial information is provided for illustrative purposes only and does not purport to represent what the actual consolidated results of operations or the consolidated financial position of Vital would have been had the Driftwood Acquisition and related financing occurred on the dates noted above, nor are they necessarily indicative of future consolidated results of operations or consolidated financial position. Future results may vary significantly from the results reflected because of various factors. For income tax purposes, the Driftwood Acquisition will be treated as an asset purchase such that the tax bases in the assets and liabilities will generally reflect the allocated fair value at closing. In Vital's opinion, all adjustments that are necessary to present fairly the unaudited pro forma condensed combined financial information have been made.

The unaudited pro forma condensed combined financial information does not reflect the benefits of potential cost savings or the costs that may be necessary to achieve such savings, opportunities to increase revenue generation or other factors that may result from the Driftwood Acquisition and, accordingly, does not attempt to predict or suggest future results.

The unaudited pro forma financial statements have been developed from and should be read in conjunction with:

- The audited financial statements and accompanying notes of Vital contained in Vital's Annual Report on Form 10-K for the year ended December 31, 2022;
- The unaudited condensed financial statements and accompanying notes contained in Vital's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2023;
- The audited consolidated financial statements and related notes of Driftwood Energy Partners, LLC and its wholly-owned subsidiaries, Driftwood Energy Operating, LLC, Driftwood Energy Management, LLC and Driftwood Energy Intermediate, LLC (collectively, "Driftwood") for the year ended December 31, 2022, which are included elsewhere in this filing; and
- The unaudited consolidated financial statements and related notes of Driftwood for the three months ended March 31, 2023, which are included elsewhere in this filing.

Vital Energy, Inc.
Pro forma condensed combined balance sheets
As of March 31, 2023
(in thousands)
(Unaudited)

	Historical		Transaction accounting adjustments				
	Vital	Driftwood	Conforming and reclass		Driftwood Acquisition		Pro forma combined
Assets							
Current assets:							
Cash and cash equivalents	$ 27,682	$ 2,492	$ (2,492)	(a)	$ (120,367)	(c)	$ 23,316
					(3,999)	(i)	
					120,000	(j)	
Accounts receivable, net	147,071	6,803	(6,803)	(a)	—		147,071
Derivatives	39,109	—	—		—		39,109
Other current assets	15,804	—	—		—		15,804
Prepaid expenses and other current assets	—	3,961	(3,961)	(a)	—		—
Total current assets	229,666	13,256	(13,256)		(4,366)		225,300
Property and equipment:							
Oil and natural gas properties:							
Evaluated properties – full cost method	9,735,559	—	—		120,367	(e)	9,945,763
					80,068	(f)	
					4,277	(g)	
					3,999	(i)	
					1,020	(h)	
					473	(k)	
Proved oil and natural gas properties – successful efforts method	—	203,956	(203,956)	(b)	—		—
Unevaluated properties not being depleted – full cost method	50,142	—	—		—		50,142
Unproved oil and natural gas properties – successful efforts method	—	10,253	(10,253)	(b)	—		—
Less: accumulated depletion and impairment	(7,401,480)	—	—		—		(7,401,480)
Accumulated depletion	—	(26,976)	26,976	(b)	—		—
Oil and natural gas properties, net	2,384,221	187,233	(187,233)		210,204		2,594,425
Midstream and other fixed assets, net	128,012	—	—		—		128,012
Property and equipment, net	2,512,233	187,233	(187,233)		210,204		2,722,437
Derivatives	26,448	—	—		—		26,448
Operating lease right-of-use assets	138,513	—	—		—		138,513
Other noncurrent assets, net	36,384	879	(879)	(a)	—		36,384
Total assets	$ 2,943,244	201,368	$ (201,368)		$ 205,838		$ 3,149,082
Liabilities and stockholders' equity							
Current liabilities:							
Accounts payable and accrued liabilities	$ 91,688	$ —	$ —		$ —		$ 91,688
Accounts payable	—	3,545	(3,545)	(a)	—		—
Accrued expenses	—	225	(225)	(a)	—		—
Accrued capital expenditures	67,221	—	—		—		67,221

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	Historical		Transaction accounting adjustments			
	Vital	Driftwood	Conforming and reclass	Driftwood Acquisition		Pro forma combined
Undistributed revenue and royalties	148,199	—	—	473	(k)	148,672
Revenue payable	—	3,048	(3,048) (a)	—		—
Derivatives	1,686	—	—	3,432	(g)	5,118
Current derivative liability	—	1,809	(1,809) (a)	—		—
Current portion of asset retirement obligations	—	255	(255) (a)	—		—
Operating lease liabilities	48,434	—	—	—		48,434
Other current liabilities	34,279	—	—	—		34,279
Total current liabilities	391,507	8,882	(8,882)	3,905		395,412
Long-term debt, net	1,163,807	—	—	120,000	(j)	1,283,807
Line-of-credit	—	49,461	(49,461) (a)	—		—
Asset retirement obligations	71,308	515	(515) (a)	1,020	(h)	72,328
Operating lease liabilities	87,301	—	—	—		87,301
Derivative liabilities	—	500	(500) (a)	845	(g)	845
Other noncurrent liabilities	3,953	—	—	—		3,953
Total liabilities	1,717,876	59,358	(59,358)	125,770		1,843,646
Commitments and contingencies						
Stockholders' equity:						
Preferred stock	—	—	—	—		—
Common stock	170	—	—	16	(d)	186
Additional paid-in capital	2,754,765	—	—	80,052	(d)	2,834,817
Accumulated deficit	(1,529,567)	—	—	—		(1,529,567)
Members' equity	—	142,486	(142,486) (a)	—		—
Members' receivables	—	(476)	476 (a)	—		—
Total stockholders' equity	1,225,368	142,010	(142,010)	80,068		1,305,436
Total liabilities and stockholders' equity	$ 2,943,244	$ 201,368	$ (201,368)	$ 205,838		$ 3,149,082

Vital Energy, Inc.
Pro forma condensed combined statements of operations
For the three months ended March 31, 2023
(in thousands, except per share data)
(Unaudited)

	Historical		Transaction accounting adjustments		
	Vital	Driftwood	Conforming and reclass	Driftwood Acquisition	Pro forma combined
Revenues:					
Oil sales	$ 266,731	$ —	$ 20,171 (a)	$ —	$ 286,902
NGL sales	33,006	—	1,182 (a)	—	34,188
Natural gas sales	18,074	—	2,427 (a)	—	20,501
Oil and natural gas sales, net	—	23,780	(23,780) (a)	—	—
Sales of purchased oil	13,851	—	—	—	13,851
Other operating revenues	845	—	—	—	845
Total revenues	332,507	23,780	—	—	356,287
Costs and expenses:					
Lease operating expenses	50,181	3,396	727 (j)	—	54,304
Gathering and processing	—	727	(727) (j)	—	—
Production and ad valorem taxes	20,531	998	—	—	21,529
Transportation and marketing expenses	10,915	—	—	—	10,915
Costs of purchased oil	14,167	—	—	—	14,167
General and administrative	25,930	884	—	—	26,814
Depletion, depreciation and amortization	86,779	—	5,069 (d)	628 (i)	92,476
Depletion expense	—	5,069	(5,069) (d)	—	—
Accretion expense	—	12	(12) (k)	—	—
Exploration	—	116	(116) (b)	—	
Other operating expenses, net	1,484	—	12 (k)	16 (i)	1,512
Total costs and expenses	209,987	11,202	(116)	644	221,717
Gain on disposal of assets, net	237	—	—	—	237
Operating income (loss)	122,757	12,578	116	(644)	134,807
Non-operating income (expense):					
Gain on derivatives, net	20,490	—	2,967 (l)	—	23,457
Realized loss on derivatives	—	(1,916)	1,916 (l)	—	—
Unrealized gain on derivatives	—	4,883	(4,883) (l)	—	—
Interest expense	(28,554)	(1,170)	1,170 (c)	(2,216) (g)	(30,770)
Gain on sale of assets	—	1,301	(1,301) (e)	—	—
Other income, net	854	—	—	—	854
Total non-operating income (expense), net:	(7,210)	3,098	(131)	(2,216)	(6,459)
Income (loss) before income taxes	115,547	15,676	(15)	(2,860)	128,348
Income tax expense:					
Current	(1,331)	—	—	— (h)	(1,331)
Deferred	(276)	—	—	—	(276)
Total income tax expense	(1,607)	—	—	—	(1,607)
Net income (loss)	$ 113,940	$ 15,676	$ (15)	$ (2,860)	$ 126,741
Net income per common share:					
Basic	$ 6.93				$ 7.04
Diluted	$ 6.89				$ 6.99
Weighted-average common shares outstanding:					
Basic	16,431			1,579 (f)	18,010
Diluted	16,545			1,579 (f)	18,124

Vital Energy, Inc.
Pro forma condensed combined statements of operations
For the year ended December 31, 2022
(in thousands, except per share data)
(Unaudited)

	Historical		Transaction accounting adjustments		
	Vital	Driftwood	Conforming and reclass	Driftwood Acquisition	Pro forma combined
Revenues:					
Oil sales	$ 1,351,207	$ —	$ 73,215 (a)	$ —	$ 1,424,422
NGL sales	234,613	—	6,492 (a)	—	241,105
Natural gas sales	208,554	—	5,978 (a)	—	214,532
Oil and natural gas sales, net	—	85,685	(85,685) (a)	—	—
Sales of purchased oil	119,408	—	—	—	119,408
Other operating revenues	7,014	—	—	—	7,014
Total revenues	1,920,796	85,685	—	—	2,006,481
Costs and expenses:					
Lease operating expenses	173,983	10,453	—	—	184,436
Production and ad valorem taxes	110,997	4,757	—	—	115,754
Transportation and marketing expenses	53,692	—	—	—	53,692
Costs of purchased oil	122,118	—	—	—	122,118
General and administrative	68,082	3,333	—	—	71,415
Organizational restructuring expenses	10,420	—	—	—	10,420
Depletion, depreciation and amortization	311,640	—	11,019 (d)	8,188 (i)	330,847
Depletion expense	—	11,017	(11,017) (d)	—	—
Depreciation expense	—	2	(2) (d)	—	—
Accretion expense	—	42	(42) (k)	—	—
Impairment expense	40	—	—	—	40
Impairment of oil and natural gas properties	—	1,005	(1,005) (e)	—	—
Exploration	—	143	(143) (b)	—	—
Other operating expenses, net	8,583	—	42 (k)	70 (i)	8,695
Total costs and expenses	859,555	30,752	(1,148)	8,258	897,417
Loss on disposal of assets, net	(1,079)	—	—	—	(1,079)
Operating income (loss)	1,060,162	54,933	1,148	(8,258)	1,107,985
Non-operating income (expense):					
Loss on derivatives, net	(298,723)	—	(14,647) (l)	—	(313,370)
Realized loss on derivatives	—	(18,855)	18,855 (l)	—	—
Unrealized gain on derivatives	—	4,208	(4,208) (l)	—	—
Interest expense	(125,121)	(2,934)	2,934 (c)	(8,862) (g)	(133,983)
Loss on extinguishment of debt, net	(1,459)	—	—	—	(1,459)
Other income, net	2,155	—	—	—	2,155
Total non-operating income (expense), net:	(423,148)	(17,581)	2,934	(8,862)	(446,657)
Income (loss) before income taxes	637,014	37,352	4,082	(17,120)	661,328
Income tax expense:					
Current	(6,121)	—	—	— (h)	(6,121)
Deferred	619	—	—	—	619
Total income tax expense	(5,502)	—	—	—	(5,502)
Net income (loss)	$ 631,512	$ 37,352	$ 4,082	$ (17,120)	$ 655,826

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	Historical			Transaction accounting adjustments					
	Vital		Driftwood	Conforming and reclass	Driftwood Acquisition		Pro forma combined	
Net income per common share:								
Basic	$	37.88					$	35.93
Diluted	$	37.44					$	35.55
Weighted-average common shares outstanding:								
Basic		16,672			1,579	(f)		18,251
Diluted		16,867			1,579	(f)		18,446

1. Basis of Presentation

The accompanying unaudited pro forma condensed combined financial statements were prepared based on the historical consolidated financial statements of Vital and the historical consolidated financial statements of Driftwood. The Driftwood Acquisition has been accounted for as an asset acquisition in accordance with ASC 805. The fair value of the consideration paid by Vital and allocation of that amount to the underlying assets acquired, on a relative fair value basis, will be recorded on Vital's books as of the date of the closing of the Driftwood Acquisition. Additionally, costs directly related to the Driftwood Acquisition are capitalized as a component of the purchase price. Certain of Driftwood's historical amounts have been reclassified to conform to the financial statement presentation of Vital. Additionally, adjustments have been made to Driftwood's historical financial information to remove certain assets and liabilities retained by Driftwood.

The Unaudited Pro Forma Condensed Combined Statements of Operations for the Three Months Ended March 31, 2023 and the Year Ended December 31, 2022 were prepared assuming the Driftwood Acquisition occurred on January 1, 2022. The Unaudited Pro Forma Condensed Combined Balance Sheet as of March 31, 2023 was prepared as if the Driftwood Acquisition had occurred on March 31, 2023.

The unaudited pro forma condensed combined financial information and related notes are presented for illustrative purposes only. If the Driftwood Acquisition and other transactions contemplated herein had occurred in the past, the Company's operating results might have been materially different from those presented in the unaudited pro forma condensed combined financial information. The unaudited pro forma condensed combined financial information should not be relied upon as an indication of operating results that the Company would have achieved if the Driftwood Acquisition and other transactions contemplated herein had taken place on the specified date. In addition, future results may vary significantly from the results reflected in the unaudited pro forma condensed combined financial statement of operations and should not be relied upon as an indication of the future results the Company will have after the contemplation of the Driftwood Acquisition and the other transactions contemplated by the unaudited pro forma condensed combined financial information. In Vital's opinion, all adjustments that are necessary to present fairly the unaudited pro forma condensed combined financial information have been made.

2. Consideration and Purchase Price Allocation

The preliminary allocation of the total purchase price in the Driftwood Acquisition is based upon management's estimates and assumptions related to the fair value of assets to be acquired and liabilities to be assumed as of the closing date of the transaction using currently available information and market data. Because the unaudited pro forma condensed combined financial information has been prepared based on these preliminary estimates, the final purchase price allocation and the resulting effect on financial position and results of operations may differ significantly from the pro forma amounts included herein.

The preliminary purchase price allocation is subject to change due to several factors, including but not limited to changes in the estimated fair value of assets acquired and liabilities assumed as of the closing date of the transaction, which could result from changes in future oil and natural gas commodity prices, reserve estimates, interest rates, as well as other factors.

The consideration transferred and the relative fair value of assets acquired and liabilities assumed by Vital are as follows (in thousands, except share amounts and share stock price):

Consideration:		
Cash consideration	$	127,647
Closing adjustments		(7,280)
Total cash consideration	$	120,367
Shares of Vital common stock issued		1,578,948
Vital common stock price as of April 3, 2023	$	50.71
Total share consideration	$	80,068
Direct transaction costs		3,999
Total consideration	$	204,434
Relative fair value of assets acquired:		
Oil and natural gas properties		210,204
Amount attributable to assets acquired	$	210,204
Fair value of liabilities assumed:		
Derivative liabilities		4,277
Asset retirement obligations		1,020
Undistributed revenue and royalties		473
Amount attributable to liabilities assumed	$	5,770

The fair value measurements of assets acquired and liabilities assumed excluding derivatives are based on inputs that are not observable in the market and therefore represent Level 3 inputs. The fair value measurements of derivative liabilities assumed are based quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the assets or liabilities and as such, represent Level 2 inputs. The fair value of oil and gas properties and asset retirement obligations were measured using the discounted cash flow technique of valuation.

Significant unobservable inputs included future commodity prices adjusted for differentials, projections of estimated quantities of recoverable reserves, forecasted production based on decline curve analysis, estimated timing and amount of future operating and development costs, and a weighted average cost of capital.

3. Adjustments to Unaudited Pro Forma Condensed Combined Balance Sheet and Unaudited Pro Forma Condensed Combined Statements of Operations

The unaudited pro forma condensed combined financial information has been compiled in a manner consistent with the accounting policies adopted by Vital. Actual results may differ materially from the assumptions and estimates contained herein.

The pro forma adjustments are based on currently available information and certain estimates and assumptions that Vital believes provide a reasonable basis for presenting the significant effects of the Driftwood Acquisition. General descriptions of the pro forma adjustments are provided below.

Unaudited Pro Forma Condensed Combined Balance Sheet

The following adjustments were made in the preparation of the Unaudited Pro Forma Condensed Combined Balance Sheet as of March 31, 2023:

(a) Adjustment to remove assets and liabilities not acquired as part of the Driftwood Acquisition.

(b) Adjustment to eliminate the historical book value and accumulated depreciation, depletion and amortization of Driftwood's oil and gas properties as of March 31, 2023.

(c) Adjustment to reflect the total cash consideration paid for the Driftwood Acquisition.

(d) Adjustment to reflect the issuance of 1,578,948 shares of Vital common stock pursuant to the Purchase Agreement.

(e) Adjustment to reflect cash paid for the oil and natural gas properties acquired of Driftwood, on a relative fair value basis.

(f) Adjustment to reflect the fair value of equity consideration paid for oil and natural gas properties acquired, on a relative fair value basis.

(g) Adjustment to reflect the fair value of Driftwood's derivative liabilities assumed as of April 3, 2023.

(h) Adjustment to reflect asset retirement obligations assumed with the Driftwood Acquisition.

(i) Adjustment for the payment of transaction costs incurred for the Driftwood Acquisition.

(j) Adjustment to record new borrowings under the Company's senior secured credit facility related to the cash consideration used in the Driftwood Acquisition.

(k) Adjustment to reflect revenues in suspense assumed with the Driftwood Acquisition.

Unaudited Pro Forma Condensed Combined Statements of Operations

The following adjustments were made in the preparation of the Unaudited Pro Forma Condensed Combined Statements of Operations for the Three Months Ended March 31, 2023, and the Year Ended December 31, 2022:

(a) Adjustments to conform Driftwood's revenue presentation to the presentation of revenues for Vital.

(b) Adjustment to remove exploration expense to align the presentation by Driftwood with the full cost method of accounting utilized by Vital.

(c) Adjustment to remove Driftwood's historical interest expense prior to the Driftwood acquisition.

(d) Adjustments to conform Driftwood's depletion and depreciation expense presentation to the presentation of depletion, depreciation and amortization expense for Vital.

(e) Adjustments to remove Driftwood's unproved impairment of oil and natural gas properties and gain on sale of assets as Vital utilizes the full cost method of accounting.

(f) Adjustment to reflect the issuance of 1,578,948 shares of Vital common stock pursuant to the Purchase Agreement. The following table reconciles historical and pro forma basic and diluted earnings per share for the period indicated (in thousands, except share and per share amounts):

	Three Months Ended March 31, 2023		Year Ended December 31, 2022	
	Historical	Pro-Forma	Historical	Pro-Forma
Net income	$ 113,940	$ 126,741	$631,512	$ 655,826
Weighted-average common shares outstanding:				
Basic	16,431	18,010	16,672	18,251
Dilutive non-vested restricted stock	114	114	183	183
Dilutive non-vested performance awards	—	—	12	12
Diluted	16,545	18,124	16,867	18,446
Net income per share:				
Basic	$ 6.93	$ 7.04	$ 37.88	$ 35.93
Diluted	$ 6.89	$ 6.99	$ 37.44	$ 35.55

(g) Adjustment to reflect the estimated interest expense in the periods presented with respect to the incremental borrowings necessary to finance the Driftwood Acquisition. The interest rate utilized as of April 3, 2023, was 7.385% for incremental borrowings. A one-eighth percent increase or decrease in the interest rate would not have had a material impact on interest expense for the three months ended March 31, 2023. A one-eighth percent increase or decrease in the interest rate would have changed interest expense by $0.2 million for the year ended December 31, 2022.

(h) Vital has not reflected any estimated tax impact related to the Driftwood Acquisition in the accompanying unaudited pro forma condensed combined statement of operations for the three months ended March 31, 2023 and year-end December 31, 2022 as it does not anticipate the impact to be material due to the Company's net operating loss carryforwards. As of March 31, 2023 and December 31, 2022, the Company had a full valuation allowance against its federal and Oklahoma net deferred tax assets.

(i) Adjustments to reflect depreciation, depletion, and amortization expense resulting from the change in basis of property and equipment acquired and accretion expense from new asset retirement obligations recognized as a result of the Driftwood Acquisition. The depletion expense adjustment was calculated using the unit-of-production method under the full cost method of accounting using estimated proved reserves and production volumes attributable to the acquired assets.

(j) Adjustment to align the presentation of lease operating and gathering and processing expenses for Driftwood to the presentation by Vital.

(k) Adjustment to conform Driftwood's historical accretion expense to the presentation by Vital.

(l) Adjustment to conform Driftwood's historical realized loss on derivatives and unrealized gain on derivatives to the presentation by Vital.

Supplemental Unaudited Pro Forma Combined Oil and Natural Gas Reserves and Standardized Measure Information

The following tables set forth information with respect to the historical and pro forma combined estimated oil and natural gas reserves as of December 31, 2022 for Vital and Driftwood. The reserve information of Vital and Driftwood have been prepared by independent petroleum engineers Ryder Scott Company, L.P. and Netherland, Sewell & Associates, Inc., respectively. The following unaudited pro forma combined proved reserve information is not necessarily indicative of the results that might have occurred had the Driftwood Acquisition taken place on January 1, 2022, nor is it intended to be a projection of future results. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Periodic revisions or removals of estimated reserves and future cash flows may be necessary as a result of a number of factors, including reservoir performance, new drilling, crude oil and natural gas prices, changes in costs, technological advances, new geological or geophysical data, changes in business strategies, or other economic factors. Accordingly, proved reserve estimates may differ significantly from the quantities of crude oil and natural gas ultimately recovered. For both Vital and Driftwood the reserve estimates shown below were determined using the average first day of the month price for each of the preceding 12 months for oil and natural gas for the year ended December 31, 2022.

Estimated oil and natural gas reserves

	As of December 31, 2022		
	Vital	**Driftwood**	**Pro forma combined**
Estimated proved developed reserves:			
Oil (MBbl)	70,333	7,321	77,654
Natural gas (MMcf)	464,567	17,340	481,907
Natural gas liquids (MBbl)	75,156	4,503	79,659
Total equivalent reserves (Mboe)(1)	222,917	14,714	237,631
Estimated proved undeveloped reserves:			
Oil (MBbl)	46,125	7,993	54,118
Natural gas (MMcf)	87,721	15,195	102,916
Natural gas liquids (MBbl)	18,656	4,003	22,659
Total equivalent reserves (Mboe)(1)	79,401	14,529	93,930
Estimated proved reserves:			
Oil (MBbl)	116,458	15,314	131,772
Natural gas (MMcf)	552,288	32,535	584,823
Natural gas liquids (MBbl)	93,812	8,506	102,318
Total equivalent reserves (Mboe)(1)	302,318	29,243	331,561

(1) BOE is calculated using a conversion rate of six Mcf per one Bbl.

The following table presents the Standardized Measure of Discounted Future Net Cash Flows relating to the proved crude oil and natural gas reserves of Vital and of the properties acquired in the Driftwood Acquisition on a pro forma combined basis as of December 31, 2022. The Pro Forma Combined Standardized Measure shown below represents estimates only and should not be construed as the market value of either Driftwood's crude oil and natural gas reserves or the acquired crude oil and natural gas reserves attributable to the Driftwood Acquisition.

Standardized measure of discounted future cash flows

(in thousands)

	As of December 31, 2022		
	Vital	Driftwood	Pro forma combined
Oil and gas producing activities:			
Future cash inflows	$ 16,343,468	$ 1,837,188	$ 18,180,656
Future production costs	(4,136,380)	(412,612)	(4,548,992)
Future development costs	(1,403,721)	(178,013)	(1,581,734)
Future income tax expense	(1,587,677)	(9,645)	(1,597,322)
Future net cash flows	9,215,690	1,236,918	10,452,608
10% discount for estimated timing of cash flows	(4,461,114)	(641,526)	(5,102,640)
Standardized measure of discounted future net cash flows	$ 4,754,576	$ 595,392	$ 5,349,968

The following table sets forth the changes in the Standardized Measure of discounted future net cash flows attributable to estimated net proved crude oil and natural gas reserves of Vital and Driftwood on a pro forma combined basis for the year ending December 31, 2022:

Changes in standardized measure of discounted future net cash flows

(in thousands)

	As of December 31, 2022		
	Vital	Driftwood	Pro forma combined
Standardized measure of discounted future net cash flows, beginning of year	$ 3,425,312	$ 336,164	$ 3,761,476
Changes in the year resulting from:			
Sales, less production costs	(1,468,946)	(70,474)	(1,539,420)
Revisions of previous quantity estimates	(99,512)	(1,309)	(100,821)
Extensions, discoveries and other additions	667,859	264,981	932,840
Net change in prices and production costs	2,565,963	78,623	2,644,586
Changes in estimated future development costs	(165,579)	(16,792)	(182,371)
Previously estimated development incurred capital expenditures during the period	260,475	15,246	275,721
Acquisitions of reserves in place	—	—	—
Divestitures of reserves in place	(96,222)	(26,279)	(122,501)
Accretion of discount	371,625	33,888	405,513
Net change in income taxes	(418,537)	(2,019)	(420,556)
Timing differences and other	(287,862)	(16,637)	(304,499)
Standardized measure of discounted future net cash flows, end of year	$ 4,754,576	$ 595,392	$ 5,349,968

NETHERLAND, SEWELL & ASSOCIATES, INC.
WORLDWIDE PETROLEUM CONSULTANTS
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March 30, 2023

Mr. Mickey Friedrich
Driftwood Energy Management, LLC
3625 North Hall Street, Suite 600
Dallas, Texas 75219

Dear Mr. Friedrich:

In accordance with your request, we have estimated the proved reserves and future revenue, as of December 31, 2022, to the Driftwood Energy Management, LLC (Driftwood) interest in certain oil and gas properties located in Reagan and Upton Counties, Texas. We completed our evaluation on or about the date of this letter. It is our understanding that the proved reserves estimated in this report constitute all of the proved reserves owned by Driftwood. The estimates in this report have been prepared in accordance with the definitions and regulations of the U.S. Securities and Exchange Commission (SEC) and conform to the FASB Accounting Standards Codification Topic 932, Extractive Activities—Oil and Gas, except that future income taxes are excluded and, as requested, per-well overhead expenses are excluded. Definitions are presented immediately following this letter. This report has been prepared for Driftwood's use in filing with the SEC; in our opinion the assumptions, data, methods, and procedures used in the preparation of this report are appropriate for such purpose.

We estimate the net reserves and future net revenue to the Driftwood interest in these properties, as of December 31, 2022, to be:

	Net Reserves			Future Net Revenue (M$)	
Category	Oil (MBBL)	NGL (MBBL)	Gas (MMCF)	Total	Present Worth at 10%
Proved Developed Producing	5,711.9	3,681.7	14,276.8	533,747.9	299,210.0
Proved Developed Non-Producing	1,609.3	821.5	3,063.1	128,287.0	66,059.1
Proved Undeveloped	7,992.9	4,002.7	15,195.4	584,528.2	234,851.2
Total Proved	15,314.1	8,505.8	32,535.2	1,246,563.1	600,120.3

Totals may not add because of rounding.

The oil volumes shown include crude oil only. Oil and natural gas liquids (NGL) volumes are expressed in thousands of barrels (MBBL); a barrel is equivalent to 42 United States gallons. Gas volumes are expressed in millions of cubic feet (MMCF) at standard temperature and pressure bases.

Reserves categorization conveys the relative degree of certainty; reserves subcategorization is based on development and production status. As requested, probable and possible reserves that may exist for these properties have not been included. The estimates of reserves and future revenue included herein have not been adjusted for risk. This report does not include any value that could be attributed to interests in undeveloped acreage beyond those tracts for which undeveloped reserves have been estimated.

Gross revenue is Driftwood's share of the gross (100 percent) revenue from the properties prior to any deductions. Future net revenue is after deductions for Driftwood's share of production taxes, ad valorem taxes, capital costs, abandonment costs, and operating expenses but before consideration of any income taxes. The future net revenue has been discounted at an annual rate of 10 percent to determine its present worth, which is shown to indicate the effect of time on the value of money. Future net revenue presented in this report, whether discounted or undiscounted, should not be construed as being the fair market value of the properties.

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Prices used in this report are based on the 12-month unweighted arithmetic average of the first-day-of-the-month price for each month in the period January through December 2022. For oil and NGL volumes, the average West Texas Intermediate spot price of $94.14 per barrel is adjusted for quality, transportation fees, and market differentials. For gas volumes, the average Henry Hub spot price of $6.357 per MMBTU is adjusted for energy content, transportation fees, and market differentials. All prices are held constant throughout the lives of the properties. The average adjusted product prices weighted by production over the remaining lives of the properties are $92.98 per barrel of oil, $31.88 per barrel of NGL, and $4.367 per MCF of gas.

Operating costs used in this report are based on operating expense records of Driftwood and include only direct lease-level costs. Operating costs have been divided into per-well costs and per-unit-of-production costs. As requested, these costs do not include the per-well overhead expenses allowed under joint operating agreements, nor do they include the headquarters general and administrative overhead expenses of Driftwood. Operating costs are not escalated for inflation.

Capital costs used in this report were provided by Driftwood and are based on authorizations for expenditure and actual costs from recent activity. Capital costs are included as required for new development wells and production equipment. Based on our understanding of future development plans, a review of the records provided to us, and our knowledge of similar properties, we regard these estimated capital costs to be reasonable. Abandonment costs used in this report are Driftwood's estimates of the costs to abandon the wells and production facilities, net of any salvage value. Capital costs and abandonment costs are not escalated for inflation.

For the purposes of this report, we did not perform any field inspection of the properties, nor did we examine the mechanical operation or condition of the wells and facilities. We have not investigated possible environmental liability related to the properties; therefore, our estimates do not include any costs due to such possible liability.

We have made no investigation of potential volume and value imbalances resulting from overdelivery or underdelivery to the Driftwood interest. Therefore, our estimates of reserves and future revenue do not include adjustments for the settlement of any such imbalances; our projections are based on Driftwood receiving its net revenue interest share of estimated future gross production. Additionally, we have made no specific investigation of any firm transportation contracts that may be in place for these properties; our estimates of future revenue include the effects of such contracts only to the extent that the associated fees are accounted for in the historical lease-level accounting statements.

The reserves shown in this report are estimates only and should not be construed as exact quantities. Proved reserves are those quantities of oil and gas which, by analysis of engineering and geoscience data, can be estimated with reasonable certainty to be economically producible; probable and possible reserves are those additional reserves which are sequentially less certain to be recovered than proved reserves. Estimates of reserves may increase or decrease as a result of market conditions, future operations, changes in regulations, or actual reservoir performance. In addition to the primary economic assumptions discussed herein, our estimates are based on certain assumptions including, but not limited to, that the properties will be developed consistent with current development plans as provided to us by Driftwood, that the properties will be operated in a prudent manner, that no governmental regulations or controls will be put in place that would impact the ability of the interest owner to recover the reserves, and that our projections of future production will prove consistent with actual performance. If the reserves are recovered, the revenues therefrom and the costs related thereto could be more or less than the estimated amounts. Because of governmental policies and uncertainties of supply and demand, the sales rates, prices received for the reserves, and costs incurred in recovering such reserves may vary from assumptions made while preparing this report.

For the purposes of this report, we used technical and economic data including, but not limited to, well logs, well test data, production data, historical price and cost information, and property ownership interests. The reserves in this report have been estimated using deterministic methods; these estimates have been prepared in accordance with generally accepted petroleum engineering and evaluation principles set forth in the Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers

(SPE Standards). We used standard engineering and geoscience methods, or a combination of methods, including performance analysis and analogy, that we considered to be appropriate and necessary to classify, categorize, and estimate reserves in accordance with SEC definitions and regulations. A substantial portion of these reserves are for undeveloped locations and developed wells that lack sufficient production history upon which performance-related estimates of reserves can be based; such reserves are based on analogy to properties with similar geologic and reservoir characteristics. As in all aspects of oil and gas evaluation, there are uncertainties inherent in the interpretation of engineering and geoscience data; therefore, our conclusions necessarily represent only informed professional judgment.

The data used in our estimates were obtained from Driftwood, public data sources, and the nonconfidential files of Netherland, Sewell & Associates, Inc. (NSAI) and were accepted as accurate. Supporting work data are on file in our office. We have not examined the titles to the properties or independently confirmed the actual degree or type of interest owned. The technical person primarily responsible for preparing the estimates presented herein meets the requirements regarding qualifications, independence, objectivity, and confidentiality set forth in the SPE Standards. Joseph M. Wolfe, a Licensed Professional Engineer in the State of Texas, has been practicing consulting petroleum engineering at NSAI since 2013 and has over 5 years of prior industry experience. We are independent petroleum engineers, geologists, geophysicists, and petrophysicists; we do not own an interest in these properties nor are we employed on a contingent basis.

Sincerely,
NETHERLAND, SEWELL & ASSOCIATES, INC.
Texas Registered Engineering Firm F-2699

By: /s/ C.H. (Scott) Rees II
C.H. (Scott) Rees III, P.E.
Executive Chairman

By: /s/ Joseph M. Wolfe
Joseph M. Wolfe, P.E. 116170
Vice President
[SEAL]

Date Signed: March 30, 2023

JMW:SRC

NETHERLAND, SEWELL & ASSOCIATES, INC.

DEFINITIONS OF OIL AND GAS RESERVES

Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

The following definitions are set forth in U.S. Securities and Exchange Commission (SEC) Regulation S-X Section 210.4-10(a). Also included is supplemental information from (1) the 2018 Petroleum Resources Management System approved by the Society of Petroleum Engineers, (2) the FASB Accounting Standards Codification Topic 932, Extractive Activities—Oil and Gas, and (3) the SEC's Compliance and Disclosure Interpretations.

(1) *Acquisition of properties.* Costs incurred to purchase, lease or otherwise acquire a property, including costs of lease bonuses and options to purchase or lease properties, the portion of costs applicable to minerals when land including mineral rights is purchased in fee, brokers' fees, recording fees, legal costs, and other costs incurred in acquiring properties.

(2) *Analogous reservoir*. Analogous reservoirs, as used in resources assessments, have similar rock and fluid properties, reservoir conditions (depth, temperature, and pressure) and drive mechanisms, but are typically at a more advanced stage of development than the reservoir of interest and thus may provide concepts to assist in the interpretation of more limited data and estimation of recovery. When used to support proved reserves, an "analogous reservoir" refers to a reservoir that shares the following characteristics with the reservoir of interest:

Same geological formation (but not necessarily in pressure communication with the reservoir of interest);

(i) Same geological formation (but not necessarily in pressure communication with the reservoir of interest);
(ii) Same environment of deposition;
(iii) Similar geological structure; and
(iv) Same drive mechanism.

Instruction to paragraph (a)(2): Reservoir properties must, in the aggregate, be no more favorable in the analog than in the reservoir of interest.

(3) *Bitumen*. Bitumen, sometimes referred to as natural bitumen, is petroleum in a solid or semi-solid state in natural deposits with a viscosity greater than 10,000 centipoise measured at original temperature in the deposit and atmospheric pressure, on a gas free basis. In its natural state it usually contains sulfur, metals, and other non-hydrocarbons.

(4) *Condensate*. Condensate is a mixture of hydrocarbons that exists in the gaseous phase at original reservoir temperature and pressure, but that, when produced, is in the liquid phase at surface pressure and temperature.

(5) *Deterministic estimate*. The method of estimating reserves or resources is called deterministic when a single value for each parameter (from the geoscience, engineering, or economic data) in the reserves calculation is used in the reserves estimation procedure.

(6) *Developed oil and gas reserves*. Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

(i) Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and
(ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

Supplemental definitions from the 2018 Petroleum Resources Management System:

Developed Producing Reserves – Expected quantities to be recovered from completion intervals that are open and producing at the effective date of the estimate. Improved recovery Reserves are considered producing only after the improved recovery project is in operation.

Developed Non-Producing Reserves – Shut-in and behind-pipe Reserves. Shut-in Reserves are expected to be recovered from (1) completion intervals that are open at the time of the estimate but which have not yet started producing, (2) wells which were shut-in for market conditions or pipeline connections, or (3) wells not capable of production for mechanical reasons. Behind-pipe Reserves are expected to be recovered from zones in existing wells that will require additional completion work or future re-completion before start of production with minor cost to access these reserves. In all cases, production can be initiated or restored with relatively low expenditure compared to the cost of drilling a new well.

(7) *Development costs.* Costs incurred to obtain access to proved reserves and to provide facilities for extracting, treating, gathering and storing the oil and gas. More specifically, development costs, including depreciation and applicable operating costs of support equipment and facilities and other costs of development activities, are costs incurred to:

(i) Gain access to and prepare well locations for drilling, including surveying well locations for the purpose of determining specific development drilling sites, clearing ground, draining, road building, and relocating public roads, gas lines, and power lines, to the extent necessary in developing the proved reserves.
(ii) Drill and equip development wells, development-type stratigraphic test wells, and service wells, including the costs of platforms and of well equipment such as casing, tubing, pumping equipment, and the wellhead assembly.

DEFINITIONS OF OIL AND GAS RESERVES
Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

(iii) Acquire, construct, and install production facilities such as lease flow lines, separators, treaters, heaters, manifolds, measuring devices, and production storage tanks, natural gas cycling and processing plants, and central utility and waste disposal systems.
(iv) Provide improved recovery systems.

(8) *Development project*. A development project is the means by which petroleum resources are brought to the status of economically producible. As examples, the development of a single reservoir or field, an incremental development in a producing field, or the integrated development of a group of several fields and associated facilities with a common ownership may constitute a development project.

(9) *Development well*. A well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

(10) *Economically producible*. The term economically producible, as it relates to a resource, means a resource which generates revenue that exceeds, or is reasonably expected to exceed, the costs of the operation. The value of the products that generate revenue shall be determined at the terminal point of oil and gas producing activities as defined in paragraph (a)(16) of this section.

(11) *Estimated ultimate recovery (EUR)*. Estimated ultimate recovery is the sum of reserves remaining as of a given date and cumulative production as of that date.

(12) *Exploration costs*. Costs incurred in identifying areas that may warrant examination and in examining specific areas that are considered to have prospects of containing oil and gas reserves, including costs of drilling exploratory wells and exploratory-type stratigraphic test wells. Exploration costs may be incurred both before acquiring the related property (sometimes referred to in part as prospecting costs) and after acquiring the property. Principal types of exploration costs, which include depreciation and applicable operating costs of support equipment and facilities and other costs of exploration activities, are:

(i) Costs of topographical, geographical and geophysical studies, rights of access to properties to conduct those studies, and salaries and other expenses of geologists, geophysical crews, and others conducting those studies. Collectively, these are sometimes referred to as geological and geophysical or "G&G" costs.
(ii) Costs of carrying and retaining undeveloped properties, such as delay rentals, ad valorem taxes on properties, legal costs for title defense, and the maintenance of land and lease records.
(iii) Dry hole contributions and bottom hole contributions.
(iv) Costs of drilling and equipping exploratory wells.
(v) Costs of drilling exploratory-type stratigraphic test wells.

(13) *Exploratory well*. An exploratory well is a well drilled to find a new field or to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir. Generally, an exploratory well is any well that is not a development well, an extension well, a service well, or a stratigraphic test well as those items are defined in this section.

(14) *Extension well*. An extension well is a well drilled to extend the limits of a known reservoir.

(15) *Field*. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition. There may be two or more reservoirs in a field which are separated vertically by intervening impervious strata, or laterally by local geologic barriers, or by both. Reservoirs that are associated by being in overlapping or adjacent fields may be treated as a single or common operational field. The geological terms "structural feature" and "stratigraphic condition" are intended to identify localized geological features as opposed to the broader terms of basins, trends, provinces, plays, areas-of-interest, etc.

(16) *Oil and gas producing activities*.

(i) Oil and gas producing activities include:

(A) The search for crude oil, including condensate and natural gas liquids, or natural gas ("oil and gas") in their natural states and original locations;
(B) The acquisition of property rights or properties for the purpose of further exploration or for the purpose of removing the oil or gas from such properties;
(C) The construction, drilling, and production activities necessary to retrieve oil and gas from their natural reservoirs, including the acquisition, construction, installation, and maintenance of field gathering and storage systems, such as:
(1) Lifting the oil and gas to the surface; and
(2) Gathering, treating, and field processing (as in the case of processing gas to extract liquid hydrocarbons); and

DEFINITIONS OF OIL AND GAS RESERVES

Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

(D) Extraction of saleable hydrocarbons, in the solid, liquid, or gaseous state, from oil sands, shale, coalbeds, or other nonrenewable natural resources which are intended to be upgraded into synthetic oil or gas, and activities undertaken with a view to such extraction.

Instruction 1 to paragraph (a)(16)(i): The oil and gas production function shall be regarded as ending at a "terminal point", which is the outlet valve on the lease or field storage tank. If unusual physical or operational circumstances exist, it may be appropriate to regard the terminal point for the production function as:

a. The first point at which oil, gas, or gas liquids, natural or synthetic, are delivered to a main pipeline, a common carrier, a refinery, or a marine terminal; and
b. In the case of natural resources that are intended to be upgraded into synthetic oil or gas, if those natural resources are delivered to a purchaser prior to upgrading, the first point at which the natural resources are delivered to a main pipeline, a common carrier, a refinery, a marine terminal, or a facility which upgrades such natural resources into synthetic oil or gas.

Instruction 2 to paragraph (a)(16)(i): For purposes of this paragraph (a)(16), the term *saleable hydrocarbons* means hydrocarbons that are saleable in the state in which the hydrocarbons are delivered.

(ii) Oil and gas producing activities do not include:

(A) Transporting, refining, or marketing oil and gas;
(B) Processing of produced oil, gas, or natural resources that can be upgraded into synthetic oil or gas by a registrant that does not have the legal right to produce or a revenue interest in such production;
(C) Activities relating to the production of natural resources other than oil, gas, or natural resources from which synthetic oil and gas can be extracted; or
(D) Production of geothermal steam.

(17) *Possible reserves.* Possible reserves are those additional reserves that are less certain to be recovered than probable reserves.

(i) When deterministic methods are used, the total quantities ultimately recovered from a project have a low probability of exceeding proved plus probable plus possible reserves. When probabilistic methods are used, there should be at least a 10% probability that the total quantities ultimately recovered will equal or exceed the proved plus probable plus possible reserves estimates.
(ii) Possible reserves may be assigned to areas of a reservoir adjacent to probable reserves where data control and interpretations of available data are progressively less certain. Frequently, this will be in areas where geoscience and engineering data are unable to define clearly the area and vertical limits of commercial production from the reservoir by a defined project.
(iii) Possible reserves also include incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than the recovery quantities assumed for probable reserves.
(iv) The proved plus probable and proved plus probable plus possible reserves estimates must be based on reasonable alternative technical and commercial interpretations within the reservoir or subject project that are clearly documented, including comparisons to results in successful similar projects.
(v) Possible reserves may be assigned where geoscience and engineering data identify directly adjacent portions of a reservoir within the same accumulation that may be separated from proved areas by faults with displacement less than formation thickness or other geological discontinuities and that have not been penetrated by a wellbore, and the registrant believes that such adjacent portions are in communication with the known (proved) reservoir. Possible reserves may be assigned to areas that are structurally higher or lower than the proved area if these areas are in communication with the proved reservoir.
(vi) Pursuant to paragraph (a)(22)(iii) of this section, where direct observation has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves should be assigned in the structurally higher portions of the reservoir above the HKO only if the higher contact can be established with reasonable certainty through reliable technology. Portions of the reservoir that do not meet this reasonable certainty criterion may be assigned as probable and possible oil or gas based on reservoir fluid properties and pressure gradient interpretations.

(18) *Probable reserves.* Probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered.

(i) When deterministic methods are used, it is as likely as not that actual remaining quantities recovered will exceed the sum of estimated proved plus probable reserves. When probabilistic methods are used, there should be at least a 50% probability that the actual quantities recovered will equal or exceed the proved plus probable reserves estimates.

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Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

(ii) Probable reserves may be assigned to areas of a reservoir adjacent to proved reserves where data control or interpretations of available data are less certain, even if the interpreted reservoir continuity of structure or productivity does not meet the reasonable certainty criterion. Probable reserves may be assigned to areas that are structurally higher than the proved area if these areas are in communication with the proved reservoir.
(iii) Probable reserves estimates also include potential incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than assumed for proved reserves.
(iv) See also guidelines in paragraphs (a)(17)(iv) and (a)(17)(vi) of this section.

(19) *Probabilistic estimate.* The method of estimation of reserves or resources is called probabilistic when the full range of values that could reasonably occur for each unknown parameter (from the geoscience and engineering data) is used to generate a full range of possible outcomes and their associated probabilities of occurrence.

(20) *Production costs*.

(i) Costs incurred to operate and maintain wells and related equipment and facilities, including depreciation and applicable operating costs of support equipment and facilities and other costs of operating and maintaining those wells and related equipment and facilities. They become part of the cost of oil and gas produced. Examples of production costs (sometimes called lifting costs) are:

(A) Costs of labor to operate the wells and related equipment and facilities.
(B) Repairs and maintenance.
(C) Materials, supplies, and fuel consumed and supplies utilized in operating the wells and related equipment and facilities.
(D) Property taxes and insurance applicable to proved properties and wells and related equipment and facilities.
(E) Severance taxes.

(ii) Some support equipment or facilities may serve two or more oil and gas producing activities and may also serve transportation, refining, and marketing activities. To the extent that the support equipment and facilities are used in oil and gas producing activities, their depreciation and applicable operating costs become exploration, development or production costs, as appropriate. Depreciation, depletion, and amortization of capitalized acquisition, exploration, and development costs are not production costs but also become part of the cost of oil and gas produced along with production (lifting) costs identified above.

(21) *Proved area.* The part of a property to which proved reserves have been specifically attributed.

(22) *Proved oil and gas reserves.* Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

(i) The area of the reservoir considered as proved includes:

(A) The area identified by drilling and limited by fluid contacts, if any, and
(B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.

(ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.
(iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.
(iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:

(A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and

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Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

(B) The project has been approved for development by all necessary parties and entities, including governmental entities.

(v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

(23) *Proved properties.* Properties with proved reserves.

(24) *Reasonable certainty.* If deterministic methods are used, reasonable certainty means a high degree of confidence that the quantities will be recovered. If probabilistic methods are used, there should be at least a 90% probability that the quantities actually recovered will equal or exceed the estimate. A high degree of confidence exists if the quantity is much more likely to be achieved than not, and, as changes due to increased availability of geoscience (geological, geophysical, and geochemical), engineering, and economic data are made to estimated ultimate recovery (EUR) with time, reasonably certain EUR is much more likely to increase or remain constant than to decrease.

(25) *Reliable technology.* Reliable technology is a grouping of one or more technologies (including computational methods) that has been field tested and has been demonstrated to provide reasonably certain results with consistency and repeatability in the formation being evaluated or in an analogous formation.

(26) *Reserves.* Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project.

Note to paragraph (a)(26): Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir, or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).

Excerpted from the FASB Accounting Standards Codification Topic 932, Extractive Activities—Oil and Gas:

932-235-50-30 A standardized measure of discounted future net cash flows relating to an entity's interests in both of the following shall be disclosed as of the end of the year:

a. Proved oil and gas reserves (see paragraphs 932-235-50-3 through 50-11B)
b. Oil and gas subject to purchase under long-term supply, purchase, or similar agreements and contracts in which the entity participates in the operation of the properties on which the oil or gas is located or otherwise serves as the producer of those reserves (see paragraph 932-235-50-7).

The standardized measure of discounted future net cash flows relating to those two types of interests in reserves may be combined for reporting purposes.

932-235-50-31 All of the following information shall be disclosed in the aggregate and for each geographic area for which reserve quantities are disclosed in accordance with paragraphs 932-235-50-3 through 50-11B:

a. Future cash inflows. These shall be computed by applying prices used in estimating the entity's proved oil and gas reserves to the year-end quantities of those reserves. Future price changes shall be considered only to the extent provided by contractual arrangements in existence at year-end.
b. Future development and production costs. These costs shall be computed by estimating the expenditures to be incurred in developing and producing the proved oil and gas reserves at the end of the year, based on year-end costs and assuming continuation of existing economic conditions. If estimated development expenditures are significant, they shall be presented separately from estimated production costs.
c. Future income tax expenses. These expenses shall be computed by applying the appropriate year-end statutory tax rates, with consideration of future tax rates already legislated, to the future pretax net cash flows relating to the entity's proved oil and gas reserves, less the tax basis of the properties involved. The future income tax expenses shall give effect to tax deductions and tax credits and allowances relating to the entity's proved oil and gas reserves.
d. Future net cash flows. These amounts are the result of subtracting future development and production costs and future income tax expenses from future cash inflows.

DEFINITIONS OF OIL AND GAS RESERVES
Adapted from U.S. Securities and Exchange Commission Regulation S-X Section 210.4-10(a)

e. *Discount. This amount shall be derived from using a discount rate of 10 percent a year to reflect the timing of the future net cash flows relating to proved oil and gas reserves.*
f. *Standardized measure of discounted future net cash flows. This amount is the future net cash flows less the computed discount.*

(27) *Reservoir.* A porous and permeable underground formation containing a natural accumulation of producible oil and/or gas that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

(28) *Resources.* Resources are quantities of oil and gas estimated to exist in naturally occurring accumulations. A portion of the resources may be estimated to be recoverable, and another portion may be considered to be unrecoverable. Resources include both discovered and undiscovered accumulations.

(29) *Service well.* A well drilled or completed for the purpose of supporting production in an existing field. Specific purposes of service wells include gas injection, water injection, steam injection, air injection, salt-water disposal, water supply for injection, observation, or injection for in-situ combustion.

(30) *Stratigraphic test well.* A stratigraphic test well is a drilling effort, geologically directed, to obtain information pertaining to a specific geologic condition. Such wells customarily are drilled without the intent of being completed for hydrocarbon production. The classification also includes tests identified as core tests and all types of expendable holes related to hydrocarbon exploration. Stratigraphic tests are classified as "exploratory type" if not drilled in a known area or "development type" if drilled in a known area.

(31) *Undeveloped oil and gas reserves.* Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

(i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.
(ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.

From the SEC's Compliance and Disclosure Interpretations (October 26, 2009):

Although several types of projects — such as constructing offshore platforms and development in urban areas, remote locations or environmentally sensitive locations — by their nature customarily take a longer time to develop and therefore often do justify longer time periods, this determination must always take into consideration all of the facts and circumstances. No particular type of project per se justifies a longer time period, and any extension beyond five years should be the exception, and not the rule.

Factors that a company should consider in determining whether or not circumstances justify recognizing reserves even though development may extend past five years include, but are not limited to, the following:

- *The company's level of ongoing significant development activities in the area to be developed (for example, drilling only the minimum number of wells necessary to maintain the lease generally would not constitute significant development activities);*
- *The company's historical record at completing development of comparable long-term projects;*
- *The amount of time in which the company has maintained the leases, or booked the reserves, without significant development activities;*
- *The extent to which the company has followed a previously adopted development plan (for example, if a company has changed its development plan several times without taking significant steps to implement any of those plans, recognizing proved undeveloped reserves typically would not be appropriate); and*
- *The extent to which delays in development are caused by external factors related to the physical operating environment (for example, restrictions on development on Federal lands, but not obtaining government permits), rather than by internal factors (for example, shifting resources to develop properties with higher priority).*

(iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined in paragraph (a)(2) of this section, or by other evidence using reliable technology establishing reasonable certainty.

(32) *Unproved properties.* Properties with no proved reserves.