Hillcrest Petroleum

Condensed Interim Consolidated Financial Statements

Nine Month Period Ended

September 30, 2016

(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 for a review of interim financial statements by an entity's auditor.

HILLCREST PETROLEUM LTD.

Condensed Interim Consolidated Statements of Financial Position

(Expressed in Canadian dollars)

(Unaudited)

	September 30, 2016 ($)	December 31, 2015 ($)
ASSETS		
Current assets		
Cash	181,355	198,581
Accounts receivable	139,490	305,095
GST receivable	3,303	5,953
Short-term investments (Note 3)	9,819	34,659
Prepaid expenses	98,065	228,338
Total current assets	432,032	772,626
Non-current assets		
Restricted Cash (Note 12)	2,319,319	2,456,013
Exploration and evaluation assets (Note 5)	410,955	87,545
Property and equipment (Notes 4)	10,794,584	11,892,067
TOTAL ASSETS	13,956,890	15,208,251
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (Note 6)	7,027,600	4,667,255
Secured loans (Note 7)	714,815	418,841
Current portion of decommissioning liability (Note 10)	653,563	2,061,484
Current portion of unsecured loans (Note 8)	192,835	227,583
Total current liabilities	8,588,813	7,375,163
Unsecured loans (Note 8)	64,372	212,176
Decommissioning liability (Note 10)	11,543,993	11,578,388
TOTAL LIABILITIES	20,197,178	19,165,727
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Share capital (Note 11)	5,828,384	5,708,384
Share subscriptions	115,750	-
Contributed surplus (Note 11)	980,454	949,834
Reserves	934,037	1,112,538
Deficit	(14,098,913)	(11,728,232)
	(6,240,288)	(3,957,476)
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY (DEFICIENCY)	13,956,890	15,208,251

Nature of operations and going concern (Note 1)

Commitments (Note 12)

Subsequent events (Note 18)

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on November 25, 2016. They were signed on the Board's behalf by:

"Don Currie" — Director

"Thomas Milne" — Director

HILLCREST PETROLEUM LTD.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

(Expressed in Canadian dollars)

(Unaudited)

	Three Month Period Ended September 30, 2016 ($)	Three Month Period Ended September 30, 2015 ($)	Nine Month Period Ended September 30, 2016 ($)	Nine Month Period Ended September 30, 2015 ($)
Revenue, net of royalties	176,982	993,644	1,238,701	3,213,155
Expenses				
Operating costs	1,187,536	731,447	1,884,574	2,147,885
Financing expenses (Note 17)	174,348	171,596	334,220	579,093
Consulting fees (Note 9)	119,553	209,770	544,037	515,431
Depletion and depreciation (Note 4)	(164,879)	167,922	613,265	2,081,324
Office and general (Note 17)	398,391	438,705	1,087,985	1,498,839
	1,714,949	1,719,440	4,464,081	6,822,572
Loss from operations	(1,537,967)	(725,796)	(3,225,380)	(3,609,417)
Impairment of short-term investments (Note 3)	(3,186)	-	(24,840)	-
Operating cost recovery (Note 4)	-	-	824,758	-
Overriding royalty interest on secured loan (Note 7)	(1,984)	(19,056)	(9,531)	(30,968)
Foreign exchange gain (loss)	(15,108)	63,616	64,312	71,139
Loss for the period	(1,558,245)	(681,236)	(2,370,681)	(3,569,246)
Item that may be subsequently reclassified to net loss				
Exchange differences on translating foreign operations	(134,695)	(344,941)	(147,881)	(236,572)
Comprehensive income (loss) for the period	(1,692,940)	(1,026,177)	(2,518,562)	(3,805,818)
Basic and diluted loss per share	(0.03)	(0.01)	(0.05)	(0.07)
Weighted average common shares outstanding:				
Basic	51,377,177	50,295,655	51,282,881	50,295,655
Diluted	51,377,177	50,295,655	51,282,881	50,295,655

HILLCREST PETROLEUM LTD.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

(Expressed in Canadian dollars)

(Unaudited)

	Share Capital				Reserves			
	Number of Shares	Amount	Share Subscriptions	Contributed Surplus	Warrants	Foreign Currency Translation	Deficit	Shareholders' Equity (Deficiency)
		($)	($)	($)	($)	($)	($)	($)
Balance at December 31, 2014	50,295,655	5,707,184	(46,000)	949,834	30,620	(34,127)	2,974,291	9,581,802
Cash received from share subscription	-	-	46,000	-	-	-	-	46,000
Share issuance cost recovery	-	1,200	-	-		-	-	1,200
Currency translation adjustment	-	-	-		-	(236,572)	-	(236,572)
Loss for the period	-	-	-	-	-	-	(3,569,246)	(3,569,246)
Balance at September 30, 2015	50,295,655	5,708,384	-	949,834	30,620	(270,699)	(594,955)	5,823,184
Currency translation adjustment	-	-	-	-	-	1,352,617	-	1,352,617
Loss for the period	-	-	-	-	-	-	(11,133,277)	(11,133,277)
Balance at December 31, 2015	50,295,655	5,708,384	-	949,834	30,620	1,081,918	(11,728,232)	(3,957,476)
Advances received against private placement	-	-	115,750	-	-	-	-	115,750
Currency translation adjustment	-	-	-	-	-	(147,881)	-	(147,881)
Shares issued for unsecured loan	1,000,000	30,000	-	-	-	-	-	30,000
Shares issued as loan bonus	1,500,000	90,000						90,000
Transfer expired warrants to contributed surplus	-	-	-	30,620	(30,620)	-	-	-
Loss for the period	-	-	-	-	-	-	(2,370,681)	(2,370,681)
Balance at September 30, 2016	52,795,655	5,828,384	115,750	980,454	-	934,037	(14,098,913)	(6,240,288)

HILLCREST PETROLEUM LTD.
Condensed Interim Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)
(Unaudited)

	Nine Month Period Ended September 30, 2016 ($)	Nine Month Period Ended September 30, 2015 ($)
Loss for the period	(2,370,681)	(3,569,246)
Adjusted for items not involving cash:		
Accretion	155,181	354,974
Accrued interest expense	7,567	1,908
Financing fees	90,000	63,792
Depletion and depreciation	613,265	2,081,324
Impairment of short-term investments	24,840	-
Unrealized foreign exchange gain	(43,421)	(66,261)
Changes in non-cash working capital:		
Accounts receivable	154,149	29,820
Prepaid expenses	120,400	58,762
GST receivable	2,650	2,495
Accounts payable and accrued liabilities	1,314,346	1,033,743
Cash flows used in operating activities	68,296	(8,689)
Release of restricted cash	-	282,209
Oil and gas property expenditures	-	(123,118)
Purchase of equipment	-	(7,897)
Exploration and evaluation expenditures	(323,410)	(39,082)
Cash flows provided by (used in) investing activities	(323,410)	112,112
Asset retirement obligation expenditures	-	(317,326)
Proceeds from share subscriptions	115,750	46,000
Proceeds from secured loan	300,000	-
Repayment of unsecured loan	(162,065)	(39,500)
Repayment of secured loan	(9,341)	(290,500)
Cash flows provided by (used in) financing activities	244,344	(601,326)
Change in cash	(10,770)	(497,903)
Effect of exchange rate changes on cash denominated in a foreign currency	(6,456)	64,594
Cash, beginning of the period	198,581	619,317
Cash, end of the period	181,355	186,008

Supplemental cash flow information (Note 16)

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's shares are listed for trading on the TSX Venture Exchange ("TSX-V") under the symbol "HRH" and on the OTCQB Exchange under the symbol "HLRTF".

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 loss for the period of $2,370,681 and had a working capital deficiency of $8,156,781 during and as at the nine month period ended September 30, 2016. 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 conditions and events as noted above, there is material uncertainty casting significant doubt on 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. These adjustments could be material.

2. Significant Accounting Policies

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, 2015.

2. Significant Accounting Policies (continued)

New standards, amendments and interpretations to existing standards

The following standards were adopted during the period:

IFRS 11, Accounting for Acquisitions of Interests in Joint Operations

Amended to provide specific guidance on accounting for the acquisition of an interest in a joint operation that is a business.

IAS 16 & IAS 38, Clarification of Acceptable Methods of Depreciation and Amortization

Amended to (i) clarify that the use of a revenue-based depreciation and amortization method is not appropriate, and (ii) provide a rebuttable presumption for intangible assets.

IAS 27, Equity Method in Separate Entity Financial Statements

Amended to restore the option to use the equity method to account for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements.

IAS 1, Presentation of Financial Statements

Amended as part of an overall disclosure initiative to improve the effectiveness of disclosure in financial statements.

The adoption of these revised standards did not have a material effect on these condensed interim consolidated financial statements.

The following standards, amendments to standards and interpretations have been issued for annual periods beginning on or after January 1, 2017 but are not yet effective:

IAS 12, Income Taxes

Amended to clarify the recognition of a deferred tax asset for unrealized losses.

The following standards, amendments to standards and interpretations have been issued for annual periods beginning on or after January 1, 2018 but are not yet effective:

IFRS 9, Financial instruments

This standard was issued in November 2009 and covers the classification and measurement of financial assets as part of its project to replace IAS 39 Financial Instruments: Recognition and Measurement. In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Under this guidance, entities have the option to recognize financial liabilities at fair value through earnings. If this option is elected, entities would be required to reverse the portion of the fair value change due to own credit risk out of earnings and recognize the change in other comprehensive income.

2. Significant Accounting Policies (continued)

IFRS 15, Revenue from Contracts with Customers

This standard was issued in May 2014 and will be the new standard for the recognition of revenue, replacing IAS 18, Revenue. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

The following standards, amendments to standards and interpretations have been issued for annual periods beginning on or after January 1, 2019 but are not yet effective:

IFRS 16, Leases

This standard was issued in January 2016 and specifies how an issuer will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less, or the underlying asset has an insignificant value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

The Company has not yet assessed the potential impact of the application of these standards, nor determined whether it will adopt the standards early.

3. Short-term Investments

Short-term investments consist of common shares of Black Stallion Oil and Gas, Inc. ("Black Stallion"), a publicly traded American energy corporation, with an original acquisition cost of $197,301.

During the nine month period ended September 30, 2016, the Company recorded an unrealized loss of $24,840 (2015 - $Nil). As at September 30, 2016, the Company held 250,000 common shares of Black Stallion with a fair value of $9,819.

(Unaudited - Expressed in Canadian dollars)

4. Property and Equipment

	Computer	Oil and Gas Interests	Total
	($)	($)	($)
Cost			
At December 31, 2014	18,341	24,038,117	24,056,458
Additions	7,888	-	7,888
Change in decommissioning estimate	-	(4,060,913)	(4,060,913)
Foreign exchange movement	1,395	4,029,315	4,030,710
At December 31, 2015	27,624	24,006,519	24,034,143
Foreign exchange movement	(645)	(1,152,031)	(1,152,676)
At September 30, 2016	**26,979**	**22,854,488**	**22,881,467**
Accumulated depletion and depreciation			
At December 31, 2014	13,343	1,246,229	1,259,572
Depletion and depreciation for the year	5,262	2,786,531	2,791,793
Foreign exchange movement	284	300,297	300,581
At December 31, 2015	18,889	4,333,057	4,351,946
Depletion and depreciation for the period	3,538	609,727	613,265
Foreign exchange movement	(258)	(252,919)	(253,177)
At September 30, 2016	**22,169**	**4,689,865**	**4,712,034**
Impairment			
At December 31, 2014	-	-	-
Impairment for the year	-	7,790,130	7,790,130
At December 31, 2015	-	7,790,130	7,790,130
Foreign exchange movement	-	(415,281)	(415,281)
At September 30, 2016	**-**	**7,374,849**	**7,374,849**
Carrying amounts:			
At December 31, 2015	8,735	11,883,332	11,892,067
At September 30, 2016	**4,810**	**10,789,774**	**10,794,584**

During the nine month period ended September 30, 2016, the Company received $824,758 from its insurance carrier for costs related to a rig incident at the Ship Shoal 271 Platform in 2013. The proceeds from the insurance claim have been recorded as a recovery of costs on the consolidated statement of income (loss).

(Unaudited - Expressed in Canadian dollars)

4. Property and Equipment (continued)

The Company included future development costs of $3,151,220 in property, plant and equipment costs in the calculation of depletion.

During the year ended December 31, 2015, the Company reviewed the carrying value of its oil and gas interests for impairment indicators. It was determined that the carrying values of the Donner 4 onshore oil well and the Eugene Island offshore oil field exceeded their recoverable amounts. Accordingly, the Company recorded an impairment of $321,426 and $7,468,704, respectively, for each CGU.

The recoverable amounts for both CGUs were based on their fair value less costs of disposal ("FVLCD"). To determine the FVCLD, the Company considered recent transactions within the industry, long-term views of commodity prices, externally evaluated reserve volumes and discount rates specific to the CGU. The discount rate applied to the onshore assets was 10% and the offshore assets was 17%.

The following commodity price estimates were used in determining whether an impairment to the carrying value of the CGUs existed at September 30, 2016 and December 31, 2015:

Year	WTI Cushing Oil Price US$/BBL	Henry Hub Natural Gas Price US$/MMBtu
2016	45.00	2.25
2017	60.00	3.00
2018	70.00	3.50
2019	80.00	4.00
2020	81.20	4.25
2021	82.42	4.31
2022	83.65	4.38
2023	84.91	4.44
2024	86.18	4.51
2025	87.48	4.58
Thereafter	esc 1.5%	esc 1.5%

Gulf of Mexico Properties

The Company 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 6 leases containing 4 producing fields. Working interests in these leases range from approximately 4% to 26%.

(Unaudited - Expressed in Canadian dollars)

4. Property and Equipment (continued)

Hartburg Project, Texas

A total 4 wells have been completed with the following working interests to the Company:

Well	Working Interest
Donner #1	30.0%
Donner #2	48.0%
Donner #4	48.0%
Brown #1	90.0%

5. Exploration and Evaluation Assets

	Muddy Creek	Woodrow	Carrera Prospect	Petit	Total
	($)	($)	($)		($)
Balance at December 31, 2014	345,706	670,434	401,120	-	1,417,260
Additions	-	-	38,429	-	38,429
Disposals	-	(670,434)	-	-	(670,434)
Impairment	(345,706)	-	(480,795)	-	(826,501)
Foreign exchange movement	-	-	128,791	-	128,791
Balance at December 31, 2015	-	-	87,545	-	87,545
Additions	-	-	4,197	319,213	323,410
Balance at September 30, 2016	-	-	91,742	319,213	410,955

<u>Muddy Creek Project – Montana</u>
On September 26, 2011, the Company entered into a purchase and sale agreement with Longshot Oil, LLC for the acquisition of certain oil and gas properties in Teton County, Montana. The Company issued 1,000,000 common shares of the Company at a fair value of $0.25 per share and paid $400,000.

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. During the year ended December 31, 2014, the Company recognized a gain on sale of working interest of $84,546.

During the year ended December 31, 2015, the Company decided that it would discontinue exploration on the Muddy Creek property and, accordingly, recorded an impairment of $345,706.

5. Exploration and Evaluation Assets (continued)

Woodrow Project – Montana
On November 30, 2011 and amended in August 2012, the Company entered into a purchase and sale agreement with Bakken Oil Holdings, LLC ("Bakken") to acquire certain oil and gas properties in Teton and Pondera Counties, Montana. As consideration, the Company paid $365,000 and gave Bakken the Company's interest in a property known as the Tulla property.

On August 14, 2013, the Company signed a definitive agreement with West Bakken Holdings Ltd ("WBHL") 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 Teton and Pondera counties, Montana.

Pursuant to the agreement, the Company received a total of US$550,000 as consideration from WBHL for the farm-in. During the year ended December 31, 2014, the Company recognized a loss on sale of working interest of $87,897.

On October 2, 2015, the Company sold its remaining 50% interest to Black Stallion Oil and Gas, Inc. ("Black Stallion") in exchange for $65,062 (US$50,000) cash and 500,000 common shares of Black Stallion, payable 250,000 common shares upon closing and 250,000 common shares upon Black Stallion spudding a well on the property. As at September 30, 2016, a total of 250,000 common shares of Black Stallion have been received. No new wells have been drilled on the property (Note 3).

Carrera Prospect – Texas
On August 1, 2013, Bazmo Exploration Inc., ("Bazmo") and the Company entered into an exploration agreement (the "Exploration Agreement"). 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. The Company currently has mineral interests of up to 80% within certain parts of the Carrera Prospect area.

During the year ended December 31, 2015, the Company reviewed the carrying value of the Carerra Prospect for impairment indicators. It was determined that the carrying value of the Carrera Prospect exceeded its recoverable amount and the Company recorded an impairment of $480,795. The recoverable amount of the Carrera Prospect was based on the fair value less costs of disposal as "value in use" was not determinable for a project that is not currently generating any cash flows. The fair value was determined in conjunction with a proposed offer of US$885,000 for all of the Hartburg assets, inclusive of the Carrera Prospect, that was received in 2015. The fair value of the asset was therefore determined to be $87,545.

Effective September 30, 2016, the Company terminated the Exploration Agreement with Bazmo in exchange for a cash payment of US$15,000 and the assignment of a 15% working interest in the certain currently held leases in the Carrera Prospect.

Petit Project - Louisiana
On July 29, 2016, the Company entered into a definitive agreement ("Petit Agreement") for the right to acquire up to a 75% working interest in 6,200 acres in the state of Louisiana. The terms of the Petit Agreement require the Company to undertake an initial six well development drilling program with a maximum commitment of US$3,000,000.

(Unaudited - Expressed in Canadian dollars)

5. Exploration and Evaluation Assets (continued)

Petit Project – Louisiana (continued)
The Company paid a US$240,000 acreage fee to the vendor for the initial six wells. The Company will pay an acreage fee of US$40,000 for each additional well drilled after the initial six well program and will implement a bonus program payable in common shares of the Company, subject to TSX-V approval, for each barrel of oil reserves incrementally added to the proved, developed producing category.

6. Accounts Payable and Accrued Liabilities

	September 30, 2016	December 31, 2015
	($)	($)
Trade payables	4,542,868	2,296,961
Related party payables	338,551	123,504
Accrued liabilities	2,146,181	2,246,790
	7,027,600	4,667,255

Included in accrued liabilities at September 30, 2016 is a provision for repair of a drilling rig and offshore platform totaling $1,636,488 (December 31, 2015 - $1,732,938). The provision has been accrued for costs and expenses related to the operation of a certain property in the Gulf of Mexico for which the operator has billed but are disputed by the Company as the expenditures were incurred without the consent of the working interest partners. The Company received an insurance settlement totalling $824,758 in May 2016, is continuing discussions with the operator of the field to resolve the disputed charges, and does not expect to be responsible for the full amount of the provision.

7. Secured Loan

ASI 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 have a two year term and bear interest at a rate of 15% per annum, compounded monthly. The principal amount of the Debentures matured on July 18, 2015 without being fully repaid, but with the lender verbally agreeing to extend the loan under the existing repayment terms.

As part of the consideration for the Loan Facility, the Lenders received an aggregate 8% 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 Hartburg 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 two installments 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 entitled 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. The Agents Warrants all expired without being exercised.

7. Secured Loan (continued)

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. Furthermore, the Parties have agreed that as a minimum monthly principal payment the revenue received from all producing wells in Newton County, less any joint interest billings and any other costs associated with the operation of these wells each month, will be paid to the Lenders until the Company has paid all past outstanding principal payments. Commencing on January 1, 2016, the Company amended the senior secured loan terms such that the $4,000 interest payment was eliminated and the stated interest rate was increased to 20%.

During the nine month period ended September 30, 2016, the Company incurred $61,425 (2015 - $135,013) and $9,531 (2015 - $30,968) in interest expense and overriding royalty payments, respectively. At September 30, 2016, a total of $409,500 (December 31, 2015 - $409,500) in loan principal remained outstanding.

<u>Bridge Loan</u>
On August 10, 2016, the Company borrowed $300,000 under a secured loan agreement (the "Bridge Loan") bearing interest at 1% per month, compounded monthly, and maturing on August 9, 2017. The Company also issued 1,500,000 common shares with a fair value of $90,000 as payment of arrangement fees and syndication fees incurred in connection with the Bridge Loan. The Bridge Loan is secured by the Petit Project assets.

During the nine month period ended September 30, 2016, the Company incurred $5,315 (2015 - $Nil) in interest expense. At September 30, 2016, a total of $300,000 (December 31, 2015 - $Nil) in loan principal remained outstanding.

8. Unsecured Loan

On November 17, 2015, the Company obtained an unsecured loan of $50,000. The loan carried an interest rate of 10% per annum and was payable on maturity. The Company agreed to a monthly payment of $3,000 commencing on December 8, 2015 and increasing to $5,500 after six months until the loan matures on December 8, 2016.

On December 10, 2015, the Company obtained access to an unsecured line of credit bearing interest at an annual rate calculated semi-annually which is equal to the lending rate of the Canadian Imperial Bank of Commerce ("CIBC"). The credit line has a term of 30 months, and it is a non-revolving facility of up to $400,000 that requires monthly repayments equal to the lesser of i) $15,000 and ii) the aggregate principal and interest outstanding. In addition, the Company issued 1,000,000 common shares as consideration to the lender. The Company borrowed $390,000 under the credit line, and the cash received has been allocated between the fair value of the loan liability and the fair value of the 1,000,000 common shares. The fair value of the common shares as at the loan date was $30,000, and the residual amount has been allocated to the loan liability.

During the nine month period ended September 30, 2016, the Company incurred $20,924 (2015 - $1,910) in interest expense, including $5,804 (2015 - $Nil) in accretion of the loan liability. At September 30, 2016, a total of $257,207 (December 31, 2015 - $439,759) in loan principal and accrued interest remained outstanding.

(Unaudited - Expressed in Canadian dollars)

9. Related Party Transactions

The following summarizes the Company's related party transactions during the nine month periods ended September 30, 2016 and 2015:

Key management compensation

	2016	**2015**
	($)	**($)**
Consulting fees paid or accrued to the Executive Chairman of the Company	207,711	114,134
Consulting fees paid or accrued to the Chief Executive Officer ("CEO") of the Company	204,951	226,341
Consulting fees paid or accrued to a corporation controlled by the Chief Financial Officer ("CFO") of the Company	88,837	64,697
Professional and consulting fees paid to two corporations controlled by the former CFO of the Company	-	17,500
Salary and consulting fees paid to the Chief Operating Officer ("COO") of the Company	208,626	230,081
	710,125	652,753

a) As at September 30, 2016, a total of $138,191 (December 31, 2015 - $66,302) was included in accounts payable and accrued liabilities owing to the CEO of the Company for consulting fees and reimbursable expenses.

b) As at September 30, 2016, a total of $106,699 (December 31, 2015 - $50,602) was included in accounts payable and accrued liabilities owing to the Executive Chairman of the Company for consulting fees.

c) As at September 30, 2016, a total of $28,201 (December 31, 2015 - $6,600) was included in accounts payable and accrued liabilities owing to a corporation controlled the CFO of the Company for consulting fees.

d) As at September 30, 2016, a total of $65,460 (December 31, 2015 - $Nil) was included in accounts payable and accrued liabilities owing to the COO of the Company for wages.

(Unaudited - Expressed in Canadian dollars)

10. Decommissioning Liability

The decommissioning liability relates to the expected present value of costs of plugging and abandoning the oil and gas held by Hillcrest. The provision for decommissioning is estimated after taking account of inflation, years to abandonment and an appropriate discount rate. As at September 30, 2016, the oil and gas properties had estimated abandonment dates between 2016 and 2034.

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

	Hartburg Project, Texas	Gulf of Mexico Properties	Total
	($)	**($)**	**($)**
Balance, December 31, 2014	104,266	14,212,362	14,316,628
Accretion	10,916	469,334	480,250
Change in estimate	41,202	(4,102,115)	(4,060,913)
Paid during the year	-	(85,247)	(85,247)
Foreign exchange movement	-	2,989,154	2,989,154
Balance, December 31, 2015	156,384	13,483,488	13,639,872
Accretion	1,759	144,649	146,408
Reclassified to accounts payable during the period	-	(1,306,647)	(1,306,647)
Foreign exchange movement	-	(282,077)	(282,077)
Balance, September 30, 2016	158,143	12,039,413	12,197,556
Current portion	14,329	639,234	653,563
Non-current portion	143,814	11,400,179	11,543,993
	158,143	12,039,413	12,197,556

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 $150,819 (US$115,200) and $13,466,859 (US$10,286,405), respectively, as at September 30, 2016. The provision has been estimated using a risk-free discount rate of 1.5% and an inflation rate of 1.0%.

In addition, the Company had $2,319,319 (US$1,771,568) in escrow as security for reclamation bonds held with ACE Wealth Management as at September 30, 2016. These funds will be released to the Company upon completion of decommissioning activities on certain properties held by the Company.

(Unaudited - Expressed in Canadian dollars)

11. Share Capital

Authorized

Unlimited number of common shares without par value

Issued and outstanding

Nine Month Period Ended September 30, 2016

The Company issued 1,000,000 common shares with a fair value of $30,000 to a lender as consideration in connection with an unsecured loan.

The Company issued 1,200,000 common shares with a fair value of $72,000 to a lender as consideration in connection with a secured loan. Furthermore, the Company issued 300,000 common shares with a fair value of $18,000 as a syndication fee in connection with the secured loan.

Year Ended December 31, 2015

The Company did not issue any common shares.

Share Purchase Warrants

During the year ended December 31, 2015, the Company extended the expiry date of 853,111 share purchase warrants to February 28, 2016. These warrants expired during the nine month period ended September 30, 2016.

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

	Number of Warrants	Weighted Average Exercise Price
		($)
Balance, December 31, 2014 and 2015	6,165,611	0.09
Expired	(853,111)	0.12
Balance, September 30, 2016	5,312,500	0.08

The following table summarizes the share purchase warrants outstanding as at September 30, 2016:

Number of Options	Weighted Average Exercise Price	Expiry Date	Weighted Average Remaining Contractual Life
	($)		(yrs)
5,312,500	0.08	December 30, 2016	0.25

(Unaudited - Expressed in Canadian dollars)

11. Share Capital (continued)

Agent's Warrants

The Company did not issue any Agent's warrants during the nine month period ended September 30, 2016 or the year ended December 31, 2015. A total of 1,360,000 Agent's warrants exercisable at $0.10 per share expired during the year ended December 31, 2015.

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 Stock Options	Weighted Average Exercise Price
		($)
Balance, December 31, 2014 and 2015	2,700,000	0.11
Expired	(800,000)	0.23
Balance, September 30, 2016	1,900,000	0.06

The following table summarizes the stock options outstanding and exercisable as at September 30, 2016:

Number of Options Outstanding	Number of Options Exercisable	Weighted Average Exercise Price	Expiry Date	Weighted Average Remaining Contractual Life
		($)		(yrs)
1,400,000	1,400,000	0.06	September 9, 2018	1.94
500,000	500,000	0.06	November 26, 2018	2.16
1,900,000	1,900,000	0.06		2.00

(Unaudited - Expressed in Canadian dollars)

12. Commitments

a) The Company's wholly-owned subsidiary, Hillcrest GOM, Inc., entered into a rental agreement in Houston, Texas on June 3, 2013, with a term of 50 months, terminating on July 31, 2017. The remaining base rent payable under the lease is US$84,193. In addition to the above base rent, the Company's share of the operating costs for calendar year 2016 is estimated at US$5,306 per month.

b) The Company entered into an office rental agreement in Vancouver, British Columbia on October 8, 2015, with a term of 24 months, terminating on November 30, 2017. The rent payable under the lease is as follows:

	Annual Base Rent
	($)
October 1, 2016 to November 30, 2016	2,930
December 1, 2016 to November 30, 2017	18,250
	21,180

In addition to the base rent, the Company's share of operating costs is estimated at approximately $1,217 per month.

c) 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 (Note 6(a)). A total of $273,273 remains unpaid at September 30, 2016 (December 31, 2015 – $361,741) and is included within accounts payable and accrued liabilities.

13. 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.

There were no changes in the Company's approach to capital management during the nine month period ended September 30, 2016. The Company is not subject to externally imposed capital requirements.

14. 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.

15. Financial Instruments and Risk Management

Financial Risk Management

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.

The fair value hierarchy has the following levels:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: 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 3: Inputs for the asset or liability that is not based on observable market data (unobservable inputs).

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's financial instruments consist of cash, restricted cash, accounts receivable, short-term investments, accounts payable, secured loans, and unsecured loans.

The Company has classified its cash, accounts receivable, other receivables and restricted cash as loans and receivables; short-term investments as available-for sale; and accounts payable, secured loan and unsecured loans as other financial liabilities. The fair value of cash, accounts receivable and accounts payable approximate their book values because of the short-term nature of these instruments. The fair value of the short-term investments are based on quoted market prices for publicly traded shares. The carrying amounts of the secured and unsecured loans approximate fair value as the applicable interest rates, which were negotiated between the Company and arm's length third parties, are similar to market interest rates which would be available to the Company at the balance sheet date.

Financial Instrument Risk Exposure

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board approves and monitors the risk management processes.

15. Financial Instruments and Risk Management (continued)

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 September 30, 2016, the maximum credit exposure is the carrying amount of the accounts receivable of $139,490 (December 31, 2015 - $305,095). Furthermore, there were no receivables overdue, and thus no allowance for doubtful debt recorded.

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 September 30, 2016, the Company had a working capital deficiency of $8,156,781 (December 31, 2015 - $6,602,537), refer to note 1 for further discussion.

As at September 30, 2016, the Company's financial liabilities had contractual maturities as follows:

	September 30, 2016	**December 31, 2015**
	($)	**($)**
Less than 6 months	7,294,828	4,821,172
Between 6 – 12 months	449,150	181,000
Between 1 – 2 years	146,374	266,834
Between 2 – 5 years	109,270	220,248
	7,999,622	5,489,255

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 is exposed to interest rate risk. The Company's bank account earns interest income at variable rates, and the Company has an unsecured loan associated with a CIBC line of credit which has a variable interest rate, recalculated semi-annually. Interest rate risk, however, is minimal as the Company does not have significant variable interest bearing assets or liabilities that are tied into market rates.

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.

(Unaudited - Expressed in Canadian dollars)

15. Financial Instruments and Risk Management (continued)

The Company was exposed to the following foreign currency risk as at September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
	(US$)	(US$)
Cash	91,166	249,259
Accounts receivable	26,681	188,269
Restricted cash	1,771,568	1,771,568
Accounts payable and accrued liabilities	(5,262,404)	(3,254,122)
	(3,372,989)	(1,045,026)

The following foreign exchange rates applied for the nine month period ended September 30, 2016 and the year ended December 31, 2015:

	September 30, 2016	December 31, 2015
Average USD to CAD	1.3220	1.2783
As at	1.3092	1.3864

16. Supplemental Cash Flow Information

	2016	2015
	($)	($)
Non-cash investing and financing activities:		
Common shares issued as a bonus in connection with an unsecured loan	30,000	-
Common shares issued as a bonus in connection with a secured loan	72,000	-
Common shares issued as a syndication fee in connection with a secured loan	18,000	-
Interest paid during the period	71,360	163,374
Income taxes paid during the period	-	-

(Unaudited - Expressed in Canadian dollars)

17. Expense By Nature

Office and general expenses for the nine month periods ended September 30, 2016 and 2015 are comprised of the following:

	2016	2015
	($)	($)
Administration	83,604	158,863
Investor relations and business development	61,465	155,438
Professional fees	84,935	205,485
Rent	190,248	164,360
Transfer and filing fees	18,756	36,333
Travel	47,454	68,658
Wages and benefits	601,522	709,702
	1,087,984	1,498,839

Financing expenses for the nine month periods ended September 30, 2016 and 2015 are comprised of the following:

	2016	2015
	($)	($)
Accretion	146,408	354,974
Bank charges and interest	10,148	8,821
Debt issue costs	90,000	78,375
Interest expense on secured loan	66,740	135,013
Interest expense on unsecured loans	20,924	1,910
	334,220	579,093

18. Subsequent Events

Subsequent to September 30, 2016, the Company:

a) completed the sale of all of its Working Interest in the Eugene Island 32 oil field in exchange for the settlement of US$1,662,121 in existing payables owing to the purchaser, and the release of liability for any future asset retirement obligations currently estimated at US$6,736,079 on an undiscounted basis.

b) announced a non-brokered private placement wherein it will issue up to 15,000,000 units at $0.05 per unit for gross proceeds of up to $750,000. Each unit will be comprised of a common share and one half of a common share purchase warrant, and each whole warrant entitles the holder to acquire an additional common share at $0.08 for a period of two years from the date of closing. The Company has completed a first tranche, subject to TSX-V approval, of 7,300,000 units for gross proceeds of $365,000.