MANAGEMENT’S REPORT

To the Shareholders of Gear Energy Ltd.

Management’s Responsibility on Financial Statements

Management is responsible for the preparation of Gear Energy Ltd.’s annual financial statements. The financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto. In management’s opinion, the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain estimates that reflect Management’s best judgments.

Management is responsible for the integrity of the financial statements. Management has developed and maintains an adequate system of internal control over financial reporting which provides reasonable assurance that all transactions are recorded, that the financial statements realistically report the Company’s operating and financial results, and that the Company’s assets are safeguarded from loss or unauthorized use. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2018. The Company has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the requirements of Canadian securities legislation.

The Board of Directors has approved the information contained in the financial statements. Its financial statement related responsibilities are fulfilled mainly through the Audit Committee which is composed entirely of independent directors, and includes at least one director with financial expertise. The Audit Committee meets regularly with management and the external auditors to discuss reporting issues and ensures each party is properly discharging its responsibilities. The Audit Committee also considers the independence of the external auditors and reviews their fees.

The financial statements have been audited by Deloitte LLP, Chartered Professional Accountants in accordance with Canadian generally accepted auditing standards, on behalf of the shareholders.

(signed)
Ingram Gillmore
President and Chief Executive Officer

(signed)
David Hwang
Vice-President and Chief Financial Officer

February 27, 2019
Calgary, Alberta

Deloitte LLP
700, 850 2 Street SW
Calgary, AB T2P 0R8
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Independent Auditor's Report

To the Shareholders of Gear Energy Ltd.:

Opinion

We have audited the financial statements of Gear Energy Ltd. (the "Company"), which comprise the consolidated balance sheets as at December 31, 2018 and 2017, and the consolidated statements of income and comprehensive income, consolidated statements of changes in shareholder's equity and the consolidated statements of cash flows for the years then ended and a summary of significant accounting policies and other explanatory information (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company's or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements
Our objectives are to obtain reasonable assurance about whether the 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 a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. 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.
- 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor’s report is Mandeep Singh.

/s/ Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
February 27, 2019

GEAR ENERGY LTD.
CONSOLIDATED BALANCE SHEETS
As at December 31

(Cdn$ thousands)		**2018**		2017
ASSETS				
Current assets				
Accounts receivable	**$**	**5,716**	$	13,240
Prepaid expenses		**3,914**		2,862
Inventory (Note 6)		**7,185**		7,297
Risk management contracts (Note 12)		**3,230**		-
		20,045		23,399
Deferred income tax asset (Note 14)		**26,531**		26,531
Risk management contracts (Note 12)		**1,644**		-
Property, plant and equipment (Notes 7 and 8)		**331,622**		256,961
Total assets	**$**	**379,842**	$	306,891
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	**$**	**12,475**	$	11,625
Decommissioning liability (Note 11)		**1,843**		-
Risk management contracts (Note 12)		**-**		5,295
		14,318		16,920
Debt (Note 9)		**78,461**		41,345
Convertible debentures (Note 10)		**12,297**		12,155
Decommissioning liability (Note 11)		**86,839**		80,541
Total liabilities		**191,915**		150,961
SHAREHOLDERS' EQUITY				
Share capital (Note 13)		**337,740**		311,240
Warrants (Notes 13)		**129**		129
Equity component of convertible debentures (Note 10)		**2,519**		2,592
Contributed surplus		**15,654**		15,178
Deficit		**(168,115)**		(173,209)
Total shareholders' equity		**187,927**		155,930
Total liabilities and shareholders' equity	**$**	**379,842**	$	306,891

See accompanying notes to the Consolidated Financial Statements

Approved by the Board of Directors

(signed)
Don Gray
Chairman of the Board of Directors and Director

(signed)
Harry English
Chair of the Audit Committee and Director

GEAR ENERGY LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the years ended December 31
(Cdn$ thousands)

	Share Capital	Warrants	Equity Component of Convertible Debentures	Contributed Surplus	Deficit	Total Equity
Balance at December 31, 2016	**$ 308,900**	**$ 335**	**$ 2,649**	**$ 13,786**	**$ (183,438)**	**$ 142,232**
Exercise of stock options	2,022	-	-	(573)	-	1,449
Cancellation of warrants (Note 13)	-	(206)	-	206	-	-
Share issue costs, net of deferred tax of $2 (Note 13)	(5)	-	-	-	-	(5)
Issued on conversion of convertible debentures (Note 10)	323	-	(57)	-	-	266
Share-based compensation (Note 13)	-	-	-	1,759	-	1,759
Net income for the year	-	-	-	-	10,229	10,229
Balance at December 31, 2017	**$ 311,240**	**$ 129**	**$ 2,592**	**$ 15,178**	**$ (173,209)**	**$ 155,930**
Exercise of stock options	1,355	-	-	(600)	-	755
Issued as consideration on corporate acquisition (Note 7)	24,743	-	-	-	-	24,743
Share issue costs (Note 13)	(7)	-	-	-	-	(7)
Issued on conversion of convertible debentures (Note 10)	409	-	(73)	-	-	336
Share-based compensation (Note 13)	-	-	-	1,076	-	1,076
Net income for the year	-	-	-	-	5,094	5,094
Balance at December 31, 2018	**$ 337,740**	**$ 129**	**$ 2,519**	**$ 15,654**	**$ (168,115)**	**$ 187,927**

See accompanying notes to the Consolidated Financial Statements

GEAR ENERGY LTD.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
For the years ended December 31

(Cdn$ thousands, except per share amounts)		**2018**		2017
REVENUE				
Sales of crude oil, natural gas and natural gas liquids (Note 17)	**$**	**109,316**	$	102,551
Royalties		**(12,858)**		(10,454)
		96,458		92,097
Realized cash loss on risk management contracts		**(10,619)**		(1,524)
Unrealized gain on risk management contracts		**14,641**		2,010
		100,480		92,583
EXPENSES				
Operating		**42,033**		39,586
General and administrative		**5,163**		5,347
Interest and financing charges		**2,728**		1,986
Depletion, depreciation and amortization (Note 6 and 8)		**42,142**		37,896
Accretion (Notes 10 and 11)		**2,303**		2,199
Share-based compensation (Note 13)		**1,076**		1,759
Transaction costs (Note 7)		**514**		-
Gain on asset disposition		**(556)**		(445)
Other		**(17)**		101
		95,386		88,429
Deferred tax recovery (Note 14)		**-**		6,075
Net income and comprehensive income	**$**	**5,094**	$	10,229
Net income per share, basic and diluted (Note 13)	**$**	**0.03**	$	0.05

See accompanying notes to the Consolidated Financial Statements

GEAR ENERGY LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31

(Cdn$ thousands)		**2018**		2017
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	**$**	**5,094**	$	10,229
Add items not involving cash:				
Unrealized gain on risk management contracts		**(14,641)**		(2,010)
Bad debt recovery		**-**		(3)
Depletion, depreciation and amortization		**42,142**		37,896
Accretion		**2,303**		2,199
Share-based compensation		**1,076**		1,759
Gain on asset disposition		**(556)**		(445)
Deferred tax recovery		**-**		(6,075)
Decommissioning liabilities settled		**(2,981)**		(2,577)
Change in non-cash working capital (Note 18)		**9,315**		(4,205)
		41,752		36,768
CASH FLOWS FROM FINANCING ACTIVITIES				
Borrowings of debt under credit facility		**37,116**		10,182
Repayment of debt assumed on corporate acquisition		**(36,251)**		-
Issuance of share capital, net of share issue costs		**748**		1,442
		1,613		11,624
CASH FLOWS USED IN INVESTING ACTIVITIES				
Property, plant and equipment expenditures		**(43,859)**		(47,765)
Cash received on corporate acquisition		**693**		-
Acquisition of petroleum and natural gas properties		**(452)**		(2,261)
Disposition of petroleum and natural gas properties		**556**		511
Change in non-cash working capital (Note 18)		**(303)**		1,123
		(43,365)		(48,392)
INCREASE IN CASH AND CASH EQUIVALENTS		**-**		-
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR		**-**		-
CASH AND CASH EQUIVALENTS, END OF YEAR	**$**	**-**	$	-
The following are included in cash flows from operating activities:				
Interest paid in cash	**$**	**2,676**	$	1,919

See accompanying notes to the Consolidated Financial Statements

1. STRUCTURE OF THE BUSINESS

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 was incorporated in Canada and its principal place of business is located at 2600, 240 – 4th Avenue SW, Calgary, Alberta T2P 4H4.

2. BASIS OF PREPARATION

These consolidated financial statements (the “financial statements”) have been prepared under International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and were prepared using accounting policies consistent with IFRS.

A summary of Gear’s significant accounting policies under IFRS is presented in Note 3. The financial statements have been prepared on the historical cost basis with the exception of risk management contracts which are measured at fair value.

The financial statements were authorized for issue by the Board of Directors on February 27, 2019.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue recognition
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 25th 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.

(b) Joint arrangements
Gear does not have any joint venture arrangements. However, Gear conducts a portion of its activities through jointly controlled operations. These financial statements reflect only the Company's proportionate interest in such activities. Joint control exists for contractual arrangements governing Gear’s assets whereby Gear has less than 100 per cent working interest, all of the partners have control of the arrangement collectively, and spending on the project requires unanimous consent of all parties that collectively control the arrangement and share the associated risks.

(c) Share-based compensation
The Company accounts for its share-based compensation plan using the fair value method estimated using the Black-Scholes model. Under this method, a compensation expense is charged over the vesting period for stock options granted using the graded vesting method with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration received, together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. Forfeitures of stock options are estimated on the grant date and are adjusted to reflect the actual number of options that vest.

(d) Crude oil inventory
Crude oil inventory consists of amounts produced and in storage tanks and is recorded at the lower of cost, determined on a weighted-average basis, and net realizable value. Cost components include royalties, operating costs (other than transportation), and an estimated capital component based on depletion rates. Net realizable value is the estimated selling price in the normal course of business.

(e) Property, plant and equipment ("PP&E")
Items of PP&E, which include oil and gas Developed and Producing ("D&P") assets and administrative assets, are measured at cost less accumulated depletion, depreciation and accumulated impairment losses.

Gains and losses on disposals of properties are determined by comparing the proceeds to the carrying value of the property net of associated decommissioning liabilities and are recognized in the Consolidated Statements of Income and Comprehensive Income.

(f) Depletion and Depreciation
D&P assets are componentized into groups of assets with similar useful lives for the purposes of performing depletion calculations. Depletion expense is calculated on the unit-of-production basis based on:
- (i) total estimated proved and probable reserves calculated in accordance with National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities;
- (ii) total capitalized costs plus estimated future development costs of proved and probable reserves, including future estimated decommissioning costs; and
- (iii) relative volumes of petroleum and natural gas reserves and production, before royalties, converted at the energy equivalent conversion ratio of six thousand cubic feet of natural gas to one barrel of oil.

Administrative assets are depreciated using the declining balance method over the useful lives of the assets.

(g) Impairment

D&P Assets
D&P assets are aggregated into cash-generating units ("CGUs") for the purposes of impairment testing and depletion calculations. CGUs are groups of assets that generate independent cash inflows and are generally defined based on geographic areas, with consideration given to how the assets are managed.

D&P assets are reviewed for impairment at a CGU level when indicators of impairment exist. When indicators of impairment exist, the carrying value of each CGU is compared to its recoverable amount which is defined as the higher of its fair value less cost to sell or its value in use.

When the carrying value exceeds the recoverable amount an impairment loss exists and is recognized in the Consolidated Statements of Income and Comprehensive Income.

Reversals of impairments are recognized when events or circumstances that triggered the original impairment have changed. Impairments can only be reversed in future periods up to the carrying amount that would have been determined, net of depletion and depreciation, had no impairment losses been previously recognized.

(h) Business combinations
Business combinations are accounted for using the acquisition method under IFRS 3 *Business Combinations*. Management's determination of whether a transaction constitutes a business combination or an asset acquisition is based on the criteria in IFRS 3. The identifiable assets acquired and liabilities assumed in a business combination are measured at their fair values at the acquisition date. The decommissioning liability associated with the acquired property is subsequently re-measured at the end of the reporting period using a risk-free discount rate, with any changes recognized in decommissioning liability and PP&E on the Consolidated Balance Sheet. The cost of an acquisition is measured as the fair value of the assets transferred, equity instruments issued, and liabilities incurred or assumed at the acquisition date. The excess of the acquisition cost over the fair value of the net assets acquired is recognized as goodwill. If the cost of the acquisition is less than the fair value of the net assets acquired, a gain on business combination is recognized immediately in the Consolidated Statements of Income and Comprehensive Income. A deferred tax asset or liability arising from the acquired net assets is also recognized in a business combination. Any resulting goodwill or a gain resulting from a bargain purchase is not considered to be taxable. Transaction costs associated with a business combination are expensed as incurred.

(i) Financial Instruments
(i) Amortized Cost
Accounts receivable, accounts payable and accrued liabilities, debt and convertible debt are measured at amortized cost. These classifications are initially measured at fair value and subsequent revaluations are recorded at amortized cost using the effective interest method.

(ii) Fair Value through Profit or Loss (“FVTPL”)
Gear enters into risk management contracts in order to manage its exposure to market risks from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. Gear has not designated its risk management contracts as effective hedges, and thus has not applied hedge accounting. All risk management contracts are initially measured at fair value through profit or loss and are subsequently measured at fair value with changes in fair value recorded in the Consolidated Statements of Income and Comprehensive Income. The fair values of these derivative instruments are based on an estimate of the amounts that would be paid or received to settle these instruments at the balance sheet date.

(iii) Impairment of Financial Assets
Impairment of financial assets is determined by measuring the assets’ expected credit loss (“ECL”). Accounts receivable are due within one year and are not considered to have a significant financing component and a lifetime ECL is measured at the date the accounts receivable are initially recognized.

(j) Decommissioning Liabilities
Gear’s oil and gas operating activities give rise to dismantling, decommissioning and site remediation activities. Gear recognizes a liability for the estimated present value of the future decommissioning liabilities at each balance sheet date using a risk free discount rate. The associated decommissioning cost is capitalized and amortized over the same period as the underlying asset. Changes in the estimated liability resulting from revisions to estimated timing, amount of cash flows, or changes in the discount rate are recognized as a change in the decommissioning liability and related capitalized decommissioning cost.

Amortization of capitalized decommissioning costs is included in depreciation, depletion and amortization in the Consolidated Statements of Income and Comprehensive Income. Increases in decommissioning liabilities resulting from the passage of time are recorded as accretion. Actual expenditures incurred are charged against the decommissioning liability.

(k) Deferred income taxes
Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted at the reporting dates.

Deferred tax is recognized in the Consolidated Statements of Income and Comprehensive Income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. Deferred tax assets are only recognized for temporary differences, unused tax losses and unused tax credits if it is probable that future tax amounts will arise to utilize those amounts.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

(l) Per Share Amounts
Basic per share amounts are computed by dividing net income or loss by the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that would occur if dilutive instruments were exercised and common shares issued.

4. CHANGES IN ACCOUNTING POLICIES

NEWLY ADOPTED ACCOUNTING POLICIES

IFRS 15 *Revenue from Contracts with Customers*

On January 1, 2018 Gear adopted IFRS 15 *Revenue from Contracts with Customers* using the retrospective approach, 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 17.

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, FVTPL or fair value through other comprehensive income 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 through profit or loss option is designated, any change in fair value resulting from an entity's own credit risk is recorded in Other Comprehensive Income 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.

	Measurement Category (1)	
Financial Instrument	**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*. IFRS 16 removes the distinction between operating and finance leases and requires the recognition of a right-of-use asset ("ROU") asset and lease liability on the balance sheet for most leases where the Company is lessee.

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 is required to be adopted either retrospectively or using a modified retrospective approach. The modified retrospective approach does not require restatement of prior periods; instead the cumulative effect of applying this standard is recognized as an adjustment to opening retained earnings and the standard is applied prospectively. IFRS 16 will be applied by Gear on January 1, 2019 using the modified retrospective approach. The Company has completed reviewing its lease contracts and has concluded that the adoption of IFRS 16 will not have a material impact on Gear's net income and financial position, but Gear will expand the disclosures in the notes to its financial statements as prescribed by IFRS 16.

5. MANAGEMENT JUDGMENTS AND ESTIMATION UNCERTAINTY

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies at the date of the financial statements, and revenues and expenses during the reporting year. Actual results could differ from those estimated. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below.

Recoverability of asset carrying values
The recoverability of D&P asset carrying values is assessed at the CGU level. Determination of what constitutes a CGU is subject to management judgments. The asset composition of a CGU can directly impact the recoverability of the assets included therein. In assessing the recoverability of oil and gas properties, each CGU's carrying value is compared to its recoverable amount, defined as the greater of its fair value less cost to sell and value in use. Management has determined that Gear's asset base represents three CGUs. The first CGU is comprised of Gear's heavy oil properties located in Eastern Alberta and Saskatchewan, the second is predominantly light oil properties

located in Western Alberta and the third is comprised of light oil properties located in Southeast Saskatchewan. The properties contained in each CGU are in close proximity to each other, with similar cost structures and marketing arrangements. Gear applies information on estimates of future commodity prices, expected production volumes, quantity of reserves and resources, future development costs, future operating costs, discount rates and income taxes when determining an acceptable range of recoverable amounts.

Gear estimates the recoverable amount of a CGU using the following information:

- The net present value of the before tax cash flows from proved plus probable reserves in each CGU, as estimated by the Company's independent reserves evaluator. The reserve evaluation is based on the estimated remaining reserve life of the Company's assets.
- The fair value of undeveloped land and seismic based on recent transactions completed within the industry on assets with similar geological and geographic characteristics within the relevant CGU.

Key estimates used in determining cash flows from the Company's reserves include:

- Reserves- Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs, required capital expenditures or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
- Crude oil and natural gas prices- Forward price estimates are used in the discounted cash flow model. These prices are adjusted for quality differentials, heat content and distance to market. Commodity prices can fluctuate for a variety of reasons including supply and demand fundamentals, inventory levels, exchange rates, weather, economic and geopolitical factors.
- Discount rate- The discount rate used to calculate the net present value of cash flows is based on estimates of an industry peer group weighted average cost of capital as appropriate for each CGU being tested. Changes in the general economic environment could result in significant changes to this estimate.

Accrual estimates
Revenue, royalty, operating expense and capital amounts are estimated at each reporting date, before actual results are known. These estimates rely on management judgment and could vary from actual results.

Depletion of oil and gas assets
Depletion of oil and gas assets is determined based on estimated total proved and probable reserves as well as estimated future development costs. Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs, required capital expenditures or recovery rates may change the economic status of reserves and may ultimately result in reserves being revised.

Business combinations
Determination of the fair value of acquired assets and liabilities in a business combination requires management to make assumptions and estimates about future events. The fair value of crude oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from crude oil and natural gas production. These assumptions and estimates generally require judgment and include estimates of reserves acquired, liabilities assumed, forecast commodity prices, expected production volumes, future development and operating costs, income taxes, and discount rates. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to the net assets acquired, goodwill or gain on business combination.

Decommissioning liability
The provision for abandonment and reclamation is based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology.

Derivative Instruments
The estimated fair value of derivative instruments resulting in financial assets and liabilities is reliant upon forward commodity prices. Any change in the forward commodity price curves could result in a change to the estimated valuation of the instruments.

Employee Compensation Costs
Compensation expense recorded for Gear's stock option plan is based on a Black-Scholes pricing model. The inputs to this model such as average expected volatility and estimated forfeiture rates rely on management judgment.

Income Taxes
Tax regulations and legislation are subject to change and differing interpretations requiring management judgement. Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in future periods, which requires management judgement. Deferred tax liabilities are recognized when it is considered probable that the tax on temporary differences will be payable to tax authorities in future periods, which

requires management judgement. Income tax filings are subject to audits and re-assessments and changes in facts, circumstances and interpretations of the regulations and legislation may result in a material increase or decrease in Gear's income tax assets and liabilities.

6. INVENTORY

At December 31, 2018 Gear recorded oil inventory valued at its production cost of $7.2 million (December 31, 2017 - $7.3 million). Gear records changes in both the capital and operating components to the Consolidated Statements of Income and Comprehensive Income. The cost components of the inventory balance are as follows:

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Capital	**3,691**	3,025
Operating	**3,494**	4,272
Balance, end of year	**7,185**	7,297

7. CORPORATE ACQUISTITION

On September 18, 2018 Gear completed the acquisition, by way of plan of arrangement, of all issued and outstanding common shares of Steppe Resources Inc. ('Steppe'), a private oil and gas company with properties in southeast Saskatchewan. The acquired assets provide Gear with increased light oil production and growth opportunities.

The preliminary purchase price is as follows:

Net Assets Acquired ($ thousands)	**Amount**
Cash	693
Accounts receivable	4,485
Prepaid expenses and deposits	1,339
Inventory	244
Property, plant and equipment	66,276
Accounts payable and accrued liabilities[1]	(3,172)
Risk management contracts	(6,213)
Debt	(36,251)
Decommissioning liability	(2,658)
Total net assets acquired	24,743

Consideration ($ thousands)	**Amount**
Common shares (21.9 million shares at $1.13 per share)	24,743
Total purchase price	24,743

(1) Includes $1.2 million of settled losses on risk management contracts payable at the acquisition date.

As part of the acquisition Gear acquired tax pools for which no deferred tax asset has been recognized due to the uncertainty of future recoverability. These financial statements incorporate the results of operations of the acquired properties from September 19, 2018 onward. The assets generated sales of crude oil, natural gas and natural gas liquids of $5.5 million and a net income of $0.6 million from September 19, 2018 to December 31, 2018. If the transaction had taken place on January 1, 2018, it is estimated that the assets acquired would have contributed incremental sales of crude oil, natural gas and natural gas liquids of $25.0 million and net income of $9.3 million, excluding losses on risk management contracts.

In conjunction with the acquisition Gear incurred $0.5 million of transaction costs including amounts relating to legal, accounting fees, and other related acquisition costs. These amounts are included in the Consolidated Statements of Income and Comprehensive Income.

8. PROPERTY, PLANT AND EQUIPMENT AND IMPAIRMENT

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

Cost ($ thousands)	D&P 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
Disposals	(85)	-	(85)
Change in decommissioning costs	2,553	-	2,553
Balance, December 31, 2017	695,665	1,273	696,938
Additions	43,770	89	43,859
Acquisitions	66,728	-	66,728
Disposals	(1)	-	(1)
Change in decommissioning costs	6,639	-	6,639
Balance, December 31, 2018	812,801	1,362	814,163
Depletion, depreciation and amortization			
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	42,298	266	42,564
Balance, December 31, 2018	481,470	1,071	482,541

Carrying amounts ($ thousands)	D&P Assets	Administrative Assets	Total
As at December 31, 2017	256,493	468	256,961
As at December 31, 2018	331,331	291	331,622

At December 31, 2018 Gear evaluated its PP&E for indicators of any potential impairment. At December 31, 2018, Gear's net asset value was greater than its market capitalization. An impairment test was conducted over Gear's CGUs, but no impairment was recognized as the estimated recoverable amount of each CGU exceeded its carrying value.

The estimated recoverable amount was based on a fair value less cost to sell calculations using a discount rate that is based on an estimated industry weighted average cost of capital ranging from 10 to 15 per cent, an inflation rate of two per cent, and the following forward commodity price estimates:

Year	Western Canadian Select Crude Oil (Cdn $/bbl)	Edmonton Light Crude Oil (Cdn $/bbl)	Light Sour Blend Crude Oil (Cdn $/bbl)	AECO Gas (Cdn $/MMBtu)	CAD$/US$ Exchange Rates
2019	51.55	67.30	68.67	1.88	0.77
2020	59.58	75.84	75.35	2.31	0.80
2021	65.89	80.17	79.70	2.74	0.80
2022	68.61	83.22	81.82	3.05	0.80
2023	70.53	85.34	84.13	3.21	0.80
2024	72.34	87.33	86.24	3.31	0.80
2025	74.31	89.50	88.62	3.39	0.80
2026	76.44	91.89	91.26	3.46	0.80
2027	78.10	93.76	93.14	3.54	0.80
2028	79.81	95.68	95.06	3.62	0.80
Remainder	+2.0%/yr	+2.0%/yr	+2.0%/yr	+2.0%/yr	0.80

For the year ended December 31, 2017, no impairment indicators were identified related to Gear's CGUs. As a result of this assessment, impairment tests were not performed.

9. DEBT

During the third quarter of 2018, in conjunction with the Steppe acquisition, Gear had its borrowing base reviewed which resulted in a $40.0 million increase in its credit facilities. As at December 31, 2018, Gear had a $95.0 million revolving term credit facility with a syndicate of three banks and a $20.0 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 risk management contracts, plus the undrawn portion of the credit facilities divided by current liabilities less risk management contracts. At December 31, 2018 Gear was in compliance with this covenant. The next semi-annual borrowing base review of the facilities will occur on or about May 31, 2019.

At December 31, 2018 Gear had $78.5 million drawn on the Credit Facilities (December 31, 2017 – $41.3 million) and an outstanding letter of credit of $0.2 million (December 31, 2017 – nil).

10. 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 table provides a continuity of balances of the Convertible Debentures and the equity component from December 31, 2016 to December 31, 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%	478	-
Conversions	(336)	(73)
Balance, December 31, 2018	**12,297**	**2,519**

11. DECOMMISSIONING LIABILITY

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Balance, beginning of year	**80,541**	78,814
Changes in estimates	**260**	1,016
Additions	**1,400**	1,733
Acquisitions (dispositions)	**240**	(196)
Liabilities acquired on acquisition of Steppe (Note 7)	**2,658**	-
Revaluation of acquired decommissioning liabilities (1)	**4,739**	-
Decommissioning liabilities settled	**(2,981)**	(2,577)
Accretion	**1,825**	1,751
Balance, end of year	**88,682**	80,541
Expected to be incurred within one year	**1,843**	-
Expected to be incurred beyond one year	**86,839**	80,541

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

The undiscounted and unescalated amount of the expected cash flows required to settle the decommissioning liability is estimated to be $91.0 million as at December 31, 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 2.18 per cent (December 31, 2017 – 2.15 per cent). Abandonments are expected to occur between 2019 and 2044 and related costs will be funded mainly from Gear's cash provided by operating activities.

12. RISK MANAGEMENT CONTRACTS

Gear uses or plans to use a variety of derivative instruments to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. Gear has not designated its risk management contracts as effective hedges, and thus has not applied hedge accounting.

The following is a summary of all risk management contracts in place as at December 31, 2018:

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, 2019	Dec 31, 2019	Three-way Collar	USD/CAD	600	-	U$66.00	C$62.00	C$52.00
Jan 1, 2019	Dec 31, 2019	Three-way Collar	USD/CAD	600	-	U$72.00	C$65.00	C$55.00
Jan 1, 2019	Dec 31, 2019	Three-way Collar	CAD	1,200	-	100.00	65.00	55.00
Jan 1, 2019	Dec 31, 2019	Collar	CAD	100	-	103.00	65.00	-
Jan 1, 2020	Dec 31, 2020	Collar	CAD	700	-	94.00	65.00	-
Jan 1, 2019	Feb 28, 2019	Swap[1]	CAD	450	61.20	-	-	-
Mar 1, 2019	Jul 31, 2019	Swap[1]	CAD	400	61.20	-	-	-
Jan 1, 2019	Jun 30, 2019	Swap[1]	CAD	250	68.90	-	-	-
Jul 1, 2019	Jul 31, 2019	Swap[1]	CAD	200	67.30	-	-	-
Aug 1, 2019	Dec 31, 2019	Swap[1]	CAD	400	67.30	-	-	-

(1) Acquired through the acquisition of Steppe; see Note 7.

Financial WCS Crude Oil Contracts

Term		Contract	Currency	Volume bbl/d	Sold Swap $/bbl	Sold Call $/bbl	Bought Put $/bbl	Sold Put $/bbl
Feb 1, 2019	Jun 30, 2019	Swap	USD	1,500	(19.00)	-	-	-

As at December 31, 2018, the fair value associated with Gear's risk management contracts was an asset of $4.9 million ($5.3 million liability at December 31, 2017).

The following table summarizes the change in the risk management contracts asset (liability) during the years ended December 31, 2018 and 2017:

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Balance, beginning of year	**(5,295)**	(7,305)
Unrealized gain on risk management contracts	**14,641**	2,010
Unrealized risk management liability assumed on acquisition of Steppe (Note 7)	**(4,472)**	-
Balance, end of year	**4,874**	(5,295)

13. SHAREHOLDERS' EQUITY

Gear is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, issuable in series. Holders of common shares are entitled to dividends if declared by the Board, one vote per share, and upon liquidation, dissolution or winding up of the Company, the remaining property and assets of Gear. There are no outstanding preferred shares as at December 31, 2018 or 2017.

a) Share Capital

(thousands of shares and $ thousands)	**Year ended December 31, 2018 Shares**		**Amount**	Year ended December 31, 2017 Shares		Amount
Balance, beginning of year	**194,968**	**$**	**311,240**	192,568	$	308,900
Issued on acquisition of Steppe (Note 7)	**21,896**		**24,743**	-		-
Exercise of stock options	**1,711**		**1,355**	2,053		2,022
Issued on conversion of debentures	**440**		**409**	347		323
Share issue costs	**-**		**(7)**	-		(5)
Balance, end of year	**219,015**	**$**	**337,740**	194,968	$	311,240

For the year ended December 31, 2018, 2.2 million stock options were exercised for 0.6 million common shares on a cash-less basis and 1.1 million stock options were exercised for 1.1 million common shares for proceeds of $0.7 million.

b) Warrants

Consideration for the purchase of Striker Exploration Corp. ("Striker") which closed on July 27, 2016 included the continuation of 0.7 million 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, 0.4 million of the outstanding warrants were cancelled, leaving 0.3 million warrants outstanding at December 31, 2018.

c) Stock Options

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 years ended December 31, 2018 and 2017 for grants made under the plan with a five-year expiry.

(thousands)	**Year ended December 31, 2018 Number of stock options**		**Weighted average exercise price**	Year ended December 31, 2017 Number of stock options		Weighted average exercise price
Outstanding, beginning of year	**5,580**	**$**	**2.46**	5,996	$	2.44
Exercised	**(117)**		**0.45**	(37)		0.49
Expired	**(1,430)**		**2.53**	(257)		2.50
Forfeited	**(31)**		**2.22**	(122)		2.06
Outstanding, end of year	**4,002**		**2.50**	5,580		2.46
Exercisable, end of year	**3,738**	**$**	**2.65**	4,324	$	2.87

As at December 31, 2018 Gear had 4.0 million stock options outstanding granted under the plan with a five-year expiry at the time of grant at exercise prices ranging from $0.35 to $6.05 per share as summarized below:

Exercise Price	**Number of stock options (thousands)**	**Weighted average remaining contractual life (years)**
$0.35 – $1.00	1,238	2.1
$1.01 – $2.00	1,558	1.4
$3.00 – $6.05	1,206	0.5
	4,002	1.3

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

	Year ended December 31, 2018			Year ended December 31, 2017		
(thousands)	**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	**5,472**		**1.00**	3,780		0.73
Exercised	**(3,188)**		**0.71**	(2,016)		0.71
Forfeited	**(139)**		**0.72**	(373)		0.83
Outstanding, end of year	**10,086**		**0.87**	7,941		0.71
Exercisable, end of year	**134**	**$**	**0.76**	100	$	0.73

As at December 31, 2018 Gear had 10.1 million stock options outstanding granted under the plan with a 30-day expiry at the time of grant at exercise prices ranging from $0.64 to $1.16 per share as summarized below:

Exercise Price	**Number of stock options (thousands)**	**Weighted average remaining contractual life (years)**
$0.64 – $1.00	6,504	1.1
$1.01 – $1.16	3,582	1.7
	10,086	1.3

During 2018, Gear has recorded an expense of $1.1 million (2017 - $1.8 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:

	Year ended December 31, 2018	Year ended December 31, 2017
Risk free interest rate (%)	**2.04**	1.39
Average expected life (years)	**2.0**	2.0
Average expected volatility (%)	**20.9**	67.6
Forfeiture rate (%)	**10.0**	10.0

d) Weighted average common shares

(thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Basic	**202,020**	193,477
Diluted	**219,452**	210,029

The dilutive impact of stock options is excluded from the diluted weighted average number of common shares when the impact is anti-dilutive.

14. INCOME TAXES

The tax provision differs from the amount computed by applying the combined Canadian federal and provincial statutory income tax rates to income before deferred income tax expense as follows:

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Income before income taxes	**5,094**	4,154
Canadian statutory rate [(1)]	**27.0%**	27.0%
Expected income tax expense at statutory rates	**1,375**	1,121
Effect on income tax of:		
Change in estimated pool balances	**(1,196)**	218
Shared-based compensation	**291**	475
Flow-through shares	**-**	123
Risk management contracts [(2)]	**(586)**	-
Tax assets (recognized) not recognized [(3)]	**111**	(7,961)
Other	**5**	(51)
Deferred tax recovery	**-**	(6,075)

(1) The statutory rate consists of the combined statutory tax rate for Gear.
(2) Settlements on risk management contracts assumed in the Steppe Acquisition.
(3) Tax assets recognized is based on current tax pools less future taxable income based on reserve value estimates and deduction estimates such as general and administrative and interest and financing charges.

($ thousands)	**December 31, 2018**	December 31, 2017
Deferred tax assets		
Decommissioning liability	**23,944**	21,746
Non-capital losses carry forward	**27,478**	27,505
Financing fees	**285**	679
Deferred tax liabilities		
Risk management contracts	**(1,316)**	1,429
Capital assets in excess of recognized tax value	**(23,860)**	(24,828)
Deferred tax asset	**26,531**	26,531

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Deferred tax asset, beginning of the year	**26,531**	20,589
Deferred tax recovery	**-**	6,075
Deferred tax asset recognized in share issue costs	**-**	2
Deferred tax liability recognized in flow-through shares	**-**	(135)
Deferred tax asset, end of the year	**26,531**	26,531

All of Gear's assets have an approximate tax basis of $633.0 million ($434.4 million in 2017) available for future use as deductions from taxable income. Included in this tax basis are estimated non-capital loss carry forwards that expire in the years 2027 through 2036.

The following is a summary of estimated tax pools:

($ thousands)	**December 31, 2018**	December 31, 2017
Canadian oil and gas property expenses	**125,286**	139,983
Canadian development expenses	**198,214**	113,343
Canadian exploration expenses	**27,277**	27,979
Undepreciated capital cost	**63,890**	48,740
Non-capital losses	**216,270**	101,872
Other	**2,050**	2,514
Estimated tax pools, federal and provincial	**632,987**	434,431

15. FINANCIAL INSTRUMENTS

Classification and Measurement
Gear's financial instruments on the Consolidated Balance Sheet are carried at amortized cost with the exception of risk management contracts, which are carried at fair value. As at December 31, 2018 and 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 cash is classified as Level 1 and risk management contracts are classified 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

Gear is exposed to a number of different financial risks arising from normal course business exposures, as well as the Company's use of financial instruments. These risk factors include market risks relating to commodity prices, foreign currency risk and interest rate risk, as well as liquidity risk and credit risk. There have been no changes in the Company's objectives, policies or risks surrounding financial instruments.

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of the business. The market price movements that could adversely affect the value of the Company's financial assets, liabilities and expected future cash flows include commodity price risk (crude oil, natural gas and NGLs), and foreign currency exchange risk.

(a) *Commodity price and foreign currency exchange risk*

Gear is subject to commodity price risk on the delivery of crude oil, and to a lesser extent, natural gas and NGLs. These prices have a significant impact on its financial condition and can be subject to volatility as a result of a number of different external factors. North American crude oil, natural gas and NGL prices are based upon US dollar denominated commodity prices. As a result, the price received by Canadian producers is affected by the Canadian/US dollar exchange rate. Gear manages the risks associated with changes in commodity prices and foreign currency exchange by entering into a variety of risk management contracts (see Note 12).

The following table illustrates the effects of movement in commodity prices on net income due to changes in the fair value of risk management contracts in place at December 31, 2018. The sensitivity is based on a 10 per cent increase and 10 per cent decrease in forward price curves for both WTI and the WCS to WTI differential at December 31, 2018. The commodity price assumptions are based on management's assessment of reasonably possible changes in oil prices that could occur in the future.

Sensitivity of Commodity Price Risk Management Contracts as at December 31, 2018
($ thousands)

	10 per cent Increase in Commodity Price		10 per cent Decrease in Commodity Price	
	WTI	**WCS**	**WTI**	**WCS**
Net income (decrease) increase	(3,852)	(791)	3,020	791

The sensitivities are hypothetical and based on management's assessment of reasonably possible changes in commodity prices after the balance sheet date. The results of the sensitivity should not be considered to be predictive of future performance. Changes in the fair value of risk management contracts cannot generally be extrapolated because the relationship of change in certain variables to a change in fair value may not be linear.

(b) *Interest rate risk*

Gear has variable interest rates on its Credit Facilities, therefore, changes in interest rates could result in an increase or decrease in the amount Gear pays to service its debt. Gear had no risk management contracts that would be affected by interest rates in place at December 31, 2018.

If interest rates were to increase or decrease by one per cent, it is estimated that Gear's net income would change by approximately $0.6 million for the year ended December 31, 2018 assuming that the debt outstanding under Gear's Credit Facilities at December 31, 2018 was outstanding for all of 2018.

(c) *Liquidity risk*

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. 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 current spending forecasts. However, access to these external sources may change at any time and are subject to numerous factors,

including changes in reserves estimates, fluctuations in commodity prices, and credit markets in general, amongst others. All the accounts payable and accrued liabilities are due in less than one year and amounts outstanding on the Credit Facilities are due on May 29, 2020. The convertible debentures have a scheduled bullet repayment date of November 30, 2020.

(d) *Credit risk*

Gear is or may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of petroleum and natural gas and other parties. In the event such entities fail to meet their contractual obligations to Gear, such failures could have a material adverse effect. The Company manages the risk by reviewing the credit risk of these entities and by entering agreements only with parties that meet certain credit tests. The maximum credit risk that the Company is exposed to is the carrying value of accounts receivable and risk management contracts.

A significant amount of the credit exposure on accounts receivable at December 31, 2018 pertains to accrued revenue for December 2018 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. At the balance sheet date 18 per cent of Gear's accounts receivable is carried by a marketing company with sound financial positioning. In addition, Gear has an accrued insurance receivable which accounts for 14 per cent of total outstanding accounts receivable and an amount outstanding from a joint venture partner which accounts for 14 per cent of total outstanding accounts receivable at December 31, 2018. 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 December 31, 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. At December 31, 2018 $1.1 million of accounts receivable are past due with all amounts collectable.

16. CAPITAL MANAGEMENT

Gear's capital management objective is to maintain a structure that will allow it to:

- Fund its development and exploration program;
- Provide financial flexibility to execute on strategic opportunities; and
- Weather periods of low commodity prices in light of changes in economic conditions.

Gear considers its capital structure to include shareholders' equity and net debt, which includes debt, convertible debentures, and working capital. As at December 31, these amounts are as follows:

($ thousands)	**December 31, 2018**	December 31, 2017
Debt	**78,461**	41,345
Convertible debentures (at face value) (1)	**13,315**	13,698
Working capital surplus (2)	**(4,340)**	(11,774)
Risk management contracts (3)	**4,472**	-
Net debt	**91,908**	43,269
Shareholders' equity	**187,927**	155,930
Total capital	**279,835**	199,199

(1) Excludes unamortized portion of issuance costs.
(2) Excludes risk management contracts and current portion of decommissioning liabilities.
(3) Risk management contracts assumed in the Steppe Acquisition.

Gear's objective is to limit net debt at two times cash flows from operating activities excluding settlement of decommissioning liabilities and changes in non-cash working capital. At certain times, this ratio may be exceeded as a result of strategic acquisitions or low commodity prices. Gear manages its capital structure and adjusts it in response to changes in economic conditions and the risk characteristics of its underlying assets. This is achieved by issuing new shares or adjusting its net debt position through the management of capital expenditures. For 2018, Gear's net debt to cash flows from operating activities excluding decommissioning liabilities settled and change in non-cash working capital is 2.6 (2017 - 1.0).

In addition to internal capital management, Gear's Credit Facilities contain a financial covenant to maintain an adjusted working capital ratio of not less than 1.0:1 as outlined in Note 9. As at December 31, 2018, Gear was in compliance with this financial covenant with an adjusted working capital ratio of 3.7.

There has been no change in Gear's capital management objectives during the year ended December 31, 2018.

17. 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)	**Year ended December 31, 2018**	Year ended December 31, 2017
Heavy oil	**72,102**	68,581
Light and medium oil	**31,961**	26,824
Natural gas liquids	**3,055**	2,596
Natural gas	**2,198**	4,550
Total sales of crude oil, natural gas and natural gas liquids	**109,316**	102,551

18. SUPPLEMENTAL DISCLOSURES CASH FLOW INFORMATION

Cash Flow Statement Presentation
The following table provides a detailed breakdown of the changes in non-cash working capital:

($ thousands)	**Year ended December 31, 2018**	Year ended December 31, 2017
Accounts receivable	**12,009**	(3,711)
Prepaid expenses	**287**	(88)
Inventory	**778**	(1,080)
Accounts payable and accrued liabilities	**(4,062)**	1,797
Total	**9,012**	(3,082)
Operating Activities	**9,315**	(4,205)
Investing Activities	**(303)**	1,123
Total	**9,012**	(3,082)

19. COMMITMENTS AND CONTINGENCIES

The following is a summary of Gear's contractual obligations and commitments as at December 31, 2018:

	Payments due by period		
($ thousands)	2019	2020	Total
Office leases	378	152	530
Drilling commitment	976	1,939	2,915
Total contractual obligations	1,354	2,091	3,445

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.

20. RELATED PARTY TRANSACTIONS

Key Management Personnel Compensation
Gear has determined that the key management personnel of the Company consists of its officers and directors. In addition to the salaries paid to officers and fees paid to directors, Gear also provides compensation through participation in Gear's stock option plan. The compensation included in general and administrative expenses relating to key management personnel for the year was $1.8 million (2017 - $1.9 million).