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

| (Cdn$ thousands) | | **March 31, 2017** | | December 31, 2016 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Accounts receivable | **$** | **10,685** | $ | 9,526 |
| Prepaid expenses | | **2,704** | | 2,774 |
| Inventory (Note 3) | | **6,335** | | 5,723 |
| | | **19,724** | | 18,023 |
| Deferred income tax asset | | **18,780** | | 20,589 |
| Property, plant and equipment (Note 4) | | **255,088** | | 242,837 |
| Total assets | **$** | **293,592** | $ | 281,449 |
| **LIABILITIES** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities | **$** | **21,795** | $ | 9,827 |
| Risk management contracts (Note 8) | | **1,987** | | 7,305 |
| Flow-through share liability (Note 9) | | **-** | | 135 |
| | | **23,782** | | 17,267 |
| Debt (Note 5) | | **30,976** | | 31,163 |
| Convertible debentures (Note 6) | | **11,813** | | 11,973 |
| Decommissioning liability (Note 7) | | **81,058** | | 78,814 |
| Total liabilities | | **147,629** | | 139,217 |
| **SHAREHOLDERS' EQUITY** | | | | |
| Share capital (Note 9) | | **309,223** | | 308,900 |
| Warrants (Note 9) | | **335** | | 335 |
| Equity component of convertible debentures (Note 6) | | **2,592** | | 2,649 |
| Contributed surplus | | **14,265** | | 13,786 |
| Deficit | | **(180,452)** | | (183,438) |
| Total shareholders' equity | | **145,963** | | 142,232 |
| Total liabilities and shareholders' equity | **$** | **293,592** | $ | 281,449 |

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 | Warrants | Equity Component of Convertible Debentures | Contributed Surplus | Deficit | Total Equity |
|---|---|---|---|---|---|---|
| Balance, beginning of period | $ 241,535 | $ - | $ - | $ 12,377 | $ (159,752) | $ 94,160 |
| Share issue costs, net of deferred tax 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 |
| Balance, beginning of period | $ 308,900 | $ 335 | $ 2,649 | $ 13,786 | $ (183,438) | $ 142,232 |
| Issued on conversion of convertible debentures (Note 6) | 323 | - | (57) | - | - | 266 |
| Share-based compensation | - | - | - | 479 | - | 479 |
| Net income for the period | - | - | - | - | 2,986 | 2,986 |
| **Balance at March 31, 2017** | **$ 309,223** | **$ 335** | **$ 2,592** | **$ 14,265** | **$ (180,452)** | **$ 145,963** |

See accompanying notes to the unaudited Condensed Financial Statements

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

| | | Three Months Ended March 31 | | |
|---|---|---|---|---|
| (Cdn$ thousands, except per share amounts) | | **2017** | | 2016 |
| **REVENUE** | | | | |
| Sales of crude oil, natural gas and natural gas liquids | **$** | **22,315** | $ | 8,173 |
| Royalties | | **(2,108)** | | (656) |
| | | **20,207** | | 7,517 |
| Gain on risk management contracts (Note 8) | | **4,660** | | 3,982 |
| | | **24,867** | | 11,499 |
| **EXPENSES** | | | | |
| Operating | | **8,653** | | 6,192 |
| General and administrative | | **1,601** | | 1,481 |
| Share-based compensation (Note 9) | | **479** | | 174 |
| Interest and financing charges | | **468** | | 616 |
| Depletion, depreciation and amortization (Note 4) | | **8,435** | | 4,283 |
| Accretion (Notes 6 and 7) | | **547** | | 389 |
| Gain on asset disposition (Note 4) | | **(75)** | | (400) |
| Other (Note 11) | | **100** | | 480 |
| | | **20,208** | | 13,215 |
| Deferred tax expense | | **(1,673)** | | - |
| Net income (loss) and comprehensive income (loss) | **$** | **2,986** | $ | (1,716) |
| Net income (loss) per share, basic (Note 9) | **$** | **0.02** | $ | (0.02) |
| Net income (loss) per share, diluted (Note 9) | **$** | **0.01** | $ | (0.02) |

See accompanying notes to the unaudited Condensed Financial Statements

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

| | Three Months Ended March 31 | |
|---|---|---|
| (Cdn$ thousands) | **2017** | 2016 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income (loss) | **$ 2,986** | $ (1,716) |
| Add items not involving cash: | | |
| Unrealized (gain) loss on risk management contracts | **(5,316)** | 1,147 |
| Share-based compensation | **479** | 174 |
| Bad debt expense | **-** | 108 |
| Accretion | **547** | 389 |
| Depletion, depreciation and amortization | **8,435** | 4,283 |
| Gain on asset disposition | **(75)** | (400) |
| Deferred tax expense | **1,673** | - |
| Decommissioning liabilities settled | **(122)** | (151) |
| Change in non-cash working capital (Note 12) | **3,638** | (278) |
| | **12,245** | 3,556 |
| **CASH FLOW USED IN FINANCING ACTIVITIES** | | |
| Repayments of debt under credit facility | **(187)** | (3,562) |
| Issuance of share capital, net of share issue costs | **-** | (36) |
| | **(187)** | (3,598) |
| **CASH FLOW (USED IN) FROM INVESTING ACTIVITIES** | | |
| Property, plant and equipment expenditures | **(18,784)** | (101) |
| Acquisition of petroleum and natural gas properties | **(7)** | - |
| Disposition of petroleum and natural gas properties | **75** | 480 |
| Change in non-cash working capital (Note 12) | **6,658** | (337) |
| | **(12,058)** | 42 |
| **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 | **$ 317** | $ 468 |

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, 240 - 4th 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, 2016, which have been prepared in accordance with IFRS.

The financial statements were authorized for issue by the Board of Directors on May 10, 2017.

## 2. SIGNIFICANT ACCOUNTING POLICIES

Adopted and Future Accounting Policy Changes

As of January 1, 2017 Gear was required to adopt amendments to IAS 7 *Statement of Cash Flows.* The amendments relate to disclosure requirements regarding changes in liabilities arising from financing activities. As of January 1, 2017 the new standard has been adopted and it did not have a material impact on the disclosures in the financial statements.

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, 2017 and December 31, 2016 Gear recorded oil inventory valued at its production cost of $6.3 million and $5.7 million respectively. The cost components of the inventory balance are as follows:

| ($ thousands) | **March 31, 2017** | December 31, 2016 |
|---|---|---|
| Capital | **2,560** | 2,531 |
| Operating | **3,775** | 3,192 |
| Balance, end of period | **6,335** | 5,723 |

## 4. PROPERTY, PLANT AND EQUIPMENT

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

| **Cost**<br>($ thousands) | **Development and Production Assets** | **Administrative Assets** | **Total** |
|---|---|---|---|
| Balance, December 31, 2015 | 550,125 | 1,202 | 551,327 |
| Additions | 14,368 | (1) | 14,367 |
| Acquisitions | 58,897 | - | 58,897 |
| Disposals | (381) | - | (381) |
| Change in decommissioning costs | 20,214 | - | 20,214 |
| Balance, December 31, 2016 | 643,223 | 1,201 | 644,424 |
| Additions | 18,781 | 3 | 18,784 |
| Acquisitions | 7 | - | 7 |
| Change in decommissioning costs | 1,924 | - | 1,924 |
| Balance, March 31, 2017 | 663,935 | 1,204 | 665,139 |

| **Depletion, depreciation and amortization**<br>($ thousands) | | | |
|---|---|---|---|
| Balance, December 31, 2015 | 371,983 | 439 | 372,422 |
| Depletion, depreciation and amortization | 28,954 | 211 | 29,165 |
| Balance, December 31, 2016 | 400,937 | 650 | 401,587 |
| Depletion, depreciation and amortization | 8,422 | 42 | 8,464 |
| Balance, March 31, 2017 | 409,359 | 692 | 410,051 |

| **Carrying amounts**<br>($ thousands) | **Development and Production Assets** | **Administrative Assets** | **Total** |
|---|---|---|---|
| As at December 31, 2016 | 242,286 | 551 | 242,837 |
| As at March 31, 2017 | 254,576 | 512 | 255,088 |

In the first quarter of 2017 Gear divested of a small non-producing property with no associated property, plant, and equipment carrying value resulting in a $0.1 million gain on sale for the three months ended March 31, 2017 (March 31, 2016 - $0.4 million gain).

No impairment indicators were identified on the property, plant and equipment as at March 31, 2017.

## 5. DEBT

As at March 31, 2017 Gear had a $42.5 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 31, 2018. The total stamping fees range, depending on Gear's Debt to EBITDA ratio, between 100 bps to 300 bps on Canadian bank prime borrowings and between 200 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 50 bps to 100 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, 2017 Gear was in compliance with this covenant. The next semi-annual borrowing base review of the facilities is currently underway and will be complete on or about May 31, 2017.

As at March 31, 2017 Gear had $31.0 million drawn on the Credit Facilities (December 31, 2016 – $31.2 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 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 tables provide a continuity of balances of the Convertible Debentures, the conversion approval option and the equity component from December 31, 2015 to March 31, 2017:

| ($ thousands) | **Convertible Debentures** | **Conversion approval option** | **Equity component** |
|---|---|---|---|
| Balance, December 31, 2015 | 12,230 | 1,800 | - |
| Accretion using effective interest rate at 8% | 441 | - | - |
| Adjustment of issuance costs | 5 | - | - |
| Change in fair value of conversion approval option | - | 1,000 | - |
| Approval of conversion feature | - | (2,800) | 2,800 |
| Conversions | (703) | - | (151) |
| Balance, December 31, 2016 | 11,973 | - | 2,649 |
| Accretion using effective interest rate at 8% | 105 | **-** | **-** |
| Conversions | (265) | **-** | (57) |
| **Balance, March 31, 2017** | **11,813** | **-** | **2,592** |

## 7. DECOMMISSIONING LIABILITY

| ($thousands) | **Three months ended March 31, 2017** | Year ended December 31, 2016 |
|---|---|---|
| Balance, beginning of period | **78,814** | 54,959 |
| Changes in estimates | **1,305** | (6,855) |
| Additions | **619** | 865 |
| Dispositions | **-** | (465) |
| Liabilities acquired through acquisitions | **-** | 4,670 |
| Revaluation of acquired decommissioning liabilities (1) | **-** | 26,274 |
| Decommissioning liabilities settled | **(122)** | (1,853) |
| Accretion | **442** | 1,219 |
| Balance, end of period | **81,058** | 78,814 |

(1) These amounts relate to the revaluation of acquired decommissioning liabilities at the end of the period using a risk-free discount rate. At the date of acquisition decommissioning liabilities are fair valued.

The undiscounted and unescalated amount of the expected cash flows required to settle the decommissioning liability is estimated to be $83.4 million as at March 31, 2017 (December 31, 2016 - $82.8 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 2.14 per cent (December 31, 2016 – 2.24 per cent). Abandonments are expected to occur between 2017 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 March 31, 2017:

**Financial WTI Crude Oil Contracts**

| Term | | Contract | Currency | Volume bbl/d | Sold Swap $/bbl | Sold Call $/bbl | Bought Put $/bbl | Sold Put $/bbl |
|---|---|---|---|---|---|---|---|---|
| Apr 1, 2017 | Jun 30, 2017 | Swap | CAD | 900 | 61.39 | - | - | - |
| Jul 1, 2017 | Dec 31, 2017 | Swap | CAD | 400 | 61.78 | - | - | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 200 | - | 71.00 | 60.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 200 | - | 72.50 | 60.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 300 | - | 67.25 | 60.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 400 | - | 75.00 | 60.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 200 | - | 79.01 | 60.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 200 | - | 77.00 | 62.00 | - |
| Jul 1, 2017 | Dec 31, 2017 | Collar | CAD | 500 | - | 70.20 | 60.00 | - |
| Jul 1, 2018 | Dec 31, 2018 | Collar | USD | 300 | - | 52.50 | 47.50 | - |

**Financial WCS Differential Crude Oil Contracts**

| Term | | Contract | Currency | Volume bbl/d | Sold Swap $/bbl | Sold Call $/bbl | Bought Put $/bbl | Sold Put $/bbl |
|---|---|---|---|---|---|---|---|---|
| Apr 1, 2017 | Dec 31, 2017 | Swap | CAD | 400 | (21.40) | - | - | - |

**Financial AECO Gas Contracts**

| Term | | Contract | Currency | Volume GJ/d | Sold Swap $/GJ | Sold Call $/GJ | Bought Put $/GJ | Sold Put $/GJ |
|---|---|---|---|---|---|---|---|---|
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 750 | - | 3.30 | 2.00 | - |
| Apr 1, 2017 | Dec 31, 2017 | Collar | CAD | 1,000 | - | 3.31 | 2.70 | - |
| Apr 1, 2017 | Dec 31, 2017 | Swap | CAD | 1,900 | 3.00 | - | - | - |
| Jan 1, 2018 | Dec 31, 2018 | Swap | CAD | 1,700 | 2.65 | - | - | - |

As at March 31, 2017, the fair value associated with Gear's risk management contracts was an liability of $2.0 million (December 31, 2016 – liability of $7.3 million).

The following table reconciles the gain on risk management contracts:

| ($ thousands) | **Three months ended December 31, 2017** | Year ended December 31, 2016 |
|---|---|---|
| Realized cash gain (loss) on risk management contracts | **(656)** | 8,801 |
| Change in unrealized fair value of risk management contracts | **5,316** | (16,478) |
| Total gain (loss) gain on risk management contracts | **4,660** | (7,677) |

Subsequent to March 31, 2017, 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, 2018 | Dec 31, 2018 | Collar | USD | 600 | - | 50.00 | 57.00 | - |

| Financial AECO Gas Contracts | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Term | | Contract | Currency | Volume GJ/d | Sold Swap $/GJ | Sold Call $/GJ | Bought Put $/GJ | Sold Put $/GJ |
| Jan 1, 2018 | Dec 31, 2018 | Collar | CAD | 1,700 | - | 2.60 | 2.40 | - |

## 9. SHAREHOLDERS' EQUITY

### a) Share capital

Common Shares

| (thousands of shares and $ thousands) | **Three months ended March 31, 2017** | | | Year ended December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | **Shares** | | **Amount** | Shares | | Amount |
| Balance, beginning of period | **192,568** | **$** | **308,900** | 85,484 | $ | 241,535 |
| Issued on offering of common shares | **-** | | **-** | 28,750 | | 20,125 |
| Issued on acquisition of Striker | **-** | | **-** | 76,238 | | 46,506 |
| Issued on offering of flow through shares | **-** | | **-** | 1,176 | | 859 |
| Issued on conversion of debentures | **347** | | **323** | 920 | | 854 |
| Share issue costs, net of deferred tax benefit of nil (2016 - $357) | **-** | | **-** | - | | (979) |
| Balance, end of period | **192,915** | **$** | **309,223** | 192,568 | $ | 308,900 |

### 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 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.

### c) Stock option plan

The following table summarizes Gear's stock option plan and activity during the periods ended March 31, 2017 and December 31, 2016.

| | **Three months ended March 31, 2017** | | | Year ended December 31, 2016 | | |
|---|---|---|---|---|---|---|
| (thousands) | **Number of stock options** | | **Weighted average exercise price** | Number of stock options | | Weighted average exercise price |
| Outstanding, beginning of period | **12,546** | **$** | **1.54** | 6,380 | $ | 2.83 |
| Granted | **165** | | **0.99** | 7,405 | | 0.67 |
| Expired | **(135)** | | **2.50** | - | | - |
| Forfeited | **-** | | **-** | (1,239) | | 3.02 |
| Outstanding, end of period | **12,576** | | **1.52** | 12,546 | | 1.54 |
| Exercisable, end of period | **3,611** | **$** | **2.76** | 3,299 | $ | 3.00 |

In the first quarter of 2017, Gear recorded an expense of $0.5 million to share-based compensation expense related to its stock option plan ($0.2 million in 2016).

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, 2017** |
|---|---|
| Risk free interest rate (%) | **0.73** |
| Dividend yield (%) | **-** |
| Average expected life (years) | **2.08** |
| Average expected volatility (%) | **74.5** |
| Forfeiture rate (%) | **10.0** |

**d) Weighted average common shares**

| (thousands) | **Three months ended March 31, 2017** | Three months ended March 31, 2016 |
|---|---|---|
| Basic | **192,840** | 85,484 |
| Dilutive impact of Convertible Debentures | **15,820** | - |
| Dilutive impact of stock options | **992** | - |
| Diluted | **209,652** | 85,484 |

For the period ended March 31, 2016 the dilutive impact of Convertible Debentures and stock options were excluded from the diluted weighted average number of common shares as they were anti-dilutive.

**e) Flow-through shares**

On November 24, 2016, Gear issued 1,176,500 flow-through common shares at $0.85 per flow-through share for gross proceeds of $1.0 million via private placement. A flow-through share premium of $0.1 million was recognized. For each flow-through share Gear renounced to the purchaser Canadian Exploration Expense equal to the purchase price of such shares in 2016. As at March 31, 2017 Gear had fully spent the committed amount.

## 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 March 31, 2017 and December 31, 2016, 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 March 31, 2017 pertains to accrued revenue for March 2017 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 three marketing companies. At March 31, 2017, 24 per cent, 19 per cent, and 18 per cent of total outstanding accounts receivable pertains to these companies. In addition, Gear has accrued a $2.0 million insurance receivable which accounts for 18 per cent of total outstanding accounts receivables at March 31, 2017. 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, 2017.

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 March 31, 2017, 99 per cent of Gear's accounts receivable was current (2016 – 97 per cent) and 1 per cent was greater than 90 days (2016 – 3 per cent).

## 11. OTHER

In the first quarter of 2017 Gear incurred a loss of $2.0 million related to costs incurred during the drilling of a well in Saskatchewan. Insurance proceeds have been estimated by management to be equal to the costs incurred and have been accrued as at March 31, 2017, net of the $0.1 million policy deductible.

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

## 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, financing and investing activities:

| ($ thousands) | **Three months ended March 31, 2017** | Three months ended March 31, 2016 |
|---|---|---|
| Accounts receivable | **(1,159)** | 460 |
| Prepaid expenses | **70** | 47 |
| Inventory | **(583)** | 265 |
| Accounts payable and accrued liabilities | **11,968** | (1,387) |
| Total | **10,296** | (615) |
| | | |
| Operating Activities | **3,638** | (278) |
| Investing Activities | **6,658** | (337) |
| Total | **10,296** | (615) |

## 13. COMMITMENTS AND CONTINGENCIES

Following is a summary of Gear's contractual obligations and commitments as at March 31, 2017:

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| ($ thousands) | 2017 | 2018 | 2019 | 2020 | Total |
| Office leases | 190 | 238 | 238 | 20 | 686 |
| Drilling commitment | 1,218 | 1,939 | 1,939 | 1,939 | 7,035 |
| Total contractual obligations | 1,408 | 2,177 | 2,177 | 1,959 | 7,721 |

(1) Excludes estimate of occupancy costs.

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.