

**HILLCREST PETROLEUM LTD.**

(formerly Hillcrest Resources Ltd.)

**Condensed Interim Consolidated Financial Statements**

**For the Three Month Period Ended March 31, 2015**

(Unaudited - Expressed in Canadian Dollars)

## **NOTICE TO READER**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed interim consolidated financial statements have been prepared by and are the responsibility of the management.

The Company's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

**HILLCREST PETROLEUM LTD.**

(formerly Hillcrest Resources Ltd.)

**Condensed Interim Consolidated Statements of Financial Position**

(Unaudited - Expressed in Canadian dollars)

|   | <b>March 31,</b>  | December 31,      |
|---|-------------------|-------------------|
|   | <b>2015</b>       | 2014              |
|   | <b>(\$)</b>       | (\$)              |
| <b>ASSETS</b>   |                   |                   |
| Current assets  |                   |                   |
| Cash  | 268,436           | 619,317           |
| Accounts receivable                                   | 432,298           | 480,890           |
| Government remittances recoverable                    | 20,215            | 12,004            |
| Prepaid expenses                                      | 180,588           | 249,035           |
| Restricted Cash (note 9)                              | 2,536,601         | 2,320,201         |
| Total current assets                                  | 3,438,138         | 3,681,447         |
| Non-current assets                                    |                   |                   |
| Deferred financing costs                              | 31,896            | 63,792            |
| Exploration and evaluation assets (note 4)            | 1,417,879         | 1,417,260         |
| Property and equipment (note 3)                       | 14,629,143        | 15,333,497        |
| <b>TOTAL ASSETS</b>                                   | <b>19,517,056</b> | <b>20,495,996</b> |
| <b>LIABILITIES</b>                                    |                   |                   |
| Current liabilities                                   |                   |                   |
| Accounts payable and accrued liabilities (note 6)     | 3,195,859         | 3,015,457         |
| Secured loan (note 7)                                 | 958,500           | 1,000,000         |
| Current portion of decommissioning liability (note 9) | 1,041,978         | 898,053           |
| Unsecured loan (note 8)                               | 37,470            | 45,498            |
| Total current liabilities                             | 5,233,807         | 4,959,008         |
| Decommissioning liability (note 9)                    | 13,421,303        | 13,418,575        |
| <b>TOTAL LIABILITIES</b>                              | <b>18,655,110</b> | <b>18,377,583</b> |
| <b>SHAREHOLDERS' EQUITY</b>                           |                   |                   |
| Share capital (note 10)                               | 5,708,384         | 5,707,184         |
| Share subscription receivable                         | -                 | (46,000)          |
| Contributed surplus                                   | 949,834           | 949,834           |
| Warrant reserve                                       | 30,620            | 30,620            |
| Foreign currency translation reserve                  | 50,739            | (34,127)          |
| Deficit   | (5,877,631)       | (4,489,098)       |
|   | 861,946           | 2,118,413         |
| <b>TOTAL LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>   | <b>19,517,056</b> | <b>20,495,996</b> |

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on May 29, 2015. They were signed on the Board's behalf by:

"Don Currie"

Director

"Thomas Milne"

Director

The accompanying notes are an integral part of these condensed interim consolidated financial statements

**HILLCREST PETROLEUM LTD.**

(formerly Hillcrest Resources Ltd.)

**Condensed Interim Consolidated Statements Loss and Comprehensive Loss**

(Unaudited - Expressed in Canadian dollars)

|   | Three Month Period Ended |            |
|---|--------------------------|------------|
|   | March 31,                |            |
|   | 2015                     | 2014       |
|   | (\$)                     | (\$)       |
| <b>Revenue</b>  | <b>977,698</b>           | 129,233    |
| <b>Expenses</b>   |                          |            |
| Operating costs   | 509,833                  | 50,224     |
| Accretion (note 9)  | 116,648                  | 1,311      |
| Bank charges and interest                                     | 2,836                    | 947        |
| Consulting fees (note 11)                                     | 156,263                  | 79,749     |
| Debt issue cost   | 38,146                   | 31,896     |
| Depletion and depreciation (note 3)                           | 949,272                  | 36,513     |
| Filing and transfer agent fees                                | 9,711                    | 8,789      |
| Investor relations and business development                   | 61,522                   | 40,746     |
| Office and general  | 104,017                  | 6,650      |
| Professional fees   | 60,536                   | 9,000      |
| Rent  | 56,989                   | 2,317      |
| Stock-based compensation                                      | -                        | 4,044      |
| Travel  | 8,182                    | 9,087      |
| Wages and benefits  | 241,555                  | -          |
|   | <b>2,315,510</b>         | 281,273    |
| <b>Loss before other items</b>                                | <b>(1,337,812)</b>       | (152,040)  |
| <b>Other items</b>  |                          |            |
| Interest expense on secured loan (note 7)                     | (48,981)                 | (37,500)   |
| Interest expense on unsecured loan (note 8)                   | (972)                    | -          |
| Overriding royalty interest on secured loan (note 7)          | (8,768)                  | -          |
| Loss on disposal of oil and gas properties                    | -                        | -          |
| Loss on disposal of exploration and evaluation assets         | -                        | (87,897)   |
| Foreign exchange gain   | 8,000                    | 11,750     |
| <b>Net loss for the period</b>                                | <b>(1,388,533)</b>       | (265,687)  |
| <b>Item that may be subsequently reclassified to net loss</b> |                          |            |
| Exchange differences on translating foreign operations        | 84,866                   | -          |
| <b>Comprehensive loss for the period</b>                      | <b>(1,303,667)</b>       | (265,687)  |
| <b>Basic and diluted loss per share</b>                       | <b>(0.03)</b>            | (0.01)     |
| <b>Weighted average common shares outstanding:</b>            |                          |            |
| Basic   | 50,295,655               | 39,570,655 |
| Diluted   | 50,295,655               | 39,570,655 |

The accompanying notes are an integral part of these condensed interim consolidated financial statements

**HILLCREST PETROLEUM LTD.**

(formerly Hillcrest Resources Ltd.)

**Condensed Interim Consolidated Statements of Changes in Shareholders' Equity**

(Unaudited - Expressed in Canadian dollars)

|   | Share Capital       |                  | Share<br>Subscription<br>Receivable | Contributed<br>Surplus | Warrant<br>Reserve | Foreign Currency<br>Translation<br>Reserve | Deficit            | Shareholders'<br>Equity |
|---|---------------------|------------------|-------------------------------------|------------------------|--------------------|--|--------------------|-------------------------|
|   | Number of<br>Shares | Amount           |                                     |                        |                    |  |                    |                         |
|   |                     | (\$)             | (\$)                                | (\$)                   | (\$)               | (\$)                                       | (\$)               | (\$)                    |
| <b>Balance, December 31, 2013</b>                   | <b>39,570,655</b>   | <b>5,182,619</b> | -                                   | <b>926,289</b>         | <b>40,843</b>      | -  | <b>3,305,126</b>   | <b>2,844,625</b>        |
| Stock-based compensation                            | -                   | -                | -                                   | 4,044                  | -                  | -  | -                  | 4,044                   |
| Transfer of contributed surplus on expired warrants | -                   | -                | -                                   | 16,892                 | (16,892)           | -  | -                  | -                       |
| Net loss for the period                             | -                   | -                | -                                   | -                      | -                  | -  | (265,687)          | (265,687)               |
| <b>Balance, March 31, 2014</b>                      | <b>39,570,655</b>   | <b>5,182,619</b> | -                                   | <b>947,225</b>         | <b>23,951</b>      | -  | <b>(3,570,813)</b> | <b>2,582,982</b>        |
| Issued for cash pursuant to private placements      | 10,625,000          | 531,250          | (46,000)                            | -                      | -                  | -  | -                  | 485,250                 |
| Issued for cash pursuant to the exercise of options | 100,000             | 6,000            | -                                   | -                      | -                  | -  | -                  | 6,000                   |
| Share issuance costs and finder's fee               | -                   | (17,811)         | -                                   | -                      | 6,669              | -  | -                  | (11,142)                |
| Stock-based compensation                            | -                   | -                | -                                   | 7,735                  | -                  | -  | -                  | 7,735                   |
| Transfer share capital on exercise options          | -                   | 5,126            | -                                   | (5,126)                | -                  | -  | -                  | -                       |
| Currency translation adjustment                     | -                   | -                | -                                   | -                      | -                  | (34,127)                                   | -                  | (34,127)                |
| Net loss for the period                             | -                   | -                | -                                   | -                      | -                  | -  | (918,285)          | (918,285)               |
| <b>Balance, December 31, 2014</b>                   | <b>50,295,655</b>   | <b>5,707,184</b> | <b>(46,000)</b>                     | <b>949,834</b>         | <b>30,620</b>      | <b>(34,127)</b>                            | <b>(4,489,098)</b> | <b>2,118,413</b>        |
| Stock-based compensation                            | -                   | -                | -                                   | -                      | -                  | -  | -                  | -                       |
| Cash received from share subscription               | -                   | -                | 46,000                              | -                      | -                  | -  | -                  | 46,000                  |
| Currency translation adjustment                     | -                   | -                | -                                   | -                      | -                  | 84,866                                     | -                  | 84,866                  |
| Share issuance costs and finder's fee               | -                   | 1,200            | -                                   | -                      | -                  | -  | -                  | 1,200                   |
| Net loss for the period                             | -                   | -                | -                                   | -                      | -                  | -  | (1,388,533)        | (1,388,533)             |
| <b>Balance, March 31, 2015</b>                      | <b>50,295,655</b>   | <b>5,708,384</b> | -                                   | <b>949,834</b>         | <b>30,620</b>      | <b>50,739</b>                              | <b>(5,877,631)</b> | <b>861,946</b>          |

The accompanying notes are an integral part of these condensed interim consolidated financial statements

**HILLCREST PETROLEUM LTD.**

(formerly Hillcrest Resources Ltd.)

**Condensed Interim Consolidated Statements of Cash Flows**

(Unaudited - Expressed in Canadian dollars)

|  | <b>Three Month Period Ended</b> |             |
|--|---------------------------------|-------------|
|  | <b>March 31,</b>                |             |
|  | <b>2015</b>                     | <b>2014</b> |
|  | <b>(\$)</b>                     | <b>(\$)</b> |
| <b>Cash flows provided by (used in) operating activities</b>                     |                                 |             |
| Net loss for the period  | <b>(1,388,533)</b>              | (265,687)   |
| Adjusted for items not involving cash:   |                                 |             |
| Accretion  | <b>116,648</b>                  | 1,311       |
| Debt issue costs   | <b>31,896</b>                   | 31,896      |
| Depletion and depreciation   | <b>948,446</b>                  | 36,513      |
| Loss on disposal of exploration and evaluation assets                            | -                               | 37,897      |
| Stock-based compensation   | -                               | 4,044       |
| Accrued interest expense   | <b>972</b>                      | -           |
| Changes in non-cash working capital:   |                                 |             |
| Accounts receivable  | <b>48,592</b>                   | (1,230)     |
| Government remittances recoverable   | <b>(8,211)</b>                  | (5,541)     |
| Prepaid expenses   | <b>68,447</b>                   | (14,555)    |
| Accounts payable and accrued liabilities   | <b>181,602</b>                  | 36,215      |
|  | <b>(141)</b>                    | (139,137)   |
| <b>Cash flows provided by (used in) investing activities</b>                     |                                 |             |
| Sale proceeds of exploration and evaluation assets                               | -                               | 653,687     |
| Oil and gas property expenditures  | <b>(162,957)</b>                | (58,618)    |
| Exploration and evaluation expenditures  | <b>(619)</b>                    | (534,991)   |
|  | <b>(163,576)</b>                | 60,078      |
| <b>Cash flows provided by (used in) financing activities</b>                     |                                 |             |
| Deferred financing costs   | -                               | (231,217)   |
| Payment of decommissioning liability   | <b>(51,956)</b>                 | -           |
| Proceeds from share subscriptions  | <b>46,000</b>                   | -           |
| Secured loan proceeds (repayment)  | <b>(41,500)</b>                 | 1,000,000   |
| Unsecured loan repayment   | <b>(9,000)</b>                  | -           |
|  | <b>(56,456)</b>                 | 768,783     |
| <b>Change in cash</b>  | <b>(220,173)</b>                | 689,724     |
| <b>Effect of exchange rate changes on cash denominated in a foreign currency</b> | <b>(131,534)</b>                | -           |
| <b>Cash, beginning of the period</b>   | <b>619,317</b>                  | 17,124      |
| <b>Cash, end of the period</b>   | <b>267,610</b>                  | 706,848     |

Supplemental Disclosure of Cash Flow Information (note 16)

The accompanying notes are an integral part of these condensed interim consolidated financial statements

## **Hillcrest Petroleum Ltd.**

*(formerly Hillcrest Resources Ltd.)*

Notes to the Condensed Interim Consolidated Financial Statements

For the Three Month Period Ended March 31, 2015

(Unaudited - Expressed in Canadian dollars)

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### **1. Nature of Operations and Going Concern**

Hillcrest Petroleum Ltd. (the "Company") was incorporated on May 2, 2006 under the Business Corporations Act of British Columbia, and is in the business of acquiring, exploring and developing exploration interests in oil and gas projects in the United States of America. Effective March 10, 2015, the Company changed its name from Hillcrest Resources Ltd. to Hillcrest Petroleum Ltd. The Company's registered office is suite 1700 – 3050 Post Oak Blvd, Houston, Texas 77056.

The Company is subject to several categories of risk associated with the exploration and development of oil and gas resources. Oil and gas exploration and production is a speculative business, and involves a high degree of risk. Among the factors that have a direct bearing on the Company's prospects are uncertainties inherent in estimating oil and gas reserves, future hydrocarbon production, and cash flows, particularly with respect to wells that have not been fully tested and with wells having limited production histories; access to additional capital; changes in the price of oil and gas; availability and cost of services and equipment; and the presence of competitors with greater financial resources and capacity.

These condensed interim consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company incurred a net loss of \$1,388,533 and had a working capital deficiency of \$1,795,669 during and as at the three month period ended March 31, 2015. The Company's ability to meet its obligations as they fall due and to continue to operate as a going concern is dependent on the continued financial support of the creditors and the shareholders and ultimately, the attainment of profitable operations. There is no certainty that the Company will continue to produce revenue due to the inherent production risks associated with the oil and natural gas industry. In the past, the Company has relied on sales of equity securities, debt instruments and asset sales to meet its cash requirements. There can be no assurance that funding from this or other sources will be sufficient in the future to satisfy operational requirements and cash commitments. Even if the Company is able to obtain new financing, it may not be on commercially reasonable terms or terms that are acceptable to it. Failure to obtain such financing on a timely basis could cause the Company to reduce or terminate its operations. Due to the uncertainties as noted above, there is significant doubt regarding the Company's ability to continue as a going concern. These condensed interim consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

### **2. Basis of Preparation**

These condensed interim consolidated financial statements, including comparatives, have been prepared in accordance with International Accounts Standards ("IAS") 34, "Condensed Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

As these are condensed interim consolidated financial statements, they do not include all the information required under IFRS for annual consolidated financial statements. Accordingly, the condensed interim consolidated financial statements should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2014.

**Hillcrest Petroleum Ltd.***(formerly Hillcrest Resources Ltd.)*

Notes to the Condensed Interim Consolidated Financial Statements

For the Three Month Period Ended March 31, 2015

(Unaudited - Expressed in Canadian dollars)

**2. Basis of Preparation (continued)**

These condensed interim consolidated financial statements have been approved by the Company's Board of Directors on May 29, 2015.

**3. Property and Equipment**

|   | <b>Computer</b> | <b>Oil and Gas</b> | <b>Total</b>      |
|---|-----------------|--------------------|-------------------|
|   | <b>(\$)</b>     | <b>Interests</b>   | <b>(\$)</b>       |
|   |                 | <b>(\$)</b>        | <b>(\$)</b>       |
| <b>Cost</b>                                   |                 |                    |                   |
| At December 31, 2013                          | 13,520          | 1,694,668          | 1,708,188         |
| Additions                                     | 4,821           | 15,115,985         | 15,120,806        |
| Disposals                                     | -               | (235,925)          | (235,925)         |
| At December 31, 2014                          | 18,341          | 16,574,728         | 16,593,069        |
| Additions                                     | -               | 244,918            | 244,918           |
| <b>At March 31, 2015</b>                      | <b>18,341</b>   | <b>16,819,646</b>  | <b>16,837,987</b> |
| <b>Accumulated depletion and depreciation</b> |                 |                    |                   |
| At December 31, 2013                          | 13,155          | 593,508            | 606,663           |
| Depletion and depreciation for the year       | 188             | 696,391            | 696,579           |
| Disposals                                     | -               | (43,670)           | (43,670)          |
| At December 31, 2014                          | 13,343          | 1,246,229          | 1,259,572         |
| Depletion and depreciation for the period     | 826             | 948,446            | 949,272           |
| <b>At March 31, 2015</b>                      | <b>14,169</b>   | <b>2,194,675</b>   | <b>2,208,844</b>  |
| <b>Carrying amounts</b>                       |                 |                    |                   |
| At December 31, 2013                          | 365             | 1,101,160          | 1,101,525         |
| At December 31, 2014                          | 4,998           | 15,328,499         | 15,333,497        |
| <b>At March 31, 2015</b>                      | <b>4,172</b>    | <b>14,624,971</b>  | <b>14,629,143</b> |

**Gulf of Mexico Properties**

On December 19, 2014, the Company completed the purchase of Gulfsands Petroleum USA Inc. ("GPUSA"), which was subsequently renamed Hillcrest GOM Inc. ("HGOM"), and is now a wholly owned subsidiary of the Company. HGOM holds a portfolio of non-operated oil and gas properties, which are located in the Gulf of Mexico, within the shallow water "shelf" region offshore Louisiana. These comprise 7 leases containing 5 producing fields. Working interests in these leases range from approximately 4% to 26.3%. With the acquisition, the Company assumed its share of the forward decommissioning liability for the facilities and wells. The decommissioning liability is a mix of relatively near term to longer term obligations that largely occur at the end of productive field life (Note 9).



## Hillcrest Petroleum Ltd.

(formerly Hillcrest Resources Ltd.)

Notes to the Condensed Interim Consolidated Financial Statements

For the Three Month Period Ended March 31, 2015

(Unaudited - Expressed in Canadian dollars)

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### 3. Property and Equipment (continued)

#### Hartburg Project, Newton County, Texas

By agreement dated December 8, 2009, the Company entered into an Assignment and Assumption Agreement for the assignment of a 60% working interest in certain land leases known as the Hartburg Project in Newton County, Texas. In consideration the Company paid a lump sum of \$117,040 (US\$111,266). The Company is responsible for their proportionate share of all future costs of the development of the property.

On March 27, 2009, Barry Lasker ("Lasker") and Delta Oil and Gas, Inc. ("Delta") entered into an exploration agreement (the "Exploration Agreement"). Pursuant to the terms of the Exploration Agreement, Lasker agreed to identify and secure leases which would subsequently be assigned to Delta and pursuant to the terms of such agreement, Delta agreed to pay 100% of the lease acquisition costs and operating costs of up to three wells. In exchange for Lasker's performance under the Exploration Agreement, Lasker obtained a 10% carried interest in the first target well, Donner #1, and a 20% carried interest in the second and third target wells, Prospect 1 (Donner #2) and Prospect 2 (Donner #4), respectively, until payout in each of the wells. Upon payout, Lasker's carried interest converted to a 50% working interest in Donner #1 and a 40% working interest in each of Prospect 1 and Prospect 2.

In August 2009, Donald Currie in his personal capacity and not in his capacity as an officer or director of the Company, entered into an oral agreement with Lasker which is evidenced by a written agreement dated January 10, 2010 to acquire 50% of all of Lasker's right, title and interest in and to the Exploration Agreement.

On December 30, 2010, Delta entered into an agreement (the "HRI Assignment") with the Company to assign 60% of all of Delta's right, title and interest in and to the Exploration Agreement.

During March 2014, the Donner 4 well was completed and placed into production. This well is part of the Hartburg Project and is located 500 feet southwest of the Company's Donner #1 well.

On February 24, 2014, the Company commenced drilling of the Brown 1 well in the Hartburg project. The well was completed and placed into production on April 9, 2014.

A total 4 wells have been completed thus far with the following net revenue interests to the Company:

| Well      | Before Payout | After Payout |
|-----------|---------------|--------------|
| Donner #1 | 40.5%         | 22.5%        |
| Donner #2 | 36.0%         | 27.0%        |
| Donner #4 | 36.0%         | 27.0%        |
| Brown #1  | 67.5%         | 37.5%        |

**Hillcrest Petroleum Ltd.***(formerly Hillcrest Resources Ltd.)*

Notes to the Condensed Interim Consolidated Financial Statements

For the Three Month Period Ended March 31, 2015

(Unaudited - Expressed in Canadian dollars)

**4. Exploration and Evaluation Assets**

|                                      | <b>Muddy<br/>Creek</b> | <b>Woodrow</b> | <b>Donner 4</b> | <b>Donner<br/>Prospect -<br/>78 acres</b> | <b>Total</b> |
|--------------------------------------|------------------------|----------------|-----------------|---|--------------|
|                                      | <b>(\$)</b>            | <b>(\$)</b>    | <b>(\$)</b>     | <b>(\$)</b>                               | <b>(\$)</b>  |
| Balance at December 31, 2013         | 481,100                | 897,493        | 250,087         | 297,272                                   | 1,925,952    |
| Reclassified to oil & gas properties | -                      | -              | (979,862)       | -   | (979,862)    |
| Additions                            | -                      | -              | 729,775         | 103,848                                   | 833,623      |
| Disposals                            | (135,394)              | (227,059)      | -               | -   | (362,453)    |
| Balance at December 31, 2014         | 345,706                | 670,434        | -               | 401,120                                   | 1,417,260    |
| Additions                            | -                      | -              | -               | 619                                       | 619          |
| Balance at March 31, 2015            | 345,706                | 670,434        | -               | 401,739                                   | 1,417,879    |

**Montana Project with Longshot Oil, LLC - Muddy Creek**

On September 26, 2011, the Company entered into a purchase and sale agreement with Longshot Oil, LLC, a private company that shared management and shareholders in common with Bakken Oil Holdings, for the acquisition of certain oil and gas properties in Teton County, Montana. The Company will issue 1,000,000 common shares of the Company (issued) at a fair value of \$0.25 per share and pay \$400,000 in cash (paid).

On September 2, 2013, the Company entered into a Letter of Intent with Nelan Advisors Corporation ("Nelan") pursuant to which Nelan has the right to farm in to a 50% working interest in the Company's oil and gas interests and related rights to the oil and gas leases in Montana. Pursuant to the Letter of Intent, the Company received an aggregate of US\$400,000 as consideration for the farm in. A non-refundable deposit of \$52,460 (US\$50,000) was received on September 4, 2013. On October 15, 2013, the Company signed a purchase and sale agreement with Nelan Advisors Corporation, at which time a further \$51,770 (US\$50,000) was paid to the Company. Remaining cash due to the Company was received in three installments at 60 day intervals following the signing of the Definitive Agreement. \$106,082 (US\$100,000) was received on December 16, 2013, \$110,170 (US\$100,000) was received on February 21, 2014, and \$109,770 (US\$100,000) was received on April 15, 2014. During the year ended December 31, 2014, the Company recognized a gain on sale of working interest of \$84,546.

**Montana Project with Bakken Oil Holdings LLC - Woodrow**

On November 30, 2011 the Company entered into a purchase and sale agreement with Bakken Oil Holdings, LLC to acquire certain oil and gas properties in Teton and Pondera Counties, Montana comprising approximately 12,333 acres. As consideration, the Company agreed to issue 4,000,000 warrants exercisable at \$0.20 per share for a period of 24 months and pay \$1,000,000 in cash (\$365,000 paid). During August 2012, the Company signed an agreement, whereby Bakken forgave the remaining amount owing in return for the Tulla property. The agreement also cancelled the requirement for the Company to issue 4,000,000 warrants at a price of \$0.20 per share.

## Hillcrest Petroleum Ltd.

(formerly Hillcrest Resources Ltd.)

Notes to the Condensed Interim Consolidated Financial Statements

For the Three Month Period Ended March 31, 2015

(Unaudited - Expressed in Canadian dollars)

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### 4. Exploration and Evaluation Assets (continued)

On August 14, 2013, the Company signed a definitive agreement with West Bakken Holdings Ltd giving them the right to farm in to the working interest of the Company. The agreement, when completed, includes 50% in the oil and gas interests, and properties and related rights and interests to the oil and gas leases in Montana, comprising 12,333 gross acres in Teton and Pondera counties. Pursuant to the agreement, the Company received a total of US\$550,000 as consideration for the farm in. A non-refundable deposit of \$52,550 (US\$50,000) was received on July 3, 2013, \$129,238 (US\$125,000) was received on August 16, 2013, and \$129,175 (US\$125,000) was received on October 16, 2013 and \$132,413 (US\$125,000) was received on December 11, 2013. The final \$139,163 (US\$125,000) was received on February 21, 2014. During the year ended December 31, 2014, the Company recognized a loss on sale of working interest of \$87,897.

#### Donner Prospect – 78 acres, Newton County

On August 1, 2013, Bazmo Exploration Inc., (“Bazmo”) and the Company entered into an exploration agreement (the “Exploration Agreement”) for US\$92,746. Pursuant to the terms of the Exploration Agreement, Bazmo agreed to identify and secure leases which would subsequently be assigned to the Company and pursuant to the terms of such agreement, the Company agreed to pay 100% of the lease acquisition costs and operating costs of all wells drilled. In exchange for Bazmo’s performance under the Exploration Agreement, Bazmo obtained a 10% carried interest in all target wells, until payout in each of the wells. Upon payout, Bazmo’s carried interest will convert to a 50% working interest in all target wells.

### 5. Acquisition

On December 19, 2014, the Company completed a Share Purchase Agreement (the “SPA”) to acquire all of the issued and outstanding common shares of Hillcrest GOM Inc., (formerly Gulfsands Petroleum USA) in consideration of \$58,195 (US\$50,000). HGOM holds a portfolio of non-operated oil and gas properties, which are located in the Gulf of Mexico, within the shallow water “shelf” region offshore Louisiana.

The acquisition has been accounted for as a business combination, with the Company being the acquirer for accounting purposes. The assets acquired and liabilities assumed from HGOM are as follows:

|  | <u>Amount</u>       |
|--|---------------------|
|  | (\$)                |
| Cash                                     | 487,741             |
| Restricted cash                          | 2,321,601           |
| Accounts receivable                      | 827,015             |
| Prepaid expenses                         | 213,177             |
| Oil and gas properties                   | 13,325,092          |
| Equipment                                | 4,824               |
| Accounts payable and accrued liabilities | (3,040,683)         |
| Abandonment reserve                      | <u>(14,206,168)</u> |
| Net assets acquired                      | <u>67,401</u>       |

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### **5. Acquisition (continued)**

The difference between the purchase consideration and the book values of HGOM's net assets has been assigned to oil and gas properties. In connection with the acquisition, the Company incurred acquisition costs of \$15,769, which have been expensed and included in net loss.

### **6. Accounts Payable and Accrued Liabilities**

Included in accounts payable and accrued liabilities are:

- a. Civil penalties of \$382,833 (US\$330,000) – The Office of Natural Resource Revenue (ONRR) assessed a civil penalty for failure to timely file corrections to monthly reports for plant products sold during the period 2007-2008. Subsequent to the year ended December 31, 2014, the Company entered into an Installment Agreement with ONRR for payment of the remaining balance (Note XX).
- b. Provision for repair of an oil rig of \$1,450,125 (US\$1,250,000) – The Company has accrued US\$1,250,000 for costs and expenses related to the operation of certain properties which the operator has billed but are disputed by the Company and the other partners. The Company is currently in settlement discussions with the operator to resolve the disputed charges.

### **7. Secured Loan**

On July 19, 2013, the Company closed its initial draw of \$1,000,000 (the "Initial Draw") pursuant to a senior secured loan facility of up to \$2,000,000 arranged with Ascendant Securities Inc. ("ASI") on behalf of a group of clients of ASI (the "Lenders"). An additional \$1,000,000 may be drawn at the option of the Company subject to the terms and conditions of a trust indenture between the Company and ASI. In connection with the Initial Draw, the Company has issued senior secured debentures of the Company (the "Debentures") in an aggregate principal amount of \$1,000,000. The Debentures will bear interest at a rate of 15% per annum, compounded monthly. The principal amount of the Debentures evidencing the Initial Draw will mature on July 18, 2015.

As part of the consideration for the Loan Facility, the Lenders received an aggregate 6% overriding royalty interest in the Company's proceeds from all oil, gas and other hydrocarbons produced from any new wells developed on the Company's Donner Properties using any portion of the proceeds from the Initial Draw. The Company has paid ASI a cash agent's fee of \$60,000, the first installment of an annual monitoring fee of \$25,000 and a 2% overriding royalty interest on the Company's proceeds from all oil, gas and other hydrocarbons produced from any well, for acting as collateral agent. The Company also issued an aggregate of 1,200,000 Agent Warrants. The Agent Warrants entitle the holder thereof to purchase up to 1,200,000 common shares of the Company at a price of \$0.10 per share until July 18, 2015.

On September 9, 2014, the Company amended the senior secured loan terms such that if the principal payments were not paid, then the Company would pay \$4,000 plus 15% interest on the outstanding principal, and the overriding royalty interest will be increased to 10% of the net revenue interest received by the Company on its Brown #1 and Donner #4 wells. The Company will also forward the revenue received from Brown #1 and Donner #4 less Joint Interest Billing on these wells on the 19<sup>th</sup> of each month until the Company has paid all past outstanding principal payments. These latter payments will be considered as part payment of the principal amount due.

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### 8. Unsecured Loan

On September 8, 2014, the Company obtained an unsecured loan of \$50,000. The loan carries an interest rate of 10% per annum and payable on maturity. The Company shall pay \$3,000 per month commencing on October 8, 2014 and on the 8<sup>th</sup> day of each month thereafter. The Company may extend the loan agreement for up to an additional three year period. At March 31, 2015, a total of \$37,470 (December 31, 2014 - \$45,498) remained owing on the loan inclusive of accrued interest of \$2,470 (December 31, 2014 - \$1,498).

### 9. Decommissioning Liability

The decommissioning liability for the Gulf of Mexico properties relates to the expected present value of costs of plugging and abandoning the exploration and development assets held by Hillcrest GOM Inc. (formerly Gulfsands Petroleum USA, Inc.) and Darcy Energy LLC. The provision for decommissioning is estimated after taking account of inflation, years to abandonment and an appropriate discount rate. As at March 31, 2015, the oil and gas properties had estimated abandonment dates between 2015 and 2025.

Actual decommissioning costs will ultimately depend upon future market prices for the decommissioning work required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain. The actual amounts paid for decommissioning may ultimately vary significantly from the provision at March 31, 2015, requiring potentially material adjustments to the carrying value of the obligations.

The movement in the provision for the decommissioning liability was as follows:

|                                  | <b>Hartburg<br/>Project, Texas</b> | <b>Gulf of<br/>Mexico<br/>Properties</b> | <b>Total</b> |
|----------------------------------|------------------------------------|--|--------------|
|                                  | <b>(\$)</b>                        | <b>(\$)</b>                              | <b>(\$)</b>  |
| Balance, December 31, 2013       | 51,766                             | -  | 51,766       |
| Additions                        | 47,256                             | -  | 47,256       |
| Assumed upon acquisition of HGOM | -                                  | 14,197,579                               | 14,197,579   |
| Accretion                        | 5,244                              | 14,783                                   | 20,027       |
| Balance, December 31, 2014       | 104,266                            | 14,212,362                               | 14,316,628   |
| Additions                        | -                                  | 30,005                                   | 30,005       |
| Accretion                        | 2,729                              | 113,919                                  | 116,648      |
| Balance, March 31, 2015          | 106,995                            | 14,356,286                               | 14,463,281   |
| Current portion                  | -                                  | 1,041,978                                | 1,041,978    |
| Non-current portion              | 106,995                            | 13,314,308                               | 13,421,303   |
|                                  | 106,995                            | 14,356,286                               | 14,463,281   |

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### **9. Decommissioning Liability (continued)**

The total undiscounted amount of estimated cash flows required to settle the provision for decommissioning liability for the Hartburg Project and the Gulf of Mexico Properties is \$158,743 (US\$125,162) and \$15,848,177 (US\$12,495,606), respectively, as at March 31, 2015. The provision has been estimated using risk-free discount rates ranging from 3% to 12%, and inflation rates ranging from 2.0% to 2.5%.

In addition, the Company had \$2,536,601 (US\$2,000,000) in reclamation bonds held with ACE Wealth Management as at March 31, 2015. These funds will be released to the Company as payment of required plugging and abandonment costs come due on certain well interests held by Hillcrest GOM Inc.

### **10. Share Capital**

#### **Authorized**

Unlimited number of common shares without par value

#### **Issued and outstanding**

During the three month period ended March 31, 2015, the Company did not issue any common shares.

On July 25, 2014, the Company issued 100,000 common shares pursuant to the exercise of 100,000 options at \$0.06 per share for total proceeds of \$6,000.

On December 30, 2014, the Company closed a non-brokered private placement and issued 10,625,000 common shares at \$0.05 per unit for aggregate gross proceeds of \$531,250. Each unit consists of one common share and one-half of one common share purchase warrant, with each full warrant being exercisable to acquire one common share at \$0.08 per share until December 30, 2016. The Company also paid a finders' fee of \$8,000 and issued 160,000 Agent's warrants. The Agent's warrants have an exercise price of \$0.08 per share and are exercisable until December 30, 2015. The Agent's warrants were valued at \$6,669 using the Black Scholes option pricing model with weighted average assumptions of an expected life of one year, dividend yield of 0%, expected volatility of 126%, and risk-free rate of return of 1.02%.

#### **Share Purchase Warrants**

During the three month period ended March 31, 2015, the Company extended the expiry date of 853,111 share purchase warrants to February 28, 2016. Each warrant is exercisable for one common share at \$0.12 per share.

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**10. Share Capital (continued)**

The continuity of the Company's share purchase warrants was as follows:

|  | <b>Number of<br/>Warrants</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> |
|--|-------------------------------|--|
|  |                               | <b>(\$)</b>                                    |
| Balance, December 31, 2013                       | 853,111                       | 0.12   |
| Issued   | 5,312,500                     | 0.08   |
| Balance, December 31, 2014 and<br>March 31, 2015 | <u>6,165,611</u>              | <u>0.09</u>                                    |

The following table summarizes the share purchase warrants outstanding as at March 31, 2015:

| <b>Number of<br/>Options</b> | <b>Exercise<br/>Price</b> | <b>Expiry Date</b> | <b>Weighted Average<br/>Remaining<br/>Contractual Life</b> |
|------------------------------|---------------------------|--------------------|--|
|                              | <b>(\$)</b>               |                    | <b>(yrs)</b>   |
| 853,111                      | 0.12                      | February 28, 2016  | 0.92   |
| 5,312,500                    | 0.08                      | December 30, 2016  | 1.75   |
| <u>6,165,611</u>             | <u>0.08 - 0.12</u>        |                    | <u>1.64</u>  |

On December 30, 2014, the Company issued 5,312,500 share purchase warrants pursuant to private placements. Each warrant is exercisable for one common share at \$0.08 per share until December 30, 2016.

**Agent's Warrants**

The continuity of the Company's Agent's warrants was as follows:

|  | <b>Number of<br/>Warrants</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> |
|--|-------------------------------|--|
|  |                               | <b>(\$)</b>                                    |
| Balance, December 31, 2013                       | 1,311,600                     | 0.11   |
| Issued   | 160,000                       | 0.08   |
| Expired  | <u>(111,600)</u>              | <u>0.18</u>                                    |
| Balance, December 31, 2014 and<br>March 31, 2015 | <u>1,360,000</u>              | <u>0.10</u>                                    |

On December 30, 2014, the Company issued 160,000 Agent's warrants with an exercise price of \$0.08 per share and exercisable until December 30, 2015, pursuant to a non-brokered private placement.

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**10. Share Capital (continued)**

The following table summarizes the Agent's warrants outstanding as at March 31, 2015:

| Number of<br>Options | Exercise<br>Price | Expiry Date       | Weighted Average<br>Remaining<br>Contractual Life |
|----------------------|-------------------|-------------------|---|
|                      | (\$)              |                   | (yrs)   |
| 1,200,000            | 0.10              | July 18, 2015     | 0.30  |
| 160,000              | 0.08              | December 30, 2015 | 0.75  |
| 1,360,000            | 0.08 - 0.10       |                   | 0.35  |

**Stock Options**

Effective November 4, 2010, the Company adopted a stock option plan to grant stock options to its directors, officers, employees and consultants. In accordance with the policies of the TSX Venture Exchange (the "Exchange"), the aggregate number of securities reserved for issuance under the plan, at any point in time, will be 10% of the number of common shares of the Company issued and outstanding at the time the option is granted (on a diluted basis), less any common share reserved for issuance under share options granted under share compensation arrangements other than the plan. The exercise price of option grants will be determined by the Board of Directors, but will not be less than the closing market price of the common shares on the Exchange at the time of grant. All options granted under the plan will expire no later than five years from the date of grant.

The continuity of the Company's stock options was as follows:

|  | Number of<br>Stock<br>Options | Weighted<br>Average<br>Exercise Price |
|--|-------------------------------|---------------------------------------|
|  |                               | (\$)                                  |
| Balance, December 31, 2013                       | 4,600,000                     | 0.12                                  |
| Cancelled  | (1,550,000)                   | 0.15                                  |
| Exercised  | (100,000)                     | 0.06                                  |
| Balance, December 31, 2014<br>and March 31, 2015 | 2,950,000                     | 0.11                                  |



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**10. Share Capital (continued)**

The following table summarizes the stock options outstanding and exercisable as at March 31, 2015:

| <b>Number of<br/>Options<br/>Outstanding</b> | <b>Exercise<br/>Price</b> | <b>Expiry Date</b> | <b>Weighted Average<br/>Remaining<br/>Contractual Life</b> | <b>Number of Options<br/>Outstanding<br/>Exercisable</b> |
|--|---------------------------|--------------------|--|--|
|  | <b>(\$)</b>               |                    | <b>(yrs)</b>   |  |
| 650,000                                      | 0.20                      | March 22, 2016     | 0.98   | 650,000  |
| 250,000                                      | 0.25                      | September 26, 2016 | 1.49   | 250,000  |
| 1,550,000                                    | 0.06                      | September 9, 2018  | 3.45   | 1,550,000  |
| 500,000                                      | 0.06                      | November 26, 2018  | 3.66   | 500,000  |
| <b>2,950,000</b>                             | <b>0.06 – 0.25</b>        |                    | <b>2.77</b>  | <b>2,950,000</b>   |

**11. Related Party Transactions**

The following summarizes the Company's related party transactions during the three month period ended March 31, 2015 and 2014:

|   | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
|   | <b>(\$)</b> | <b>(\$)</b> |
| Consulting fees paid to a Director of the Company | 16,236      | 9,921       |

**Key management compensation**

|   | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
|   | <b>(\$)</b> | <b>(\$)</b> |
| Consulting fees paid or accrued to the CEO of the Company   | 74,949      | 22,500      |
| Professional fees paid to a corporation controlled by the CFO of the Company                          | 5,000       | -           |
| Professional and consulting fees paid to two corporations controlled by the former CFO of the Company | 10,500      | 19,500      |
| Salary paid to the COO of the Company   | 74,400      | -           |

- a) As at March 31 2015, a total of \$29,295 (December 31, 2014 - \$10,618) was included in accounts payable and accrued liabilities owing to the Chief Executive Officer for consulting fees.
- b) These transactions were entered into in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties.

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### 12. Geographical Segmented Information

The Company is engaged in one business activity, being the acquisition, exploration, development and production of oil and gas reserves. The two geographical segments are Canada and United States. All non-current assets, revenue and operating costs are held solely in the United States segment.

### 13. Commitments

The Company entered into a rental agreement on June 3, 2013, with a term of 50 months, terminating on July 31, 2017. The base rent payable under the lease is as follows;

|                                 | <b>Annual Base<br/>Rent</b> |
|---------------------------------|-----------------------------|
|                                 | <b>(US\$)</b>               |
| April 1, 2015 to July 31, 2015  | 31,740                      |
| August 1, 2015 to July 31, 2016 | 98,105                      |
| August 1, 2016 to July 31, 2017 | 101,031                     |
|                                 | <u>230,876</u>              |

In addition to the above base rent, the Company's share of the operating costs for calendar year 2015 is US\$5,306 per month.

On February 12, 2015, the Company entered into an Installment Agreement with the United States Department of the Interior and through the Office of Natural Resources Revenue (ONRR) in connection with civil penalties. The Company agreed to pay the balance of civil penalties of US\$313,176 in 60 monthly installments of US\$5,220 beginning on March 12, 2015. The first three installments have been made and subsequent installment payments will be due on the 12th of each month until the 60th installment of US\$5,220 is paid on February 12, 2020.

### 14. Capital Management

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of oil and gas properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company is primarily dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional funds as needed using best efforts. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient economic potential and if it has adequate available or committed financial resources to complete such acquisitions.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the size of the Company, is reasonable.

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There were no changes in the Company's approach to capital management during the three month period ended March 31, 2015. The Company is not subject to externally imposed capital requirements.

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### **15. Risk Factors**

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

#### **Credit risk**

The Company's credit risk is primarily attributable to cash and accounts receivable. The Company's maximum exposure to credit risk at the end of the reporting period is the carrying value of these assets. Substantially all of the Company's customers are in the oil and natural gas industry and are subject to normal industry credit risks. The Company has minimal collection risk related to these receivables and expects to collect the outstanding receivables in the normal course of operations. At March 31, 2015, the maximum credit exposure is the carrying amount of the accounts receivable of \$432,298 (December 31, 2014 - \$480,890). The Company has no significant concentration of credit risk arising from operations. Cash is held with reputable financial institutions, from which management believes the risk of loss to be remote.

#### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquid capital to meet its current liabilities as they come due. At March 31, 2015, the Company had a working capital deficiency of 1,795,669 (December 31, 2014 - \$1,277,561 deficiency).

#### **Market risk**

Market risk is the risk of loss that may arise from changes in market factor such as interest rates, foreign exchange rates, and commodity and equity prices.

#### **Interest rate risk**

The Company has cash balances and secured loan bears interest. The Company's current policy is to invest excess cash in investment-grade short-term certificates of deposits issued by its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

#### **Foreign currency risk**

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company operates in Canada and the United States. All of the Company's oil and natural gas sales are denominated in United States dollars.

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### 15. Risk Factors (continued)

The Company was exposed to the following foreign currency risk:

|  | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|--|---------------------------|------------------------------|
|  | <b>(US\$)</b>             | <b>(US\$)</b>                |
| Cash                                     | 178,593                   | 485,732                      |
| Accounts receivable                      | 278,679                   | 359,639                      |
| Restricted cash                          | 2,000,000                 | 2,000,000                    |
| Accounts payable and accrued liabilities | (2,405,930)               | (2,379,703)                  |
|  | <u>51,342</u>             | <u>465,668</u>               |

The following foreign exchange rates applied for the three month period ended March 31, 2015 and the year ended December 31, 2014:

|                                 | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|---------------------------------|---------------------------|------------------------------|
| Year-to-date average USD to CAD | 1.2411                    | 1.1046                       |
| As at                           | <u>1.2683</u>             | <u>1.1601</u>                |

#### Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and US dollar, but also world economic events that dictate the levels of supply and demand. The Company closely monitors commodity prices of natural resources, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

#### Financial Instruments

The Company's financial instruments that are measured at fair value on a recurring basis in periods subsequent to initial recognition and the fair value hierarchy used to measure them are presented in the table below. The Company classifies its other financial assets and other financial liabilities measured at fair value using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

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### 15. Risk Factors (continued)

The fair value hierarchy has the following levels:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities; Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 2: Inputs for the asset or liability that is not based on observable market data (unobservable inputs).
- Level 3: inputs).

Cash is measured at Level 1 of the fair value hierarchy.

### 16. Supplemental Disclosure of Cash Flow Information

|  | <b>March 31,<br/>2015</b> | <b>March 31,<br/>2014</b> |
|--|---------------------------|---------------------------|
|  | <b>(\$)</b>               | <b>(\$)</b>               |
| <i>Non-cash investing and financing activities:</i>                                    |                           |                           |
| Oil and gas property expenditures included in accounts payable and accrued liabilities | -                         | 43,153                    |