

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

(Cdn\$ thousands)	<b>June 30, 2018</b>	December 31, 2017
<b>ASSETS</b>		
Current assets		
Accounts receivable	\$ 13,215	\$ 13,240
Prepaid expenses	3,687	2,862
Inventory (Note 3)	6,852	7,297
	<b>23,754</b>	23,399
Deferred income tax asset	26,531	26,531
Property, plant and equipment (Note 4)	254,050	256,961
<b>Total assets</b>	<b>\$ 304,335</b>	<b>\$ 306,891</b>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 15,441	\$ 11,625
Current portion of decommissioning liability (Note 7)	1,390	-
Risk management contracts (Note 8)	11,704	5,295
	<b>28,535</b>	16,920
Debt (Note 5)	33,675	41,345
Convertible debentures (Note 6)	12,303	12,155
Decommissioning liability (Note 7)	79,344	80,541
<b>Total liabilities</b>	<b>153,857</b>	150,961
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	311,453	311,240
Warrants (Note 9)	129	129
Equity component of convertible debentures (Note 6)	2,573	2,592
Contributed surplus	15,695	15,178
Deficit	(179,372)	(173,209)
<b>Total shareholders' equity</b>	<b>150,478</b>	155,930
<b>Total liabilities and shareholders' equity</b>	<b>\$ 304,335</b>	<b>\$ 306,891</b>

See accompanying notes to the unaudited Condensed Financial Statements

**GEAR ENERGY LTD.****INTERIM CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY** (unaudited)

For the six months ended June 30

(Cdn\$ thousands)

	Share Capital	Warrants	Equity Component of Convertible Debentures	Contributed Surplus	Deficit	Total Equity
<b>Balance, beginning of period</b>	<b>\$ 308,900</b>	<b>\$ 335</b>	<b>\$ 2,649</b>	<b>\$ 13,786</b>	<b>\$ (183,438)</b>	<b>\$ 142,232</b>
Exercise of stock options	13	-	-	(5)	-	8
Cancellation of warrants (Note 9)	-	(206)	-	206	-	-
Issued on conversion of convertible debentures (Note 6)	323	-	(57)	-	-	266
Share-based compensation	-	-	-	917	-	917
Net income for the period	-	-	-	-	5,987	5,987
<b>Balance at June 30, 2017</b>	<b>\$ 309,236</b>	<b>\$ 129</b>	<b>\$ 2,592</b>	<b>\$ 14,904</b>	<b>\$ (177,451)</b>	<b>\$ 149,410</b>
Balance, beginning of period	311,240	129	2,592	15,178	(173,209)	155,930
Issued on conversion of convertible debentures (Note 6)	107	-	(19)	-	-	88
Exercise of stock options	108	-	-	(26)	-	82
Share issue costs	(2)	-	-	-	-	(2)
Share-based compensation	-	-	-	543	-	543
Net loss for the period	-	-	-	-	(6,163)	(6,163)
<b>Balance at June 30, 2018</b>	<b>\$ 311,453</b>	<b>\$ 129</b>	<b>\$ 2,573</b>	<b>\$ 15,695</b>	<b>\$ (179,372)</b>	<b>\$ 150,478</b>

See accompanying notes to the unaudited Condensed Financial Statements

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

	Three Months Ended June 30		Six Months Ended June 30	
(Cdn\$ thousands, except per share amounts)	2018	2017	2018	2017
<b>REVENUE</b>				
Sales of crude oil, natural gas and natural gas liquids (Note 11)	\$ 33,674	\$ 25,929	\$ 58,574	\$ 48,244
Royalties	(3,238)	(2,942)	(6,144)	(5,050)
	<b>30,436</b>	22,987	<b>52,430</b>	43,194
Realized loss on risk management contracts	(3,550)	(458)	(5,986)	(1,114)
Unrealized (loss) gain on risk management contracts	(4,400)	4,377	(6,409)	9,693
	<b>22,486</b>	26,906	<b>40,035</b>	51,773
<b>EXPENSES</b>				
Operating	10,973	10,531	20,264	19,184
General and administrative	1,629	1,259	3,293	2,860
Share-based compensation (Note 9)	251	438	543	917
Interest and financing charges	592	491	1,132	959
Depletion, depreciation and amortization (Notes 3 and 4)	10,330	9,349	19,853	17,784
Accretion (Notes 6 and 7)	562	545	1,111	1,092
Gain on asset disposition	-	-	-	(75)
Other	18	-	2	100
	<b>24,355</b>	22,613	<b>46,198</b>	42,821
Deferred tax expense	-	(1,292)	-	(2,965)
Net (loss) income and comprehensive (loss) income	\$ (1,869)	\$ 3,001	\$ (6,163)	\$ 5,987
Net (loss) income per share, basic (Note 9)	\$ (0.01)	\$ 0.02	\$ (0.03)	\$ 0.03
Net (loss) income per share, diluted (Note 9)	(0.01)	0.01	(0.03)	0.03

See accompanying notes to the unaudited Condensed Financial Statements

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

(Cdn\$ thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>				
Net (loss) income	\$ (1,869)	\$ 3,001	\$ (6,163)	\$ 5,987
Add items not involving cash:				
Unrealized loss (gain) on risk management contracts	4,400	(4,377)	6,409	(9,693)
Share-based compensation	251	438	543	917
Depletion, depreciation and amortization	10,330	9,349	19,853	17,784
Accretion	562	545	1,111	1,092
Gain on asset disposition	-	-	-	(75)
Deferred tax expense	-	1,292	-	2,965
Decommissioning liabilities settled	(373)	(676)	(1,262)	(798)
Change in non-cash working capital (Note 12)	(4,705)	(4,210)	2,892	(572)
	<b>8,596</b>	<b>5,362</b>	<b>23,383</b>	<b>17,607</b>
<b>CASH FLOW USED IN FINANCING ACTIVITIES</b>				
(Repayments) borrowings of debt under credit facilities	(2,552)	6,341	(7,670)	6,154
Issuance of share capital, net of share issue costs	80	8	80	8
	<b>(2,472)</b>	<b>6,349</b>	<b>(7,590)</b>	<b>6,162</b>
<b>CASH FLOW USED IN INVESTING ACTIVITIES</b>				
Property, plant and equipment expenditures	(6,385)	(6,161)	(15,628)	(24,945)
Acquisition of petroleum and natural gas properties	(10)	(136)	(400)	(143)
Disposition of petroleum and natural gas properties	-	9	-	84
Change in non-cash working capital (Note 12)	271	(5,423)	235	1,235
	<b>(6,124)</b>	<b>(11,711)</b>	<b>(15,793)</b>	<b>(23,769)</b>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	-	-	-	-
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	-	-	-	-
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
The following are included in cash flow from operating activities:				
Interest paid in cash	\$ 766	\$ 619	\$ 1,148	\$ 936

See accompanying notes to the unaudited Condensed Financial Statements

**GEAR ENERGY LTD.**

**NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS** (unaudited)

June 30, 2018 and 2017

(all tabular amounts in Cdn\$ thousands, except as noted)

**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, 240 - 4<sup>th</sup> Avenue SW, Calgary, Alberta T2P 4H4.

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, 2017, which have been prepared in accordance with IFRS.

The financial statements were authorized for issue by the Board of Directors on August 8, 2018.

**2. SIGNIFICANT ACCOUNTING POLICIES**

Adopted Accounting Policy Changes

*IFRS 15 Revenue from Contracts with Customers*

On January 1, 2018 Gear retrospectively adopted IFRS 15 *Revenue from Contracts with Customers*, which replaces International Accounting Standard (“IAS”) 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive when control is transferred to the purchaser. The adoption of IFRS 15 did not result in any adjustments to Gear’s financial statements. Gear has expanded the disclosures in the notes to its financial statements as prescribed by IFRS 15, including disclosing the Company’s disaggregated revenue streams by product type. See Note 11.

Revenue associated with the sale of crude oil, natural gas, and natural gas liquids (“NGLs”) owned by Gear is recognized when title is transferred from Gear to its customers. Gear’s commodity sales contracts represent a series of distinct transactions. Revenue is measured at the consideration specified in the contracts and represents amounts receivable for goods or services provided in the normal course of business. Substantially all revenue is based on floating prices. Gear considers its performance obligations to be satisfied and control to be transferred when all the following conditions are satisfied:

- Gear has transferred title and physical possession of the goods to the buyer;
- Gear has transferred the significant risks and rewards of ownership of the goods to the buyer; and
- Gear has the present right to payment.

Revenue is collected from Gear’s customers on the 25<sup>th</sup> day of the month following delivery. Gear does not have any contracts where the period between the transfer of the contracted goods and payment by the customer exceeds one year. As such, Gear does not adjust its revenue transactions for the time value of money. The contracts to sell the Company’s crude oil, natural gas and natural gas liquids have varying terms not longer than one year. As a result, Gear has immediately expensed costs of obtaining contracts as these costs would have been amortized within a period of one year.

*IFRS 9 Financial Instruments*

On January 1, 2018 Gear retrospectively adopted IFRS 9 *Financial Instruments* without restatement. IFRS 9 introduces a single approach to determine whether a financial asset is measured at amortized cost or fair value and replaces the multiple rules in IAS 39. The approach is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. For financial liabilities, IFRS 9 retains most of the requirements of IAS 39; however, where the fair value option is applied to financial liabilities, any change in fair value

resulting from an entity's own credit risk is recorded in OCI rather than the statement of income. The adoption of IFRS 9 did not have an impact on the measurement and carrying values of the Company's financial assets or liabilities.

In addition, IFRS 9 introduces a new expected credit loss model for calculating impairment of financial assets, replacing the incurred loss impairment model required by IAS 39. Gear has determined that the new impairment model does not result in changes to the valuation of its financial assets on adoption of IFRS 9. IFRS 9 also contains a new model to be applied for hedge accounting. The Company does not currently apply hedge accounting to its risk management contracts and has not applied hedge accounting to any of its existing risk management contracts on adoption of IFRS 9.

The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 as at January 1, 2018 for each class of the Company's financial assets and liabilities.

Financial Instrument	Measurement Category <sup>(1)</sup>	
	IAS 39	IFRS 9
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Financial liabilities measured at amortized cost	Amortized cost
Debt	Financial liabilities measured at amortized cost	Amortized cost
Convertible debentures	Financial liabilities measured at amortized cost	Amortized cost
Risk management contracts	FVTPL	FVTPL

(1) There were no adjustments to the carrying amounts of financial instruments as a result of the change in classification from IAS 39 to IFRS 9

#### Future Accounting Policy Changes

##### IFRS 16 Leases

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. The Company has completed the contract identification stage of its IFRS 16 project and is currently evaluating the impact of the standard on Gear's financial statements.

### 3. INVENTORY

At June 30, 2018 and December 31, 2017 Gear recorded oil inventory valued at its production cost of \$6.9 million and \$7.3 million, respectively. Gear records changes in both the capital and operating components to the statement of (loss) income. The cost components of the inventory balance are as follows:

(\$ thousands)	June 30, 2018	December 31, 2017
Capital	2,691	3,025
Operating	4,161	4,272
Balance, end of period	6,852	7,297

### 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, 2016	643,223	1,201	644,424
Additions	47,693	72	47,765
Acquisitions	2,281	-	2,281
Dispositions	(85)	-	(85)
Change in decommissioning costs	2,553	-	2,553
Balance, December 31, 2017	695,665	1,273	696,938
Additions	15,628	-	15,628
Acquisitions	400	-	400
Change in decommissioning costs	580	-	580
Balance, June 30, 2018	712,273	1,273	713,546

<b>Depletion, depreciation and amortization</b>			
(\$ thousands)			
Balance, December 31, 2016	400,937	650	401,587
Depletion, depreciation and amortization	38,235	155	38,390
Balance, December 31, 2017	439,172	805	439,977
Depletion, depreciation and amortization	19,325	194	19,519
Balance, June 30, 2018	458,497	999	459,496

<b>Carrying amounts</b>	<b>Development and</b>	<b>Administrative</b>	<b>Total</b>
(\$ thousands)	<b>Production Assets</b>	<b>Assets</b>	
As at December 31, 2017	256,493	468	256,961
As at June 30, 2018	253,776	274	254,050

No impairment indicators were identified on the property, plant and equipment as at June 30, 2018 and December 31, 2017.

## 5. DEBT

As at June 30, 2018 Gear had a \$67.5 million revolving term credit facility with a syndicate of three banks and a \$7.5 million operating facility (the "Credit Facilities"). The maturity date on the Credit Facilities is May 29, 2020. The total stamping fees range, depending on Gear's Debt to EBITDA ratio, between 50 bps to 300 bps on Canadian bank prime borrowings and between 150 bps and 400 bps on Canadian dollar bankers' acceptances. The undrawn portion of the Credit Facilities is subject to a standby fee in the range of 34 bps to 90 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 June 30, 2018, Gear was in compliance with this covenant. As at June 30, 2018 Gear had \$33.7 million drawn on the Credit Facilities (December 31, 2017 – \$41.3 million).

## 6. CONVERTIBLE DEBENTURES

On November 30, 2015, the Company completed the issuance of unsecured subordinated debentures (the "Convertible Debentures") for gross proceeds of \$14.8 million. The Convertible 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. The Convertible Debentures are convertible at the option of the holder at any time prior to the maturity date or redemption date at a conversion price of \$0.87 per common share such that for every \$1,000 principal amount of Convertible Debentures a holder will receive approximately 1,149.43 common shares. Holders converting their Convertible 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.

The Convertible Debentures may be redeemable on or after December 31, 2018 by Gear if the current market price of Gear's common shares at such time is at least 125 per cent of the conversion price. On or after December 31, 2019, the Convertible 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. Gear has the option to satisfy its obligation to repay the principal amount of the Convertible Debentures due at maturity or redemption of the Convertible 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.

The following table provides a continuity of balances of the Convertible Debentures and the equity component from December 31, 2016 to June 30, 2018:

(\$ thousands)	Convertible Debentures	Equity component
Balance, December 31, 2016	11,973	2,649
Accretion using effective interest rate at 8%	448	-
Conversions	(266)	(57)
Balance, December 31, 2017	12,155	2,592
Accretion using effective interest rate at 8%	236	-
Conversions	(88)	(19)
<b>Balance, June 30, 2018</b>	<b>12,303</b>	<b>2,573</b>

## 7. DECOMMISSIONING LIABILITY

(\$thousands)	Six months ended June 30, 2018	Year ended December 31, 2017
Balance, beginning of period	80,541	78,814
Changes in estimates	21	1,016
Additions	559	1,733
Dispositions	-	(196)
Decommissioning liabilities settled	(1,262)	(2,577)
Accretion	875	1,751
Balance, end of period	80,734	80,541
Expected to be incurred within one year	1,390	-
Expected to be incurred beyond one year	79,344	80,541

The undiscounted and unescalated amount of the expected cash flows required to settle the decommissioning liability is estimated to be \$83.3 million as at June 30, 2018 (December 31, 2017 - \$83.0 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 2.15 per cent (December 31, 2017 – 2.15 per cent). Abandonments are expected to occur between 2018 and 2050 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 June 30, 2018:

Financial WTI Crude Oil Contracts							
Term	Contract	Currency	Volume	Sold Call	Bought Put	Sold Put	
			bbl/d	\$/bbl	\$/bbl	\$/bbl	\$/bbl
Jul 1, 2018	Dec 31, 2018	Collar	300	52.50	47.50	-	-
Jul 1, 2018	Dec 31, 2018	Collar	600	57.00	50.00	-	-
Jul 1, 2018	Aug 31, 2018	Collar	500	52.25	46.00	-	-
Jul 1, 2018	Aug 31, 2018	Collar	1,000	56.00	46.00	-	-
Sep 1, 2018	Dec 31, 2018	Collar	1,500	56.00	46.00	-	-
Jul 1, 2018	Dec 31, 2018	Collar	400	82.00	62.50	-	-
Jan 1, 2019	Dec 31, 2019	Three-way Collar	600	U\$66.00	C\$62.00	C\$52.00	-
Jan 1, 2019	Dec 31, 2019	Three-way Collar	600	U\$72.00	C\$65.00	C\$55.00	-
Jan 1, 2019	Dec 31, 2019	Three-way Collar	600	100.00	65.00	55.00	-



<b>Financial AECO Gas Contracts</b>							
<b>Term</b>		<b>Contract</b>	<b>Currency</b>	<b>Volume</b>	<b>Sold Swap</b>	<b>Sold Call</b>	<b>Bought Put</b>
				<b>GJ/d</b>	<b>\$/GJ</b>	<b>\$/GJ</b>	<b>\$/GJ</b>
Jul 1, 2018	Dec 31, 2018	Swap	CAD	1,700	2.65	-	-
Jul 1, 2018	Dec 31, 2018	Collar	CAD	1,700	-	2.60	2.40

As at June 30, 2018, the fair value associated with Gear's risk management contracts was a liability of \$11.7 million (December 31, 2017 – liability of \$5.3 million).

## 9. SHAREHOLDERS' EQUITY

### a) Share capital

(thousands of shares and \$ thousands)	<b>Six months ended</b>		Year ended	
	<b>June 30, 2018</b>		December 31, 2017	
	<b>Shares</b>	<b>Amount</b>	Shares	Amount
Balance, beginning of period	194,968	\$ 311,240	192,568	\$ 308,900
Exercise of stock options	130	108	2,053	2,022
Issued on conversion of debentures	115	107	347	323
Share issue costs	-	(2)	-	(5)
Balance, end of period	195,213	\$ 311,453	194,968	\$ 311,240

### b) Warrants

Consideration for the purchase of Striker Exploration Corp. ("Striker") which closed on July 27, 2016 included the continuation of 650 thousand fully vested Striker warrants held, controlled or directed by certain directors of Striker who were appointed to the board of directors of Gear at the effective time of the arrangement. Each warrant gives the holder an option to purchase 2.325 Gear shares at an exercise price of \$1.03 per share. These warrants expire on July 8, 2019. In May 2017, 400 thousand of the outstanding warrants were cancelled, leaving 250 thousand warrants outstanding at June 30, 2018.

### c) Stock option plan

Gear's stock option plan provides for the grant of options to purchase common shares of Gear to directors, officers, employees and consultants of Gear. In the third quarter of 2016, the Board of Directors of Gear determined that future grants of options under the option plan would vest as to one third on each of the first, second and third anniversary dates of the date of grant and expire 30 business days after such vesting dates. The terms of options outstanding prior to the determination by the Gear Board of Directors of the new terms remained unchanged and had the same vesting terms as the new terms but had a five year expiry.

The following table summarizes Gear's stock option plan activity during the periods ended June 30, 2018 and December 31, 2017 for grants made under the plan with a five year expiry.

(thousands)	<b>Six months ended</b>		Year ended	
	<b>June 30, 2018</b>		December 31, 2017	
	<b>Number of</b>	<b>Weighted</b>	<b>Number of</b>	<b>Weighted</b>
	<b>stock options</b>	<b>average</b>	<b>stock options</b>	<b>average</b>
		<b>exercise price</b>		<b>exercise price</b>
Outstanding, beginning of year	5,580	\$ 2.46	5,996	\$ 2.44
Exercised	(117)	0.45	(37)	0.49
Expired	(1,350)	2.50	(257)	2.50
Forfeited	(31)	2.22	(122)	2.06
Outstanding, end of period	4,082	2.51	5,580	2.46
Exercisable, end of period	3,580	\$ 2.78	4,324	\$ 2.87

The following table summarizes Gear's stock option plan activity during the periods ended June 30, 2018 and December 31, 2017 for grants made under the plan with a 30 day expiry following their vesting date.

(thousands)	Six months ended June 30, 2018		Year ended December 31, 2017	
	Number of stock options	Weighted average exercise price	Number of stock options	Weighted average exercise price
Outstanding, beginning of year	7,941	\$ 0.71	6,550	\$ 0.71
Granted	2,013	0.84	3,780	0.73
Exercised	(368)	0.78	(2,016)	0.71
Forfeited	(139)	0.72	(373)	0.83
Outstanding, end of period	9,447	0.74	7,941	0.71
Exercisable, end of period	-	\$ -	100	\$ 0.73

During the first half of 2018, Gear has recorded an expense of \$0.5 million (2017 - \$0.9 million) to share-based compensation expense recognizing the stock option activity for the period based on the fair value of options issued, amortized using a graded vesting calculation.

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

	Period ended June 30, 2018
Risk free interest rate (%)	1.82
Dividend yield (%)	-
Average expected life (years)	2.08
Average expected volatility (%)	23
Forfeiture rate (%)	10.0

#### d) Weighted average common shares

(thousands)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Basic	195,045	192,922	195,007	192,881
Dilutive impact of Convertible Debentures	-	15,744	-	15,782
Dilutive impact of stock options	-	305	-	411
Diluted	195,045	208,971	195,007	209,074

The dilutive impact of Convertible Debentures and stock options are excluded from the diluted weighted average number of common shares when the impact is 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 which are carried at fair value. As at June 30, 2018 and December 31, 2017, 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 and risk management contracts as Level 2. 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

### Credit risk

The majority of the credit exposure on accounts receivable at June 30, 2018 pertains to accrued revenue for June 2018 production volumes. Gear transacts with a number of oil and natural gas marketing companies. Marketing companies typically remit amounts to Gear by the 25<sup>th</sup> day of the month following production. A significant portion of Gear's accounts receivable is carried by three marketing companies. At June 30, 2018, 29 per cent, 26 per cent, and 18 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 June 30, 2018.

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. As at June 30, 2018, 99 per cent of Gear's trade accounts receivable was current (2017 – 99 per cent) and 1 per cent was greater than 90 days (2017 – 1 per cent).

## 11. SALES OF CRUDE OIL, NATURAL GAS AND NATURAL GAS LIQUIDS

Gear sells its production pursuant to variable-price contracts. The transaction price for these contracts is based on commodity prices adjusted for quality and other factors. The contracts to sell the Company's crude oil, natural gas and natural gas liquids have varying terms not longer than one year. The following table provides a summary of Gear's revenue streams:

(\$ thousands)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Heavy oil	23,911	16,029	40,279	30,534
Light and medium oil	8,482	7,665	15,435	13,611
Natural gas liquids	807	824	1,603	1,282
Natural gas	474	1,411	1,257	2,817
Total sales of crude oil, natural gas and natural gas liquids	33,674	25,929	58,574	48,244

## 12. 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 and investing activities:

(\$ thousands)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Accounts receivable	(3,736)	(769)	25	(1,928)
Prepaid expenses	(991)	67	(825)	137
Inventory	765	(205)	111	(787)
Accounts payable and accrued liabilities	(472)	(8,726)	3,816	3,241
Total	(4,434)	(9,633)	3,127	663
Operating Activities	(4,705)	(4,210)	2,892	(572)
Investing Activities	271	(5,423)	235	1,235
Total	(4,434)	(9,633)	3,127	663

### 13. COMMITMENTS AND CONTINGENCIES

Following is a summary of Gear's contractual obligations and commitments as at June 30, 2018:

(\$ thousands)	Payments due by period			
	2018	2019	2020	Total
Office leases	186	364	146	696
Drilling commitment	521	1,939	1,939	4,399
Total contractual obligations	707	2,303	2,085	5,095

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.

### 14. SUBSEQUENT EVENT

On July 23, 2018, Gear entered into a definitive agreement providing for the acquisition by Gear of all the issued and outstanding common shares of Steppe Resources Inc. ("Steppe"), a private oil and gas company with properties in southeast Saskatchewan. Total consideration for the transaction is estimated to be \$70.4 million with Gear issuing 21.9 million shares and assuming Steppe's net debt of approximately \$40.9 million. The transaction is expected to close in the third quarter. In conjunction with the close of the acquisition, Gear expects to increase its Credit Facilities from \$75 million to \$115 million; all other terms of the Credit Facilities are expected to remain unchanged from those disclosed in Note 5.