GEAR ENERGY

Monthly Update

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FROM THE DESK OF DAVID HWANG, VP FINANCE & CFO

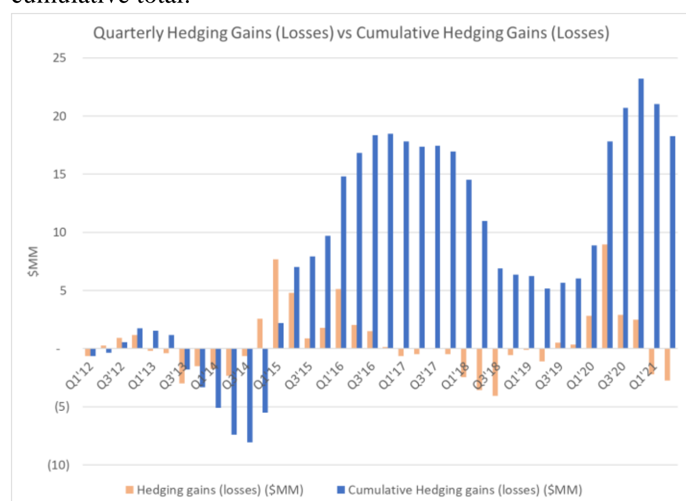
Gear is pleased to provide the following key operational and financial information for investors:

	Q2 20	Q3 20	Q4 20	2020	Q1 21	Apr-21	May-21	Jun-21	Q2 21	2021 TD
WTI Benchmark Price ($US/bbl)	27.85	40.93	42.66	39.40	57.84	61.70	65.16	71.35	66.07	61.96
WCS Heavy Oil Differential ($US/bbl)	(11.47)	(9.09)	(9.31)	(12.60)	(12.47)	(11.19)	(10.38)	(12.89)	(11.49)	(11.98)
MSW Light Oil Differential (US$/bbl)	(6.14)	(3.51)	(4.07)	(5.33)	(5.24)	(2.34)	(3.11)	(3.89)	(3.11)	(4.18)
Funds from Operations ($MM)	8.1	10.8	8.3	33.4	8.3	3.7	4.5	4.1	12.2	20.5
Capital and Abandonment Expenditures ($MM)	0.3	0.8	0.5	13.4	8.3	0.5	2.4	3.1	6.0	14.3
Net Debt ($MM)	70.2	60.5	52.9	52.9	42.9	36.5	34.4	33.4	33.4	33.4
Production (boe/d)	2,749	5,867	5,821	5,298	5,335	5,534	5,439	5,348	5,440	5,388

Note: All items are based on estimates; actuals will vary from estimates due to accruals and adjustments. Such variances may be material.

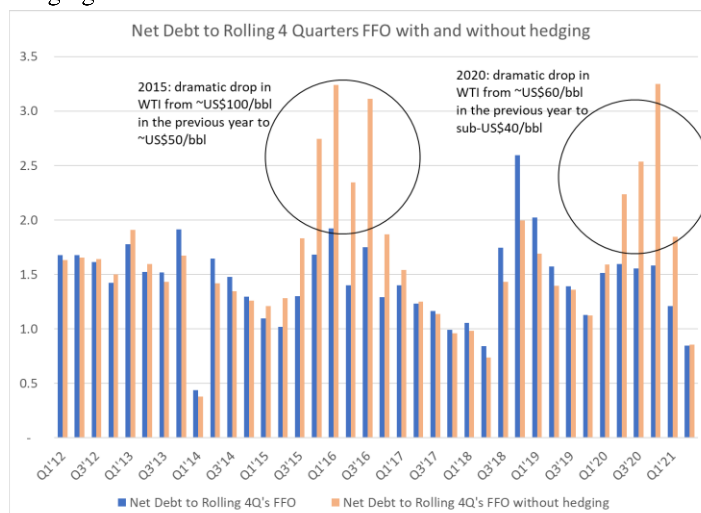
At Gear, we have an exceptional team with diverse skills and backgrounds. Every single talented member of the team is focused on both creating value for our shareholders and on providing energy we all depend on for our everyday needs. David Hwang, our VP Finance and CFO, will be providing some colour on how Gear manages price risk through hedging.

First some history: Gear started managing its price risk exposure in 2012 and has, on average, hedged approximately half of its production throughout the years. Those actions have resulted in a cumulative hedging gain of $18.3 million to June 30, 2021. The following shows the quarterly gains and losses along with a running cumulative total:



What is the key objective when it comes to managing price risk? The answer differs depending on who you ask. For some companies, protecting the economics of a capital drilling program is the primary objective. For others, ensuring that a dividend can be sustained drives the hedging program. And some may answer that hedging is purely a speculative activity with success and failures measured by gains and losses, respectively.

At Gear, the hedging program's purpose is to ensure that the company can survive price shocks to its balance sheet by targeting the ratio of net debt to funds from operations ("FFO") to remain below two times. Here's a look at Gear's net debt to rolling four quarters FFO from 2012 onwards with and without the impacts of hedging:



Without the hedging program, Gear would have experienced material jumps in its leverage metric. In fact, over this long history there is only one quarter where Gear exceeded its net debt to FFO target – Q4 2018. In that quarter, heavy oil differentials widened dramatically with the WCS differential averaging almost US$40 per barrel.

In order to insulate the balance sheet from price shocks, Gear has employed a variety of hedging structures ranging from swaps (a fixed price), enhanced swaps, collars (a floor price and a capped ceiling price), three-way collars, bought puts (a floor price), and put spreads. Why the use of various hedges? Two reasons: firstly, Gear analyzes the value proposition of every hedge. At certain times, the market may value one instrument more than another because of supply and demand and also because of a bias towards one factor within an option value. Secondly, and more importantly, Gear looks at the risk contained within the balance sheet – specifically, how much debt does Gear have? High debt levels mean that Gear is more sensitive to movements in commodity prices when it comes to net debt to FFO. In that situation, Gear may be more inclined to enter into fixed price swaps which provide a greater certainty to FFO generation. Low debt levels mean the opposite: Gear can employ hedges that provide less certainty to FFO generation but allow it to capture more commodity price upside (collars, three-way collars, bought puts, and put spreads).

For Gear's 2021 hedging program (much of which was established in 2020), there will be some hedging losses which will be greatly exceeded by some much larger gains through stronger FFO as a result of higher realized prices. In particular, the second half of 2021 will have 800 bbl/d capped at a WTI price of C$71/bbl, 800 bbl/d at C$74/bbl, and 400 bbl/d at C$83/bbl. However, looking forward to 2022 as net debt approaches very low levels, Gear will be entering into hedges that provide less price certainty but will allow Gear to generate strong FFO unencumbered by hedging losses should WTI continue to strengthen.