GEAR ENERGY LTD.
INTERIM CONDENSED BALANCE SHEETS (unaudited)
As at

(Cdn$ thousands)		**March 31, 2016**		December 31, 2015
ASSETS				
Current assets				
Accounts receivable	**$**	**5,304**	$	5,872
Prepaid expenses		**2,054**		2,101
Inventory (Note 3)		**5,477**		3,440
Risk management contracts (Note 8)		**8,026**		9,173
		20,861		20,586
Deferred income tax asset		**26,243**		26,243
Property, plant and equipment (Note 4)		**174,055**		178,905
Total assets	**$**	**221,159**	$	225,734
LIABILITIES				
Current liabilities				
Accounts payable, accrued liabilities and deferred credits	**$**	**5,473**	$	6,860
Conversion approval option (Note 6)		**1,800**		1,800
Debt (Note 5)		**52,112**		55,725
		59,385		64,385
Debentures (Note 6)		**12,379**		12,230
Decommissioning liability (Note 7)		**56,803**		54,959
Total liabilities		**128,567**		131,574
SHAREHOLDERS' EQUITY				
Share capital (Note 9)		**241,509**		241,535
Contributed surplus		**12,551**		12,377
Deficit		**(161,468)**		(159,752)
Total shareholders' equity		**92,592**		94,160
Total liabilities and shareholders' equity	**$**	**221,159**	$	225,734

See accompanying notes to the unaudited Condensed Financial Statements

GEAR ENERGY LTD.
INTERIM CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)
For the three months ended March 31
(Cdn$ thousands)

	Share Capital	Contributed Surplus	Deficit	Total Equity
Balance, beginning of period	**231,067**	**10,183**	**(63,233)**	**178,017**
Share-based compensation	-	571	-	571
Net loss for the period	-	-	(4,357)	(4,357)
Balance at March 31, 2015	**231,067**	**10,754**	**(67,590)**	**174,231**
Balance, beginning of period	241,535	12,377	(159,752)	94,160
Share issue costs, net of deferred tax benefit of $10	(26)	-	-	(26)
Share-based compensation	-	174	-	174
Net loss for the period	-	-	(1,716)	(1,716)
Balance at March 31, 2016	**241,509**	**12,551**	**(161,468)**	**92,592**

See accompanying notes to the unaudited Condensed Financial Statements

GEAR ENERGY LTD.
INTERIM CONDENSED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS (unaudited)

		Three Months Ended March 31		
(Cdn$ thousands, except per share amounts)		**2016**		2015
Sales of crude oil, natural gas and natural gas liquids	**$**	**8,173**	$	21,096
Royalties		**(656)**		(3,745)
REVENUE		**7,517**		17,351
Gain on risk management contracts (Note 8)		**3,982**		1,091
		11,499		18,442
EXPENSES				
Operating		**6,192**		10,675
General and administrative		**1,481**		1,648
Share-based compensation (Note 9)		**174**		571
Interest and financing charges		**616**		826
Accretion (Notes 6 and 7)		**389**		411
Depletion, depreciation and amortization (Notes 3 and 4)		**4,283**		9,503
Drilling commitments (Note 12)		**480**		-
Gain on foreign exchange		**-**		(310)
Gain on asset disposition (Note 4)		**(400)**		-
		13,215		23,324
Deferred tax recovery		**-**		(525)
Net loss and comprehensive loss	**$**	**(1,716)**	$	(4,357)
Net loss per share, basic and diluted (Note 9)	**$**	**(0.02)**	$	(0.06)

See accompanying notes to the unaudited Condensed Financial Statements

GEAR ENERGY LTD.
INTERIM CONDENSED STATEMENTS OF CASH FLOWS (unaudited)

(Cdn$ thousands)	Three Months Ended March 31 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	**$ (1,716)**	$ (4,357)
Add items not involving cash:		
Unrealized loss on risk management contracts (Note 8)	**1,147**	6,607
Share-based compensation (Note 9)	**174**	571
Bad debt expense	**108**	-
Accretion (Notes 6 and 7)	**389**	411
Depletion, depreciation and amortization (Notes 3 and 4)	**4,283**	9,503
Deferred tax recovery	**-**	(525)
Gain on asset disposition	**(400)**	-
Decommissioning liabilities settled (Note 7)	**(151)**	(298)
Change in non-cash working capital (Note 11)	**(278)**	527
	3,556	12,439
CASH FLOW USED IN FINANCING ACTIVITIES		
Repayments of debt under demand credit facility	**(3,562)**	(5,773)
Share issue costs	**(36)**	-
	(3,598)	(5,773)
CASH FLOW FROM (USED IN) INVESTING ACTIVITIES		
Property, plant and equipment expenditures	**(101)**	(171)
Acquisition of petroleum and natural gas properties (Note 4)	**-**	(95)
Disposition of petroleum and natural gas properties (Note 4)	**480**	227
Change in non-cash working capital (Note 11)	**(337)**	(6,627)
	42	(6,666)
INCREASE IN CASH AND CASH EQUIVALENTS	**-**	-
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	**-**	-
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ -**	$ -
The following are included in cash flow from operating activities:		
Interest paid in cash	**$ 468**	$ 826

See accompanying notes to the unaudited Condensed Financial Statements

1. BASIS OF PRESENTATION

The principal undertakings of Gear Energy Ltd. (the “Company” or “Gear”) are to carry on the business of acquiring, developing and holding interests in petroleum and natural gas properties and assets.

Gear’s principal place of business is located at 2600, 500 - 4th Avenue SW, Calgary, Alberta T2P 2V6.

These unaudited interim condensed financial statements (the “financial statements”) have been prepared in accordance with International Accounting Standards (“IAS”) 34 *Interim Financial Reporting* using accounting policies aligned with International Financial Reporting Standards (“IFRS”). The financial statements do not include all of the information required for annual financial statements and should be read in conjunction with the Audited Financial Statements for the year ended December 31, 2015, which have been prepared in accordance with IFRS.

The financial statements were authorized for issue by the Board of Directors on May 11, 2016.

2. SIGNIFICANT ACCOUNTING POLICIES

Adopted and Future Accounting Policy Changes

As of January 1, 2016 Gear was required to adopt amendments to IFRS 11 *Joint Arrangements*. The amendments to this standard requires entities acquiring an interest in a joint operation to apply the principles of IFRS 3 as it relates to business combinations. As of January 1, 2016 the new standard has been adopted and is not anticipated to have a material impact on Gear.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, which replaces International Accounting Standard ("IAS") 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by Gear on January 1, 2018 and the Company is currently evaluating the impact of the standard on Gear’s financial statements.

In July 2014, the IASB completed the final elements of IFRS 9 *Financial Instruments*. The standard supersedes earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss’ impairment model and a substantially-reformed approach to hedge accounting. The standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied on a retrospective basis by Gear on January 1, 2018 and the Company is currently evaluating the impact of the standard on Gear’s financial statements.

In January 2016, the IASB issued IFRS 16 *Leases*, which replaces IAS 17 *Leases*. For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 *Revenue from Contracts with Customers*. IFRS 16 will be applied by Gear on January 1, 2019 and the Company is currently evaluating the impact of the standard on Gear’s financial statements.

3. INVENTORY

At March 31, 2016 and December 31, 2015 Gear recorded oil inventory valued at its net realizable value of $5.5 million and $3.4 million respectively. The cost components of the inventory balance are as follows:

($ thousands)	**March 31, 2016**	December 31, 2015
Capital	**2,302**	-
Operating	**3,175**	3,440
Balance, end of period	**5,477**	3,440

4. PROPERTY, PLANT AND EQUIPMENT

The following table reconciles Gear's property, plant and equipment:

Cost ($ thousands)	**Development and Production Assets**	**Administrative Assets**	**Total**
Balance, December 31, 2014	555,951	418	556,369
Additions	14,099	784	14,883
Acquisitions	(458)	-	(458)
Disposals	(227)	-	(227)
Change in decommissioning costs	(19,240)	-	(19,240)
Balance, December 31, 2015	550,125	1,202	551,327
Additions	101	-	101
Disposals	(80)	-	(80)
Change in decommissioning costs	1,714	-	1,714
Balance, March 31, 2016	551,860	1,202	553,062

Depletion, depreciation and amortization ($ thousands)			
Balance, December 31, 2014	235,747	279	236,026
Depletion, depreciation and amortization	43,536	160	43,696
Impairment	92,700	-	92,700
Balance, December 31, 2015	371,983	439	372,422
Depletion, depreciation and amortization	6,524	61	6,585
Balance, March 31, 2016	378,507	500	379,007

Carrying amounts ($ thousands)	**Development and Production Assets**	**Administrative Assets**	**Total**
As at December 31, 2015	178,142	763	178,905
As at March 31, 2016	173,353	702	174,055

In the first quarter of 2016 Gear divested of a small non-core property with no associated production and fee titles on another property for combined proceeds of $0.5 million.

No impairment indicators were identified on the property, plant and equipment as at March 31, 2016.

5. DEBT

As at March 31, 2016 Gear had syndicated demand facilities ("the Credit Facilities") with three banks with a borrowing limit on the Credit Facilities of $60 million. The Credit Facilities bear interest at Canadian bank prime or, at Gear's option, Canadian bankers' acceptances, plus applicable margin and stamping fee. The total stamping fees range, depending on Gear's senior debt to EBITDA ratio, between 50 bps to 250 bps on Canadian bank prime borrowings and between 175 bps and 375 bps on Canadian dollar bankers' acceptances. The undrawn portion of the Credit Facilities is subject to a standby fee in the range of 20 bps to 45 bps. The Credit Facilities carry a single covenant to maintain an adjusted working capital ratio of not less than 1.0:1. Adjusted working capital ratio is defined as current assets less unrealized hedging gains, plus the undrawn portion of the credit facilities divided by accounts payable and accrued liabilities. At March 31, 2016 Gear was in compliance with this covenant. The Credit Facilities are secured by a fixed and floating charge on the assets of Gear and are subject to semi-annual reviews. The next scheduled review is to be complete by June 1, 2016 and it is likely that this review will result in a decrease in the current $60 million borrowing limit.

As at March 31, 2016 Gear had $52.1 million drawn (December 31, 2015 – $55.7 million) and had no outstanding letters of credit (December 31, 2015 - nil).

6. DEBENTURES

On November 30, 2015, the Company completed the issuance of unsecured subordinated debentures (the "Debentures") for gross proceeds of $14.8 million. The Debentures have a maturity date of November 30, 2020 and carry a coupon of 4 per cent per annum payable semi-annually in arrears on May 31 and November 30 until maturity, commencing May 31, 2016. These Debentures carry an equity conversion feature which is subject to shareholder approval. Gear intends to seek shareholder approval for conversion of the Convertible Debentures at its next annual and special meeting of shareholders on May 11, 2016. If shareholder approval is received, the Debentures will be convertible at the option of the holder at any time prior to the maturity date at a conversion price of $0.87 per common share such that for every $1,000 principal amount of Debentures a holder will receive approximately 1,149.43 common shares. Holders converting their Debentures will be entitled to receive accrued and unpaid interest thereon for the period from the date of the latest interest payment date to, but excluding, the date of conversion. If shareholder approval is not received on May 11, 2016 the annual interest rate on the Debentures will increase to 6.0 per cent per annum.

If shareholder approval on the conversion feature is received, the debentures may be redeemable on or after November 30, 2018 by Gear if the current market price of Gear's common shares is at least 125 per cent of the conversion price. On or after November 30, 2019, the Debentures may be redeemed by Gear at a redemption price equal to the principal amount plus accrued and unpaid interest up to the date of redemption. If the shareholder approval on the conversion feature is received, Gear will have the option to satisfy its obligation to repay the principal amount of the Debentures due at maturity or redemption of the Debentures by the issuance of common shares with the number of such common shares based on 95% of the weighted average trading price of the common shares prior to the date of maturity or redemption.

A derivative financial instrument has been identified associated with the shareholder vote - an option exists for Gear's shareholders to approve the conversion feature. This option will expire on or before May 11, 2016 coincident with the shareholder vote. The instrument has been valued using a Monte Carlo valuation model to calculate various scenarios on how shareholders will vote based on the future probability of the intrinsic difference between the share price and the conversion price. As at the date of issuance the fair value of this conversion approval option was determined to be a $1.8 million liability and has been recorded on the Balance Sheet. The fair value was derived using an 80 per cent probability that shareholders will vote to approve the conversion option. The change in fair value of the conversion approval option from December 31, 2015 to March 31, 2016 is negligible and as such no gain or loss has been recorded in the Statement of Loss and Comprehensive Loss for the three months ended March 31, 2016. The host liability component of the Debenture has been measured as the residual value from deducting the fair value of the derivative liability from the transaction price. Issuance costs have been added to the carrying amount of the Debenture. The balance of the Debenture liability will be accreted to the principal amount at maturity through the effective interest rate method.

The following tables provides a continuity of balances of the Debentures and the conversion approval option from December 31, 2015 to March 31, 2016:

($ thousands)	**Debentures**	**Conversion approval option**
Balance, December 31, 2015	12,230	1,800
Accretion using effective interest rate at 8%	108	-
Adjustment of issuance costs	41	-
Change in fair value of conversion approval option	-	-
Balance, March 31, 2016	**12,379**	**1,800**

7. DECOMMISSIONING LIABILITY

($ thousands)	Three months ended March 31, 2016	Year ended December 31, 2015
Balance, beginning of period	**$ 54,959**	$ 74,114
Changes in estimates	**1,714**	(19,653)
Additions	**-**	413
Decommissioning liabilities settled	**(151)**	(1,383)
Accretion	**281**	1,468
Balance, end of period	**$ 56,803**	$ 54,959

The undiscounted and unescalated amount of the expected cash flows required to settle the decommissioning liability is estimated to be $55.3 million as at March 31, 2016 (December 31, 2015 - $55.3 million). The liability for the expected cash flows, as reflected in the financial statements, has been inflated at two per cent and discounted using a risk free rate of 1.86 per cent (December 31, 2015 – 2.04 per cent). Abandonments are expected to occur between 2016 and 2035 and related costs will be funded mainly from Gear's cash provided by operating activities.

8. RISK MANAGEMENT CONTRACTS

Following is a summary of all risk management contracts in place as at March 31, 2016:

Financial WTI Crude Oil Contracts

Term		Contract	Currency	Volume bbl/d	Sold Swap $/bbl	Sold Call $/bbl	Bought Put $/bbl	Sold Put $/bbl
Jan 1, 2016	Jun 30, 2016	Collar	CAD	250	-	87.25	65.00	-
Jan 1, 2016	Jun 30, 2016	Collar	CAD	250	-	82.50	65.00	-
Jan 1, 2016	Jun 30, 2016	Collar	USD	230	-	67.65	57.00	-
Jan 1, 2016	Jun 30, 2016	Collar	USD	270	-	67.50	57.00	-
Jan 1, 2016	Dec 31, 2016	Swap	CAD	1,000	66.00	-	-	-
Jan 1, 2016	Dec 31, 2016	Swap	CAD	500	68.00	-	-	-
Jul 1, 2016	Dec 31, 2016	Swap	CAD	500	68.50	-	-	-
Jan 1, 2017	Jun 30, 2017	Swap	CAD	120	60.00	-	-	-

As at March 31, 2016, the fair value associated with Gear’s risk management contracts was an asset of $8.0 million (December 31, 2015 - $9.2 million).

The following table reconciles the gain on risk management contracts:

($ thousands)	Three months ended March 31, 2016	Year ended December 31, 2015
Realized cash gain on risk management contracts	**5,129**	15,179
Change in unrealized fair value of risk management contracts	**(1,147)**	(4,517)
Total net gain on risk management contracts	**3,982**	10,662

Subsequent to March 31, 2016, Gear entered into the following risk management contracts:

Financial WTI Crude Oil Contracts

Term		Contract	Currency	Volume bbl/d	Sold Swap $/bbl	Sold Call $/bbl	Bought Put $/bbl	Sold Put $/bbl
Jan 1, 2017	Jun 30, 2017	Swap	CAD	80	60.00	-	-	-
Jan 1, 2017	Dec 31, 2017	Swap	CAD	200	60.00	-	-	-

9. SHAREHOLDERS' EQUITY

a) Share capital

Common Shares

(thousands of shares, $ thousands)	**Three months ended March 31, 2016**		Year ended December 31, 2015	
	Shares	**Amount**	Shares	Amount
Balance, beginning of period	**85,484**	**$ 241,535**	70,817	$ 231,067
Issued on offering of common shares	**-**	**-**	14,667	11,000
Share issue costs, net of deferred tax benefit of $10 (2015 - $197)	**-**	**(26)**	-	(532)
Balance, end of period	**85,484**	**$ 241,509**	85,484	$ 241,535

b) Stock Option Plan

The following table summarizes Gear's stock option plan and activity during the periods ended March 31, 2016 and December 31, 2015.

	Three months ended March 31, 2016		Year ended December 31, 2015	
(thousands)	**Number of stock options**	**Weighted average exercise price**	Number of stock options	Weighted average exercise price
Outstanding, beginning of period	**6,380**	**$ 2.83**	4,794	$ 3.54
Granted	**855**	**0.35**	2,608	1.53
Exercised	**-**	**-**	-	-
Expired	**-**	**-**	(663)	2.50
Forfeited	**(776)**	**3.41**	(359)	3.49
Outstanding, end of period	**6,459**	**2.43**	6,380	2.83
Exercisable, end of period	**2,589**	**$ 2.92**	1,900	$ 3.33

In the first quarter of 2016, Gear recorded an expense of $0.2 million to share-based compensation expense related to its stock option plan ($0.6 million in 2015).

The Black-Scholes option-pricing model was used to determine the fair value of stock options granted using the following assumptions:

	Period ended March 31, 2016
Risk free interest rate (%)	**0.66**
Dividend yield (%)	**-**
Average expected life (years)	**5.0**
Average expected volatility (%)	**73.0**
Forfeiture rate (%)	**10.0**

c) Weighted average common shares

(thousands)	**Three months ended March 31, 2016**	Three months ended March 31, 2015
Basic	**85,484**	70,817
Diluted	**85,484**	70,817

For the period ended March 31, 2016 6.5 million options were excluded from the weighted average number of common shares as they were anti-dilutive (March 31, 2015 – 5.1 million options were excluded from the weighted average numbered common shares as they were anti-dilutive).

10. FINANCIAL INSTRUMENTS

Classification and Measurement

Gear's financial instruments on the balance sheet are carried at amortized cost with the exception of risk management contracts and the conversion approval option, which are carried at fair value. As at March 31, 2016 and December 31, 2015, no significant differences existed between the carrying value of financial instruments and their estimated fair values

All of Gear's risk management contracts are transacted in active markets. Gear classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Gear's risk management contracts have been assessed on the fair value hierarchy described above. Gear's cash is classified as Level 1, risk management contracts as Level 2, and the conversion approval option as Level 3. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

Market Risk Management

Liquidity risk

Gear's next scheduled review of its "Credit Facilities" is scheduled for June 1, 2016. Gear's borrowing limit under the facility is dependent on the Company's reserve values which are highly sensitive to commodity prices and as such a reduction in Gear's borrowing limit is anticipated. If the reduction to the borrowing limit is significant and/or the repayment requirements are shorter than six months alternative external sources of funding will be necessary. The Company believes that it has access to sufficient capital through internally generated cash flows and external sources (bank credit markets and equity financing, if required) to meet any repayment requirements as well as current operational spending forecasts. However, there is no certainty that such debt or equity financing will be available, access to these external sources may change at any time and is subject to certain factors beyond the control of the Company.

Credit risk

The majority of the credit exposure on accounts receivable at March 31, 2016 pertains to accrued revenue for March 2016 production volumes. Gear transacts with a number of oil and natural gas marketing companies. Marketing companies typically remit amounts to Gear by the 25th day of the month following production. A significant portion of Gear's accounts receivable is carried by two marketing companies. At March 31, 2016, 49 per cent and 29 per cent of total outstanding accounts receivable pertains to these companies. Gear did not have any other customers from which it had outstanding accounts receivable greater than 10 per cent of the total outstanding balance at March 31, 2016.

When determining whether amounts that are past due are collectable, management assesses the credit worthiness and past payment history of the counterparty, as well as the nature of the past due amount. Gear considers all amounts greater than 90 days to be past due. At March 31, 2016 management determined $0.1 million of accounts receivable past due to be uncollectable and as such recorded an expense in the Statement of Loss and Comprehensive Loss for these amounts (nil in 2015).

As at March 31, 2016, 97 per cent of Gear's accounts receivable was current (2015 – 98 per cent) and 3 per cent was greater than 90 days (2015 – 2 per cent).

11. SUPPLEMENTAL DISCLOSURES CASH FLOW INFORMATION

Cash Flow Statement Presentation

The following table provides a detailed breakdown of the changes in non-cash working capital within cash flow from operating, financing and investing activities:

($ thousands)	**Three months ended March 31, 2016**	Three months ended March 31, 2015
Accounts receivable	**460**	3,228
Prepaid expenses	**47**	(474)
Inventory	**265**	2,417
Accounts payable and accrued liabilities	**(1,387)**	(11,271)
Total	**(615)**	(6,100)
Operating Activities	**(278)**	527
Investing Activities	**(337)**	(6,627)
Total	**(615)**	(6,100)

12. COMMITMENTS AND CONTINGENCIES

Following is a summary of Gear's contractual obligations and commitments as at March 31, 2016:

	Payments due by period					
($ thousands)	2016	2017	2018	2019	2020	Total
Office leases [1]	127	-	-	-	-	127
Drilling commitments	679	1,939	1,939	1,939	1,939	8,435
Total contractual obligations	806	1,939	1,939	1,939	1,939	8,562

(1) Excludes estimate of occupancy costs.

During the first quarter of 2016, Gear negotiated certain drilling commitments to extend the service period and incurred a renegotiation fee of $0.5 million, which has been included in the Statement of Loss and Comprehensive Loss.

Gear enters into commitments for capital and decommissioning expenditures in advance of the expenditures being made. At a given point in time, it is estimated that Gear has committed to capital expenditures equal to approximately one quarter of its capital budget by means of giving the necessary authorizations to incur the expenditures in a future period.

Gear is involved in litigation and claims arising in the normal course of operations. Management is of the opinion that pending litigation will not have a material impact on Gear's financial position or results of operations.