



Condensed Interim Consolidated Financial Statements
Three Month Period Ended
March 31, 2017

(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)

| | March 31, 2017 | December 31, 2016 |
|---|---------------------------|------------------------------|
| | (\$) | (\$) |
| ASSETS | | |
| Current assets | | |
| Cash (Note 16) | 232,726 | 184,940 |
| Accounts receivable | 8,641 | 29,402 |
| GST receivable | 2,961 | 3,945 |
| Prepaid expenses | 97,065 | 63,953 |
| Total current assets | 341,393 | 282,240 |
| Non-current assets | | |
| Restricted Cash (Note 16) | - | 2,048,604 |
| Property and equipment (Note 4) | - | 272,530 |
| TOTAL ASSETS | 341,393 | 2,603,374 |
| LIABILITIES | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities (Notes 5 and 16) | 220,060 | 5,763,186 |
| Secured loans (Note 6) | 554,371 | 526,381 |
| Current portion of decommissioning liability (Note 9) | 27,019 | 27,019 |
| Current portion of unsecured loans (Note 7) | 180,000 | 245,000 |
| Total current liabilities | 981,450 | 6,561,586 |
| Unsecured loans (Note 7) | 105,265 | 84,761 |
| Decommissioning liability (Notes 9 and 16) | 29,122 | 2,740,024 |
| TOTAL LIABILITIES | 1,115,837 | 9,386,371 |
| SHAREHOLDERS' DEFICIENCY | | |
| Share capital (Note 10) | 6,618,184 | 6,178,384 |
| Contributed surplus (Note 10) | 1,211,854 | 980,454 |
| Reserves | 199,415 | 1,348,392 |
| Deficit | (8,803,897) | (15,290,227) |
| | (774,444) | (6,782,997) |
| TOTAL LIABILITIES & SHAREHOLDERS' DEFICIENCY | 341,393 | 2,603,374 |

Nature of operations and going concern (Note 1)**Commitments (Note 11)****Subsequent events (Note 17)**

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on May 30, 2017. They were signed on the Board's behalf by:

"Don Currie"
Director

"Thomas Milne"
Director

HILLCREST PETROLEUM LTD.**Condensed Interim Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)**

(Expressed in Canadian dollars)

(Unaudited)

| | Three Month Period Ended March 31, 2017 | Three Month Period Ended March 31, 2016 |
|---|--|--|
| | (\$) | (\$) |
| Revenue, net of royalties | 28,449 | 478,752 |
| Expenses | | |
| Operating costs | 30,715 | 446,318 |
| Consulting fees (Note 8) | 16,910 | 209,602 |
| Depletion and depreciation (Note 4) | 3,588 | 435,561 |
| Office and general | 123,419 | 361,511 |
| Share-based payments (Note 10) | 231,400 | - |
| | 406,032 | 1,452,992 |
| Loss from operations | (377,583) | (974,240) |
| Financing expenses | (48,674) | (86,549) |
| Gain on disposal of oil and gas properties (Note 4) | 56,728 | - |
| Impairment of short-term investments (Note 3) | - | (8,613) |
| Gain on loss of control of HGOM (Note 16) | 6,847,550 | - |
| Foreign exchange gain (Note 16) | 8,309 | 85,266 |
| Income (loss) for the period | 6,486,330 | (984,136) |
| Item that may be subsequently reclassified to net loss | | |
| Exchange differences on translating foreign operations | 191,600 | (595,220) |
| Comprehensive income (loss) for the period | 6,677,930 | (1,579,356) |
| Basic and diluted loss per share | 0.10 | (0.02) |
| Weighted average common shares outstanding: | | |
| Basic | 67,314,544 | 50,295,655 |
| Diluted | 67,314,544 | 50,295,655 |

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

HILLCREST PETROLEUM LTD.**Condensed Interim Consolidated Statements of Changes in Shareholders' Deficiency**

(Expressed in Canadian dollars)

(Unaudited)

| | <u>Share Capital</u> | | <u>Reserves</u> | | | | <u>Shareholders' Deficiency</u> |
|--|-------------------------|---------------|----------------------------|-----------------|-------------------------------------|----------------|---------------------------------|
| | <u>Number of Shares</u> | <u>Amount</u> | <u>Contributed Surplus</u> | <u>Warrants</u> | <u>Foreign Currency Translation</u> | <u>Deficit</u> | |
| | | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| Balance at December 31, 2015 | 50,295,655 | 5,708,384 | 949,834 | 30,620 | 1,081,918 | (11,728,232) | (3,957,476) |
| Shares issued for unsecured loan | 1,000,000 | 30,000 | - | - | - | - | 30,000 |
| Transfer expired warrants to contributed surplus | - | - | 30,620 | (30,620) | - | - | - |
| Loss and comprehensive loss for the period | - | - | - | - | (595,220) | (984,136) | (1,579,356) |
| Balance at March 31, 2016 | 51,295,655 | 5,738,384 | 980,454 | - | 486,698 | (12,712,368) | (5,506,832) |
| Proceeds from private placement | 7,300,000 | 365,000 | - | - | - | - | 365,000 |
| Shares issued for secured loan | 1,500,000 | 75,000 | - | - | - | - | 75,000 |
| Warrant extension | - | - | - | 76,000 | - | - | 76,000 |
| Loss and comprehensive loss for the period | - | - | - | - | 785,694 | (2,577,859) | (1,792,165) |
| Balance at December 31, 2016 | 60,095,655 | 6,178,384 | 980,454 | 76,000 | 1,272,392 | (15,290,227) | (6,782,997) |
| Proceeds from private placement | 8,900,000 | 445,000 | - | - | - | - | 445,000 |
| Share issuance costs | - | (5,200) | - | - | - | - | (5,200) |
| Grant of stock options | - | - | 231,400 | - | - | - | 231,400 |
| Loss of control of subsidiary | - | - | - | - | (1,340,577) | - | (1,340,577) |
| Income and comprehensive income for the period | - | - | - | - | 191,600 | 6,486,330 | 6,677,930 |
| Balance at March 31, 2017 | 68,995,655 | 6,618,184 | 1,211,854 | 76,000 | 123,415 | (8,803,897) | (774,444) |

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

HILLCREST PETROLEUM LTD.**Condensed Interim Consolidated Statements of Cash Flows**

(Expressed in Canadian dollars)

(Unaudited)

| | Three Month Period Ended March 31, 2017 | Three Month Period Ended March 31, 2016 |
|--|--|--|
| | (\$) | (\$) |
| Income (loss) for the period | 6,486,330 | (984,136) |
| Adjusted for items not involving cash: | | |
| Accretion | 21,813 | 53,591 |
| Accrued interest expense | 9,458 | 1,037 |
| Depletion and depreciation | 3,588 | 435,561 |
| Impairment of short-term investments | - | 8,613 |
| Gain on loss of control of HGOM | (6,847,550) | - |
| Gain on disposal of oil and gas properties | (56,728) | - |
| Share-based payments | 231,400 | - |
| Foreign exchange gain | (3,936) | (64,547) |
| Changes in non-cash working capital: | | |
| Accounts receivable | 20,761 | 43,523 |
| Prepaid expenses | (33,112) | 98,860 |
| GST receivable | 984 | (45) |
| Accounts payable and accrued liabilities | (375,684) | 522,581 |
| Cash flows provide by (used in) operating activities | (542,676) | 115,038 |
| Proceeds from disposal of oil and gas properties | 309,873 | - |
| Cash disposed of from derecognition of HGOM | (111,763) | - |
| Cash flows provided by investing activities | 198,110 | - |
| Asset retirement obligation expenditures | - | (194,128) |
| Proceeds from private placement | 380,000 | - |
| Share issuance costs | (5,200) | - |
| Proceeds from secured loan | 60,000 | - |
| Repayment of unsecured loan | (42,448) | (50,638) |
| Repayment of secured loan | - | (9,341) |
| Cash flows provided by (used in) financing activities | 392,352 | (254,107) |
| Change in cash | 47,786 | (139,069) |
| Effect of exchange rate changes on cash denominated in a foreign currency | - | (3,068) |
| Cash, beginning of the period | 184,940 | 198,581 |
| Cash, end of the period | 232,726 | 56,444 |
| Supplemental cash flow information (Note 15) | | |

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

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

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 located in North 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 1410 – 1030 West Georgia Street, Vancouver, BC, V6E 2Y2. 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 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 recorded income for the three month period ended March 31, 2017 of \$6,486,330 and had a working capital deficiency of \$640,057 as at March 31, 2017. 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 its creditors and its 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. On February 3, 2017, the Company placed its wholly-owned subsidiary, Hillcrest GOM Inc., into Chapter 7 liquidation in the U.S. Court for the Southern District of Texas in order to preserve the existing cash in the consolidated entity (Note 16).

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, 2016.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

New standards, amendments and interpretations to existing standards

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

IFRS 9 is effective for annual periods beginning on or after January 1, 2018. This new standard replaces International Accounting Standards ("IAS") 39, Financial Instruments: Recognition and Measurement. IFRS 9 addresses the classification, measurement and de-recognition of financial assets and financial liabilities, introduces a new impairment model for financial assets and new rules for hedge accounting.

IFRS 9 requires financial assets to be classified into one of three measurement categories on initial recognition: FVTPL, fair value through OCI and amortized cost. Measurement and classification of financial assets is dependent on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial asset. The new standard retains most of the existing requirements for financial liabilities.

IFRS 9 introduces a new impairment model for financial assets. This new model may result in the earlier recognition of credit losses as it requires the Company to account for expected credit losses from the time the financial instruments are first recognized.

IFRS 15, Revenue from Contracts with Customers

IFRS 15 is effective for annual periods beginning on or after January 1, 2018. This new standard is based on the principle that revenue should be recognized to depict the transfer of goods or services to customers at an amount that the entity expects it will be entitled to in exchange for those goods.

IFRS 15 introduces a new five step model for the recognition of revenue based on when control of a good or service transfers to a customer. The notion of control replaces the existing notion of risks and rewards and could result in changes in the timing of revenue recognition for certain contracts

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

IFRS 16 is effective for annual periods beginning on or after January 1, 2019. This new standard replaces the existing leasing guidance in IAS 17, Leases.

IFRS 16 distinguishes between leases and service contracts on the basis of whether the customer controls the asset being leased. For those contracts determined to meet the definition of a lease, IFRS 16 requires a lessee to recognize on the balance sheet a lease asset along with the associated lease liability which reflects future lease payments, similar to current finance lease accounting. There are limited exceptions for leases with a term of less than 12 months or leases of assets which have a very low value. As a result of the adoption of IFRS 16, operating leases which were previously only recognized on the statement of earnings will be recognized on the balance sheet.

The purpose of the standard is to provide users of the financial statements with a more accurate picture of a company's leased assets and associated liabilities, while also improving the comparability of companies that lease assets to those that purchase them.

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

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three Month Period Ended March 31, 2017

(Unaudited - Expressed in Canadian dollars)

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 three month period ended March 31, 2017, the Company recorded an impairment loss of \$Nil (2016 - \$8,613). As at March 31, 2017, the Company held 250,000 common shares of Black Stallion with a fair value of \$Nil (December 31, 2016 - \$Nil).

4. Property and Equipment

| | Computers | Oil and Gas Interests | Total |
|---|------------------|------------------------------|-----------------|
| | (\$) | (\$) | (\$) |
| Cost | | | |
| At January 1, 2016 | 27,624 | 24,006,519 | 24,034,143 |
| Disposals | - | (19,889,477) | (19,889,477) |
| Change in decommissioning estimate | - | (80,205) | (80,205) |
| Foreign exchange movement | (331) | (767,502) | (767,833) |
| At December 31, 2016 | 27,293 | 3,269,335 | 3,296,628 |
| Disposals | (10,886) | (3,269,335) | (3,280,221) |
| Foreign exchange movement | (379) | - | (379) |
| At March 31, 2017 | 16,028 | - | 16,028 |
| Accumulated depletion and depreciation | | | |
| At January 1, 2016 | 13,343 | 1,246,229 | 1,259,572 |
| Depletion and depreciation for the year | 4,967 | 801,951 | 806,918 |
| Disposals | - | (2,586,082) | (2,586,082) |
| Foreign exchange movement | (56) | (202,921) | (202,977) |
| At December 31, 2016 | 23,800 | 2,346,005 | 2,369,805 |
| Depletion and depreciation for the year | - | 3,588 | 3,588 |
| Disposals | (7,510) | (2,349,593) | (2,357,103) |
| Foreign exchange movement | (262) | - | (262) |
| At March 31, 2017 | 16,028 | - | (16,028) |
| Impairment | | | |
| At January 1, 2016 | - | 7,790,130 | 7,790,130 |
| Impairment for the year | - | 332,865 | 332,865 |
| Disposals | - | (7,192,475) | (7,192,475) |
| Foreign exchange movement | - | (276,227) | (276,227) |
| At December 31, 2016 | - | 654,293 | 654,293 |
| Disposals | - | (654,293) | (654,293) |
| At March 31, 2017 | - | - | - |
| Carrying amounts: | | | |
| At December 31, 2016 | 3,493 | 269,037 | 272,530 |
| At March 31, 2017 | - | - | - |

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(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:

| <u>Well</u> | <u>Working Interest</u> |
|-------------|-------------------------|
| Donner #1 | 30.0% |
| Donner #2 | 48.0% |
| Donner #4 | 48.0% |
| Brown #1 | 90.0% |

During the three month period ended March 31, 2017, the Company sold its interest in the Donner #1 well for a cash payment of \$309,873 (US\$232,742) and the release of liability for any future asset retirement obligations currently estimated at US\$12,113 on an undiscounted basis. As a result, the Company recorded a gain on disposal of \$56,728.

As at March 31, 2017, the three remaining wells are shut-in and under re-evaluation.

Gulf of Mexico Properties

During the year ended December 31, 2016, the Company disposed of the Eugene Island offshore oil field. This portfolio of non-operated oil and gas properties located shallow offshore waters of the Gulf of Mexico were comprised of 6 leases containing 4 producing fields. It was sold to the operator of the property in exchange for the settlement of \$2,218,932 (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\$7,083,105 on an undiscounted basis. Accordingly, the Company recorded a gain on disposal of \$961,134.

During the three month period ended March 31, 2017, the Company placed its wholly-owned subsidiary HGOM into a Chapter 7 liquidation in the U.S. Court for the Southern District of Texas. This has resulted in the disposal of the remaining non-operated assets located shallow offshore waters of the Gulf of Mexico. (Note 16)

Impairment

During the year ended December 31, 2016, the Company reviewed the carrying value of its oil and gas interests for impairment indicators. It was determined that the carrying values of the Brown 1 and Donner 2 onshore oil wells exceeded their recoverable amounts. Accordingly, the Company recorded an impairment of \$332,865.

The recoverable amount for the CGUs were based on their fair value less costs of disposal ("FVLCD"). To determine the FVLCD, the Company considered the current operational status and asset sales which occurred during the three month period ended March 31, 2017.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

5. Accounts Payable and Accrued Liabilities

| | March 31, 2017 | December 31, 2016 |
|------------------------|-------------------|----------------------|
| | (\$) | (\$) |
| Trade payables | 93,331 | 3,196,190 |
| Related party payables | 49,729 | 386,428 |
| Accrued liabilities | 77,000 | 2,180,568 |
| | <u>220,060</u> | <u>5,763,186</u> |

6. Secured Loans

ASI Loan

As at March 31, 2017, the Company has \$259,500 (December 31, 2016 - \$259,500) outstanding on a senior secured loan facility that bears interest at a rate of 20% per annum and is currently payable on demand. As part of the consideration for the loan facility, the lenders and the arranging agent receive an aggregate 10% 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 loan.

During the three month period ended March 31, 2017, the Company incurred \$12,825 (2016 - \$20,475) and \$Nil (2016 - \$4,587) in interest expense and overriding royalty payments, respectively.

Bridge Loan

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 Bridge Loan is secured by the Company's interest in the Pettit Project leases. The Company also issued 1,500,000 common shares with a value of \$75,000 as payment of arrangement fees and syndication fees incurred in connection with the Bridge Loan. The cash received under the Bridge Loan has been allocated between the fair value of the loan liability and the value of the 1,500,000 common shares. The value ascribed to the common shares as at the loan date was \$75,000, and the residual amount has been allocated to the loan liability.

During the three month period ended March 31, 2017, the Company incurred \$27,990 (2016 - \$Nil) in interest expense, including \$18,532 (2016 - \$Nil) in accretion of the loan liability. At March 31, 2017 a total of \$324,283 (December 31, 2016 - \$314,825) in loan principal and accrued interest remained outstanding.

7. Unsecured Loans

On July 29, 2016, the Company received a cash subscription of \$65,000 for a proposed equity financing. In January 2017, the Company completed the equity financing and the loan liability was recognized as paid in full.

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 initially 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.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three Month Period Ended March 31, 2017

(Unaudited - Expressed in Canadian dollars)

7. Unsecured Loans (continued)

During the three month period ended March 31, 2017, the Company borrowed an additional \$60,000 (2016 - \$10,000) and incurred \$5,729 (2016 - \$6,517) in interest expense, including \$2,952 (2016 - \$2,890) in accretion of the loan liability. As at March 31, 2017, a total of \$299,882 (December 31, 2016 - \$282,330) in loan principal and accrued interest remained outstanding.

8. Related Party Transactions

The following summarizes the Company's related party transactions during the three month periods ended March 31, 2017 and 2016:

Key management compensation

| | <u>2017</u> | <u>2016</u> |
|---|----------------|----------------|
| | (\$) | (\$) |
| Consulting fees paid or accrued to the Executive Chairman of the Company | - | 81,620 |
| Consulting fees paid or accrued to the Chief Executive Officer ("CEO") of the Company | - | 81,188 |
| Consulting fees paid or accrued to a corporation controlled by the Chief Financial Officer ("CFO") of the Company | 7,500 | 34,739 |
| Salary and consulting fees paid or accrued to the Chief Operating Officer ("COO") of the Company | - | 82,440 |
| Share-based payments paid to certain directors and officers of the Company in connection with the extension of the expiry date of share purchase warrants | 141,411 | - |
| | <u>148,911</u> | <u>279,987</u> |

- a) As at March 31, 2017, a total of \$22,475 (December 31, 2016 - \$158,767) was included in accounts payable and accrued liabilities owing to the CEO of the Company for consulting fees and reimbursable expenses.
- b) As at March 31, 2017, a total of \$27,253 (December 31, 2016 - \$135,209) was included in accounts payable and accrued liabilities owing to the Executive Chairman of the Company for consulting fees and reimbursable expenses.
- c) As at March 31, 2017, a total of \$Nil (December 31, 2016 - \$25,117) was included in accounts payable and accrued liabilities owing to a corporation controlled the CFO of the Company for consulting fees.
- d) As at March 31, 2017, a total of \$Nil (December 31, 2016 - \$67,335) was included in accounts payable and accrued liabilities owing to the COO of the Company for wages.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three Month Period Ended March 31, 2017

(Unaudited - Expressed in Canadian dollars)

9. 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 March 31, 2017, the oil and gas properties had estimated abandonment dates between 2017 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 movement in the provision for the decommissioning liability was as follows:

| | Hartburg Project, Texas | Gulf of Mexico Properties | Total |
|------------------------------|------------------------------------|--------------------------------------|--------------|
| | (\$) | (\$) | (\$) |
| Balance, January 1, 2016 | 156,384 | 13,483,488 | 13,639,872 |
| Accretion | 2,346 | 160,730 | 163,076 |
| Change in estimate | (90,612) | 331,575 | 240,963 |
| Disposal | - | (8,854,449) | (8,854,449) |
| Expenditures during the year | - | (1,968,586) | (1,968,586) |
| Foreign exchange movement | - | (453,833) | (453,833) |
| Balance, December 31, 2016 | 68,118 | 2,698,925 | 2,767,043 |
| Accretion | 329 | - | 329 |
| Disposal | (12,306) | (2,608,160) | (2,620,466) |
| Foreign exchange movement | - | (90,765) | (90,765) |
| Balance, March 31, 2017 | 56,141 | - | 56,141 |
| Current portion | 27,019 | - | 27,019 |
| Non-current portion | 29,122 | - | 29,122 |
| | 56,141 | - | 56,141 |

The total undiscounted amount of estimated cash flows required to settle the provision for decommissioning liability for the Hartburg Project is \$57,600 (December 31, 2016 - \$75,694) as at March 31, 2017. The provision has been estimated using a risk-free discount rate of 1.93% and an inflation rate of 2.00%.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three Month Period Ended March 31, 2017

(Unaudited - Expressed in Canadian dollars)

10. Share Capital

Authorized

Unlimited number of common shares without par value

Issued and outstanding

Three Month Period Ended March 31, 2017

- a) The Company completed the second and final tranche of a non-brokered private placement wherein it issued 8,900,000 units at a price of \$0.05 per unit. Each unit consisted of one common share in the capital of the Company plus one half of one common share purchase warrant. Each whole warrant of this second tranche offering will entitle the holder to purchase one additional share at a price of \$0.08 until January 18, 2019. The Company paid cash commissions of \$5,200 in connection with the closing of the second tranche.

Year Ended December 31, 2016

- a) The Company issued 1,000,000 common shares with a fair value of \$30,000 to a lender as partial consideration for an unsecured loan.
- b) The Company issued 1,200,000 common shares with a fair value of \$60,000 to a lender as partial consideration for a secured loan. Furthermore, the Company issued 300,000 common shares with a fair value of \$15,000 as a syndication fee in connection with the secured loan.
- c) The Company completed the first tranche of a non-brokered private placement wherein it issued 7,300,000 units at \$0.05 per unit for gross proceeds of \$365,000. Each unit is comprised of a common share and one half of a common share purchase warrant. Each whole warrant entitles the holder to acquire an additional common share at \$0.08 until December 8, 2018. No finder's fees were paid in connection with this placement.

Share Purchase Warrants

Three Month Period Ended March 31, 2017

- a) The Company issued 4,450,000 share purchase warrants in connection with a non-brokered private placement. Each warrant entitles the holder to acquire a common share of the Company at \$0.08 until January 18, 2019.

Year Ended December 31, 2016

- a) The Company extended the expiry date of 5,312,500 share purchase warrants to December 30, 2017. Accordingly, the Company recorded \$76,000 as a share-based payment.
- b) The Company issued 3,650,000 share purchase warrants in connection with a non-brokered private placement. Each warrant entitles the holder to acquire a common share of the Company at \$0.08 until December 8, 2018.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

10. Share Capital (continued)

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

| | Number of Warrants | Weighted Average Exercise Price (\$) |
|----------------------------|-----------------------|---|
| Balance, January 1, 2016 | 6,165,611 | 0.09 |
| Expired | (853,111) | 0.12 |
| Issued | 3,650,000 | 0.08 |
| Balance, December 31, 2016 | 8,962,500 | 0.08 |
| Issued | 4,450,000 | 0.08 |
| Balance, March 31, 2017 | 13,412,500 | 0.08 |

The following table summarizes the share purchase warrants outstanding as at March 31, 2017:

| Number of Warrants | Weighted Average Exercise Price (\$) | Expiry Date | Weighted Average Remaining Contractual Life (yrs) |
|--------------------|---|-------------------|--|
| 4,450,000 | 0.08 | January 18, 2019 | 1.80 |
| 3,650,000 | 0.08 | December 8, 2018 | 1.69 |
| 5,312,500 | 0.08 | December 30, 2017 | 0.75 |
| 13,412,500 | 0.08 | | 1.36 |

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.

On February 21, 2017, the Company granted 4,500,000 stock options with a fair value of \$231,400. The options were fully vested on the grant date, and the Company expensed \$231,400 as share-based compensation.

The options granted during the three month period ended March 31, 2017 were valued using the Black-Scholes option pricing model under the following weighted average assumptions:

| | 2017 |
|-----------------------------|--------|
| Risk-free interest rate | 1.16% |
| Expected life of options | 5 yrs |
| Volatility | 98% |
| Expected Dividend yield | Nil |
| Forfeiture rate | Nil |
| Weighted average fair value | \$0.05 |

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

10. Share Capital (continued)

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

| | Number of Stock Options | Weighted Average Exercise Price |
|----------------------------|----------------------------|---------------------------------------|
| | | (\$) |
| Balance, January 1, 2016 | 2,700,000 | 0.11 |
| Expired | (800,000) | 0.23 |
| Balance, December 31, 2016 | 1,900,000 | 0.06 |
| Issued | 4,500,000 | 0.07 |
| Balance, March 31, 2017 | 6,400,000 | 0.07 |

The following table summarizes the stock options outstanding and exercisable as at March 31, 2017:

| 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 | 1.44 |
| 500,000 | 500,000 | 0.06 | November 26, 2018 | 1.66 |
| 4,500,000 | 4,500,000 | 0.07 | February 21, 2022 | 4.90 |
| 6,400,000 | 6,400,000 | 0.07 | | 3.89 |

11. Commitments

- a) 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 remaining base rent payable under the lease is \$12,167 up until the lease expires. In addition to the base rent, the Company's share of operating costs is estimated at approximately \$1,217 per month.
- b) HEL entered into an office rental agreement with a term of 72 months, terminating on February 28, 2023. The remaining base rent payable under the lease is \$159,827 up until the lease expires. In addition to the base rent, the Company's share of operating costs is estimated at approximately \$1,547 per month.

12. Geographical Segmented Information

The Company is engaged in one business activity, being the acquisition, exploration, development and production of oil and gas reserves.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

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 three month period ended March 31, 2017. The Company is not subject to externally imposed capital requirements.

14. 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 is 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.

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements
Three Month Period Ended March 31, 2017
(Unaudited - Expressed in Canadian dollars)

14. 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 March 31, 2017, the maximum credit exposure is the carrying amount of the accounts receivable of \$8,641 (December 31, 2016 - \$29,402). 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.

Market risk

Market risk is the risk of loss that may arise from changes in market factors 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.

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, 2017, the Company had a working capital deficiency of \$640,057 (December 31, 2016 - \$6,279,346), refer to note 1 for further discussion.

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. However, since the disposal of all of the Company's producing oil assets and the derecognition of HGOM, the Company has minimal exposure to foreign exchange risk.

15. Supplemental Cash Flow Information,

| | <u>2017</u> | <u>2016</u> |
|--|-------------|-------------|
| | (\$) | (\$) |
| Non-cash investing and financing activities: | | |
| Common shares issued as a bonus in connection with an unsecured loan | - | 30,000 |
| Interest paid during the period | 2,552 | 36,202 |
| Income taxes paid during the period | - | - |

Hillcrest Petroleum Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

Three Month Period Ended March 31, 2017

(Unaudited - Expressed in Canadian dollars)

16. Loss of Control of HGOM

On February 3, 2017, the Company placed its wholly-owned subsidiary HGOM into a Chapter 7 liquidation in the U.S. Court for the Southern District of Texas. Consequently, the Company has lost control over all of the assets and liabilities of HGOM. In accordance with the guidance of IFRS 10, Consolidated Financial Statements, the Company derecognized the carrying value of the assets and liabilities of HGOM on the effective date.

| | Amount |
|---|-------------------------|
| | (\$) |
| Cash | (111,764) |
| Restricted cash | (1,979,709) |
| Equipment | (3,376) |
| Accounts payable | 4,993,662 |
| Asset retirement obligations | <u>2,608,160</u> |
| | 5,506,973 |
| Reclassification of foreign currency balances | <u>1,340,577</u> |
| Gain on loss of control of HGOM | <u><u>6,847,550</u></u> |

17. Subsequent Events

Subsequent to March 31, 2017, the Company:

- a) signed a binding joint venture agreement (“JV Agreement”) with a Canadian oil and gas company whereby the Company, via a wholly-owned subsidiary, will be appointed operator and earn up to a 75% working interest in two petroleum assets located in western Canada. In addition to providing technical expertise to restore production from the fields, the Company must also supply project financing, including the placement of operator deposits and licence liability rating bonds, which is estimated to cost \$2,200,000. The Company’s working interest will revert to 50% once the Company has recovered all production restoration costs from the production revenues. The agreement is subject to regulatory approval in the provinces of Alberta and Saskatchewan.
- b) announced a non-brokered equity private placement wherein it will issue up to 7,142,857 units at \$0.07 per unit for gross proceeds of \$500,000. Each unit will consist of a common share and one half of a common share purchase warrant wherein each whole warrant entitles the holder to acquire an additional common share at a price of \$0.10 for a period of two years from the date of closing.