Hillcrest Petroleum

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Three Month Period Ended March 31, 2015

## INTRODUCTION

This Management's Discussion and Analysis ("MD&A") is provided by the management of Hillcrest Petroleum Ltd. ("Hillcrest" or the "Company") as at and for the three month period ended March 31, 2015. The commentary in this MD&A is based on information available up to May 29, 2015 (the "Report Date"). This MD&A should be read in conjunction with the Company's condensed interim consolidated financial statements for the three month period ended March 31, 2015 (the "Interim Financial Statements") and the audited annual consolidated financial statements for the year ended December 31, 2014 (the "Annual Financial Statements"). All amounts are in Canadian dollars unless otherwise specified.

Additional information relating to the Company, including the Interim Financial Statements and the Annual Financial Statements are available on the Hillcrest website at **www.hillcrestpetroleum.com** or on the Canadian System for Electronic Document Analysis and Retrieval ("SEDAR") website at **www.sedar.com.**

## FORWARD-LOOKING STATEMENTS

This MD&A, which contains certain forward-looking statements pertaining to, among other things: additional capital funding; the Company's ability to obtain such funding and the use thereof; the Company's ability to continue as a going concern; the completion of private placements and the use of proceeds thereof; the existence of reserves; oil production rates and recovery from drilling operations; commercial viability of drilled wells; additional drilling locations; storage and transportation of oil and costs thereof; the timing, method, cost and recovery from drilling operations; infrastructure development and the timing and effects thereof; the Company's next phase of capital expenditures; regulatory approvals and the Company's ability to obtain applicable permits; future operation, general and administrative expenditures and the anticipated impact of the reduction thereof; performance and financial results; capital expenditures; the release of restricted cash; the Company's working capital deficiency and capital requirements; the ability of the Company to satisfy the interest and principal owed to debt holders; estimates and assumptions made in accordance with IFRS requirements; and the Company's ability to generate shareholder value, is intended to provide readers with a reasonable basis for assessing the financial performance of the Company. The use of any of the words "believe", "expect", "estimate", "will", "should", "intend" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by the Company, are inherently subject to significant business, economic and competitive uncertainties and contingencies. The estimates and assumptions of the Company contained in this MD&A, which may prove to be incorrect, include, but are not limited to: the general continuance of current or, where applicable, assumed industry conditions and the lack of any significant disruptions affecting operations, whether due to labour disruptions, supply disruptions, power disruptions, damage to equipment, adverse weather conditions or otherwise; the ability of the Company to obtain necessary permits; acquisition of lands; the Company's status as a going concern; costs and availability of equipment, labour, natural gas, fuel, oil, electricity, water and other key supplies; the accuracy of production data; the continuance of existing and, in certain circumstances, proposed tax and royalty regimes; the continuance of laws and regulations relating to environmental matters; the Company's ability to retain key employees and executives; assumptions relating to the costs of future wells; the accuracy of estimates of reserves volumes; the availability and timing of additional financing to fund the Company's capital and operating requirements as needed; and certain commodity price and other cost assumptions. Statements regarding future production, capital expenditures and development plans are subject to all of the risks and uncertainties normally incident to the exploration for and development and production of oil and gas that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. These risks include, but are not limited to: inflation or lack of availability of goods and services; changes in commodity prices; unanticipated operating results or production declines; third party pipeline issues; environmental risks; drilling risks; financial markets; economic conditions; volatility in the debt and equity markets; regulatory changes; changes in tax or environmental laws or royalty rates; and certain other known and unknown risks listed under the section "Risks & Uncertainties" herein.

Although Hillcrest believes that the material factors, expectations and assumptions expressed in such forward-looking statements are reasonable based on information available to it on the date such statements were made, no assurances can be given as to future results, levels of activity and achievements and such statements are not guarantees of future performance.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## NON-IFRS FINANCIAL MEASURES

This MD&A includes references to certain financial measures, as described below, which do not have standardized meanings prescribed by IFRS, however, as these measures are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors and they are measures that the Company uses to evaluate its performance. Investors are cautioned that these non-IFRS financial measures should not be construed as an alternative to the measures calculated in accordance with IFRS as, given their non-standardized meanings; they are unlikely to be comparable to similar measures presented by other issuers.

*a) EBITDA*

Earnings before Interest, Income Taxes, Depreciation and Amortization ("EBITDA") is used because it is a financial measure used by many investors to compare companies on the basis of operating results, asset value and the ability to incur and service debt. EBITDA is used because Hillcrest's net income (loss) alone does not give an accurate picture of its' cash-generating potential. Management believes that EBITDA is an important measure in evaluating performance and in determining whether to invest in Hillcrest.

*b) Netback*

Netback is calculated on a dollar per barrel of oil equivalent ("boe") basis as oil and gas sales, less royalties, operating and transportation expenses. Netback is used by management to measure operating results and to better analyze performance against prior periods.

## CORPORATE OVERVIEW

Hillcrest was originally incorporated under the Company Act (British Columbia) on May 2, 2006 under the name Shanghai Creek Minerals Ltd. and on May 28, 2007 the Company changed its name to Hillcrest Resources Ltd. The Company listed its common shares for trading on the TSX Venture Exchange (the "Exchange") and commenced trading under the symbol "HRH" on March 22, 2011. On March 11, 2015, the Company changed its name to Hillcrest Petroleum Ltd.

The Company is in the business of acquiring and developing exploration and production interests in oil and gas projects in the United States of America. Management and consultants of the Company have extensive experience in oil and gas exploration, development and production and have the capability to expand the scope of the Company's activities as appropriate opportunities arise. Since incorporation, the Company has successfully drilled and acquired producing well interests in Texas and offshore Louisiana (Refer to "Oil and Gas Properties" section).

## OIL AND GAS PROPERTIES

Hillcrest currently has working interests in the following oil and gas properties:

**a) Gulf of Mexico Properties, Louisiana**

With an effective date of December 19, 2014, The Company completed the purchase of Gulfsands Petroleum USA Inc. ("GPUSA"). GPUSA was subsequently renamed Hillcrest GOM Inc. ("HGOM"), and is now a wholly owned subsidiary of Hillcrest.

Hillcrest, through its wholly owned subsidiary HGOM, owns a portfolio of non-operated oil & gas properties in the Gulf of Mexico, within the shallow water "shelf" region offshore Louisiana. These properties comprise 7 leases containing 5 producing fields. Working interests in these leases range from approximately 4% to 26%. With the acquisition, the Company assumed its share of the forward Asset Retirement Obligations ("ARO") for the existing facilities and wells. The ARO expenditure timing ranges from near term to longer term, with the majority occurring at the end of productive field life.

The fields are relatively mature, although additional infield drilling and recompletion opportunities have been identified in the Eugene Island 32 Field. Additional exploration potential also exists in the largely undrilled deeper section in some of the leases.

<u>Eugene Island 32</u>

The majority of the Hillcrest oil production from the Gulf of Mexico assets is sourced from the Eugene Island 32 Field. Production is from Lower Pliocene and Upper Miocene aged conventional sandstone reservoirs contained within a large, faulted anticline structure. There are multiple proven reservoirs within the field area, occurring at vertical drilling depths of approximately 6,000 to 11,000 feet. Water depth at the Eugene Island Field is approximately 10-12 feet. The Company owns a 26.3% Working Interest in the Eugene Island 32 Field.

The Company recognizes significant value within the Eugene Island 32 Field both in proved, developed but not producing reserves ("PDNP" or "behind pipe" reserves within existing well-bores) as well as proved but un-developed reserves ("PUD" or un-drilled infield locations). The Company is developing an action plan for accessing these reserves that is designed to deliver maximum additional value to the organization.

<u>Other Producing Fields</u>

Hillcrest also produces relatively small volumes of oil and gas from the Ship Shoal 271 Field, the West Cameron 310 Field, the West Cameron 498 Field and the West Delta 64 Field. The Company owns a between a 4% and a 26.3% Working Interest in these Other Producing Fields.

All disclosure of scientific or technical information on the Company's Gulf of Mexico oil and gas property reserves contained in this MD&A is based on information prepared by or under the supervision of the Company's Independent Qualified Reserves Evaluator, Lily Cheung of Netherland, Sewell and Associates, Inc. The Company filed its most recent annual 51-101F2 Report on Reserves Data as of December 31, 2014 on SEDAR on April 30, 2015.

**b) Hartburg Property, Texas**

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

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

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

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

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

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

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

All disclosure of scientific or technical information on the Company's Hartburg oil and gas property reserves contained in this MD&A is based on information prepared by or under the supervision of the Company's Independent Qualified Reserves Evaluator, Rosa Yvonne Scherz of D. Braxton and Associates. The Company filed its most recent annual 51-101F2 Report on Reserves Data as of December 31, 2014 on SEDAR on April 30, 2015.

## SELECTED ANNUAL & QUARTERLY INFORMATION

### Selected Annual Information

Selected annual information for the years ended December 31, 2014, 2013 and 2012 is presented below:

| | 2014 ($) | 2013 ($) | 2012 ($) |
|---|---|---|---|
| **Total assets** | 20,495,996 | 4,014,585 | 3,553,604 |
| **Total liabilities** | 18,377,583 | 1,169,960 | 170,665 |
| **Shareholders' equity** | 2,118,413 | 2,844,625 | 3,382,939 |
| **Revenue** | 1,163,004 | 677,435 | 785,622 |
| **Write down of resource properties** | - | - | 478,145 |
| **Expenses** | 2,080,688 | 1,306,211 | 1,029,106 |
| **EBITDA** [1] | (106,872) | (233,055) | (534,637) |
| **Net loss** | (1,183,972) | (684,192) | (731,133) |
| **Loss per share** | (0.03) | (0.02) | (0.02) |

Note – The increase in total assets, liabilities, revenue and expenses for the year ended December 31, 2014, was due to the acquisition of HGOM on December 19, 2014.

### Selected Quarterly Information

The table below summarized information reported for the most recent eight quarterly periods:

| | Mar. 31, 2015 ($) | Dec. 31, 2014 ($) | Sept. 30, 2014 ($) | Jun. 30, 2014 ($) |
|---|---|---|---|---|
| **Total assets** | 19,517,056 | 20,495,996 | 3,736,059 | 3,900,169 |
| **Total liabilities** | 18,655,110 | 18,377,583 | 1,338,504 | 1,251,507 |
| **Shareholders' equity** | 861,946 | 2,118,413 | 2,397,555 | 2,648,662 |
| **Revenues** | 977,698 | 304,216 | 268,316 | 461,239 |
| **EBITDA** [1] | (225,746) | (237,831) | 52,584 | 236,842 |
| **Net loss** | (1,388,533) | (754,050) | (159,248) | (39,114) |
| **Loss per share** | (0.03) | (0.02) | (0.00) | (0.00) |
| **Weighted average common shares outstanding** | 50,295,655 | 39,901,633 | 39,634,589 | 39,598,128 |

| | Mar. 31, 2014 ($) | Dec. 31, 2013 ($) | Sept. 30, 2013 ($) | Jun. 30, 2013 ($) |
|---|---|---|---|---|
| **Total assets** | 3,812,162 | 4,014,585 | 4,235,398 | 3,396,572 |
| **Total liabilities** | 1,229,180 | 1,169,960 | 1,164,428 | 121,000 |
| **Shareholders' equity** | 2,582,982 | 2,844,625 | 3,070,970 | 3,275,572 |
| **Revenues** | 129,233 | 146,188 | 168,978 | 184,157 |
| **EBITDA** [1] | (158,467) | (65,245) | (262,724) | 49,738 |
| **Net loss** | (265,687) | (265,826) | (310,999) | (52,639) |
| **Loss per share** | (0.01) | (0.01) | (0.01) | (0.00) |
| **Weighted average common shares outstanding** | 39,570,655 | 39,570,655 | 39,570,655 | 39,570,655 |

[1] Refer to Non-IFRS Financial Measures

Significant variations in the most recent eight quarters are discussed below:

a) During the quarter ended December 31, 2014, the total assets and total liabilities increased significantly due to the HGOM acquisition.

b) During the quarter ended September 30, 2013, the total liabilities increased by approximately $1,000,000 due to the issuance of a $1,000,000 secured loan.

## RESULTS OF OPERATIONS

### Three Month Period Ended March 31, 2015

*Revenues*

The Company generated total revenue of $977,698 during for the three month period ended March 31, 2015, an increase of $848,465 (657%) over the same period in the prior year. The increase is a result of the additional revenue generated from the newly acquired HGOM oil properties.

*Costs and Expenses*

The Company incurred expenses in the amount of $2,315,510 for the 3 month period ended March 31, 2015, representing an increase of $2,034,327 (723%) over expenses of $281,273 incurred for the three month period ended March 31, 2014.

The significant increase in expenses during this period is primarily attributable to the collective results of the following factors:

1. Operating costs relating to the production of oil and natural gas sales was $509,833 (2014: $50,224). The $459,609 (915%) increase in operating costs was primarily caused by additional costs related to the acquisition of the HGOM properties.

2. Depletion and depreciation increased to $949,272 (2014: $36,513). The $912,759 (2,500%) increase was caused by the production from additional wells acquired in the HGOM transaction as well as additional wells that were drilled in the Hartburg project in 2014.
3. Accretion costs increased to $116,648 (2014: $1,311). The $115,337 (8,798%) increase is due to the additional reclamation costs associated with the wells acquired in the HGOM transaction.
4. Office and general costs increased to $104,017 (2014: $6,650). The $97,367 (1,464%) increase is due to the additional costs associated with the new Houston based office acquired in the HGOM transaction.
5. Wages and benefits increased to $241,555 for the three month period ended March 31, 2015 (2014: $nil) due to the inclusion of wages and benefits from the employees retained in the HGOM acquisition.

*Other items*

The Company reported interest expense of $49,953 for the three month period ended March 31, 2015 compared to $37,500 for the corresponding period in the prior year. There was a $11,481 (31%) increase during the current period was due to additional monthly bonus payments of $4,000 that were required to be paid when the Company was late in making its normal loan principal repayments.

The Company paid $8,768 for the three month period ended March 31, 2015 (2014: $nil) as an overriding royalty interest on the secured loan facility.

**Production Information**

The table below shows the Company's net production data from all of its well interests:

| | Three Month Period Ended March 31, | | |
|---|---|---|---|
| | 2015 | 2014 | Change |
| | | | (%) |
| **Crude oil and NGL (bbl)** | 14,690 | 749 | 1,861 |
| **Natural gas (mcf)** | 37,666 | 4,353 | 765 |
| **Total boe** | 17,201 | 1,041 | 1,552 |
| **Crude oil and NGL (bopd)** | 163 | 8 | 1,938 |
| **Natural gas (mcfgpd)** | 419 | 48 | 773 |
| **Total boepd** | 191 | 11.6 | 1,547 |
| **Crude oil and NGL (%)** | 85 | 72 | 18 |
| **Natural gas (%)** | 15 | 28 | (46) |
| **Total (%)** | 100 | 100 | |

The daily oil production and the total oil produced during the three month period ended March 31, 2015 increased by approximately 1,900% over the same period in the prior year due to the HGOM assets that were acquired in December 2014.

## LIQUIDITY AND CAPITAL RESOURCES

The Company had a working capital deficiency of $1,795,669 as at March 31, 2015, compared to $1,277,561 as at December 31, 2014. The decrease in working capital deficiency was caused by the deferral of a portion of the Company's decommissioning liabilities and their reclassification to long term status.

In the first Quarter of 2015, the Company by way of verbal agreement further amended the senior secured loan terms such that if the principal payments were not paid on their due dates, then the Company would pay the contracted rate of 15% interest on the remaining principal balance plus an additional $4,000 until the loan payments are caught up. The Over Riding Royalty Interest will be increased from 8% to 10% of the Net Revenue Interest received by the Company on its Brown #1 and Donner #4 wells until such time as the loan is caught up or retired. The Parties agreed, as a minimum principal payment, the revenue received from all producing wells in Newton County less any Joint Interest Billings on these wells each month will be paid until the Company has paid all past outstanding principal payments.

The revenue currently generated from natural gas and oil sales does not exceed the Company's operating expenses. As a result, management anticipates that the current cash on hand may not be sufficient to fund continued operations at the current level for the next twelve months. The Company will also require additional funds to complete well activities on existing wells and to drill additional wells on the Hartburg and HGOM properties and to acquire and develop additional oil and natural gas assets to implement the Company's overall growth strategy. Management has successfully utilized both debt and equity financing in the past, but there is no assurance that such funding will be available in the future or if it is that it will be on terms that are acceptable. If the Company is unable to obtain additional financing, it will experience liquidity problems and management expects that it will need to curtail operations, liquidate assets, seek additional capital on less favorable terms and/or pursue other remedial measures. Any additional equity financing may involve substantial dilution.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company did not have any off-balance sheet debt nor did it have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that may have material current or future effect on financial conditions, changes in the financial conditions, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses.

## OUTSTANDING SHARE DATA

The total number of common shares outstanding as of the Report Date was 50,295,655.

## SHARE PURCHASE WARRANTS

The total number of share purchase warrants outstanding as at the Report Date are summarized below:

| Number of Options | Exercise Price ($) | Expiry Date |
|---|---|---|
| 1,200,000 [(1)] | 0.10 | July 18, 2015 |
| 160,000 [(1)] | 0.08 | December 30, 2015 |
| 853,111 | 0.12 | February 28, 2016 |
| 5,312,500 | 0.08 | December 30, 2016 |
| 7,525,611 | 0.09 | |

(1) Designates Agents' warrants

## STOCK OPTIONS

The total number of stock options outstanding as of the Report Date are summarized below:

| Number of Options | Exercise Price ($) | Expiry Date |
|---|---|---|
| 650,000 | 0.20 | March 22, 2016 |
| 250,000 | 0.25 | September 26, 2016 |
| 1,550,000 | 0.06 | September 9, 2018 |
| 500,000 | 0.06 | November 26, 2018 |
| 2,950,000 | 0.11 | |

## COMMITMENTS

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

| Period | Annual Base Rent (US$) |
|---|---|
| April 1, 2015 to July 31, 2015 | 31,740 |
| August 1, 2015 to July 31, 2016 | 98,105 |
| August 1, 2016 to July 31, 2017 | 101,031 |
| | 230,876 |

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

On February 12, 2015, the Company entered into an Installment Agreement with the United States Department of the Interior and through the Office of Natural Resources Revenue (ONRR) in connection with civil penalties (Note 9(a)). The Company agreed to pay the balance of civil penalties of US$313,176 in 60 monthly installments of US$5,220 beginning on March 12, 2015. The first and second installments have been made and subsequent installment payments will be due on the 12th of each month until the 60th installment of US$5,220 is paid on February 12, 2020.

## OUTLOOK

Hillcrest Petroleum Ltd. is focused on adding, creating and increasing value through the acquisition, development and production of conventional oil and gas assets in the Southern half of the United States. The Company's business plan in any acquisition or asset development is to be the operator of the asset or to hold a majority working interest where available. Accordingly, the Company is actively evaluating production projects with development upside for acquisition with an aim to increasing its daily production to a minimum 750 boepd by the end of the second quarter of 2016.

## SUBSEQUENT EVENTS

There were no material events subsequent to the end of the period.

## RELATED PARTY TRANSACTIONS

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

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

***Key management compensation***

| | 2015 ($) | 2014 ($) |
|---|---|---|
| Management fees paid to the CEO of the Company | 74,949 | 22,500 |
| Professional fees paid to a corporation controlled by the CFO of the Company | 5,000 | - |
| Professional and consulting fees paid to the former CFO of the Company | 10,500 | 19,500 |
| Salaries paid to the COO | 74,400 | - |

a) As at March 31 2015, a total of $29,295 (December 31, 2014 - $10,618) was included in accounts payable and accrued liabilities owing to the Chief Executive Officer for consulting fees.

b) These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties.

## ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

Significant accounting policies used by Hillcrest are disclosed in note 3 to the December 31, 2014 audited annual consolidated financial statements. Preparing financial statements in accordance with IFRS requires management to make certain judgments and estimates. Changes to these judgments and estimates could have a material effect on the Company's financial statements and financial position. There were no changes to Hillcrest's critical accounting estimates during the three month period ended March 31, 2015.

## NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

The following describes new accounting pronouncements that been issued but are not yet effective:

*Financial instruments (IFRS 9)*
IFRS 9 replaces IAS 39 "Financial Instruments: Recognition and Measurement", which eliminates the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classifications: amortized cost and fair value. In November 2013, the IASB amended IFRS 9 to include the new general hedge accounting model which remains optional, allows more opportunities to apply hedge accounting, and will be effective on January 1, 2018 and applied retroactively to each period presented.

Management anticipates that the above standard will be adopted in the Company's financial statements for the period beginning January 1, 2018 or later, and currently evaluating the impact of the adoption of this standard.

## 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 resource 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 dependent on external financing to fund its activities. In order to carry out planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional funds as needed. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or 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, 2015.

## RISKS & UNCERTAINTIES

The business and operations of the Company are subject to numerous risks, many of which are beyond the Company's control. The Company considers the risks set out below to be some of the most significant to current and potential investors in the Company, but readers are cautioned that the list is not exhaustive. If any of these risks materialize into actual events or circumstances, or any other additional risks or uncertainties which are material to the Company's business actually occur, the Company's assets, liabilities, financial condition, results of operations (including future results of operations), and business and business prospects are likely to be materially and adversely affected. In such circumstances, the price of the Company's securities could decline and investors may lose all or part of their investment. The Company is engaged in the acquisition, exploration and development of oil and gas properties. Given the nature of the oil and gas business, the limited extent of the Company's assets and the present stage of exploration, the following risks, among others, should be considered.

### Exploration, Development and Operating Risks

Oil and gas exploration and development is highly speculative in nature and involves a high degree of risk. There is no assurance that expenditures made on future exploration and development by the Company will result in new discoveries of oil and gas in commercial quantities. The recovery of expenditures on oil and gas properties and the related deferred exploration expenditures are dependent on the ability of the Company to obtain financing necessary to complete the exploration and development of its projects, and upon future profitable production, or alternatively, on the sufficiency of proceeds from disposition. The long-term commercial success of the Company depends on its ability to acquire, develop and commercially produce oil and gas reserves. The Company is in the process of exploring its properties and determining the technical feasibility and economically recoverable reserves. No assurance can be given that the Company will be able to locate satisfactory properties for acquisition or participation. Additionally, if such acquisitions and participation are identified, the Company may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisition or participation uneconomic. Even if the Company is successful in locating satisfactory properties, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. The Company attempts to control operating risks by maintaining a disciplined approach to execution of its exploration and development programs. Exploration risks are managed by utilizing management experience and expertise along with technical professionals and by concentrating on the exploration activity on specific core regions that have multi-zone potential. Operational control allows the Company to manage costs, timing and sales of production and to ensure new production is brought on-stream in a timely manner. Additionally, oil and gas operations are subject to the usual risks involved in the acquisition, exploration, development and production of oil and gas properties, including whether any of the remaining projects contain economically recoverable reserves and are able to generate any revenues from production.

### Fluctuating Oil and Gas Prices

The economics of oil and gas exploration are affected by many factors beyond the Company's control, including commodity prices, supply and demand in the market and the cost of operations. Depending on the price of commodities, the Company may determine that it is impractical to continue exploration. Any material decline in prices may result in the reduction of existing and potential profitable exploration and development activities as well as reducing the financing options available to the Company. Prices are prone to fluctuations and marketability is affected by government regulations relating to price, royalties and allowable production, the effect of which cannot be accurately predicted. There is no assurance that a profitable market will exist for the sale of any commodities found on the properties.

**Regulatory, Permit and License Requirements**

The current or future operations of the Company require permits from various governmental authorities, and such operations are and will be governed by laws and regulations concerning exploration, development, production, taxes, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, site safety and other matters. Companies engaged in the exploration and development of oil and gas properties generally experience increased costs and delays in development and other schedules as a result of the need to comply with applicable laws, regulations and permits. Adverse changes to laws and regulations could have a material adverse effect on present and future exploration and development projects, operations, and capital expenditures. There can be no assurance that all permits which the Company may require for facilities and to conduct exploration and development operations on the properties will be obtainable on reasonable terms, or that such laws and regulations will not have an adverse effect on any exploration or development project which the Company might undertake. Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed and may include corrective measures requiring capital expenditures, installation of additional equipment or remedial actions. Parties engaged in exploration and development operations may be required to compensate those suffering loss or damage by reason of the exploration and development activities and may have civil or criminal fines or penalties imposed upon them for violation of applicable laws or regulations. Amendments to current laws, regulations and permits governing operations and activities of oil and gas companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures or exploration and development costs, or require abandonment or delays in the development of new or existing properties.

**Financing Risks and Dilution to Shareholders**

The Company has limited financial resources and further exploration or acquisitions will be require additional funds to complete. There can be no assurance that the Company will be successful in its efforts to obtain adequate financing in the future or that such financing will be available on favourable terms or at all. It is likely such additional capital may be raised through the issuance of additional equity or other forms of capital such as debt or sale of assets which may result in dilution to the Company's existing shareholders.

**Competition**

The oil and gas exploration and development industry is highly competitive. The Company will have to compete with other companies, many of which have greater financial, technical and other resources than the Company, for, among other things, the acquisition of leases and other interests as well as for the recruitment and retention of qualified employees and other personnel. Failure to compete successfully against other companies could have a material adverse effect on the Company and its prospects.

**Reliance on Management and Dependence on Key Personnel**

The success of the Company will be largely dependent upon the performance of its directors and officers and on the Company's ability to attract and retain key personnel. The loss of the services of these persons may have a material adverse effect on the Company's business and prospects. The Company will compete with numerous other companies for the recruitment and retention of qualified employees and contractors. There is no assurance that the Company can maintain the service of its directors and officers or other qualified personnel required to operate its business. Failure to do so could have a material adverse effect on the Company and its prospects.

**Environmental Risks**

The Company's exploration and appraisal programs will, in general, be subject to approval by regulatory bodies. Additionally, all phases of the oil and gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, state and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs.

**Uninsurable Risks**

Exploration, development and production operations of oil and gas reserves involve numerous risks, including unexpected or unusual geological operating conditions, rock bursts, cave-ins, fires, floods, hurricanes, earthquakes and other environmental occurrences, any of which could result in damage to, or destruction of, wells and other producing facilities, damage to life or property, environmental damage and possible legal liability. Although the Company intends to take precautions to minimize risk that will be taken, operations are subject to hazards that may result in environmental pollution and consequent liability that could have a material adverse impact on the business, operations and financial performance of the Company. It is not always possible to obtain insurance against all such risks and the Company may decide not to insure against certain risks, such as environmental risks, as a result of high premiums or other reasons. Should such liabilities arise, they could have an adverse impact on the Company's operations and financial condition and could cause a decline in the value of the Company's shares.

**Local Resident Concerns**

In addition to ordinary environmental issues, the exploration and development of the Company's projects could be subject to resistance from local residents that could either prevent or delay exploration and development of its properties.

**Availability of Equipment and Labour**

The oil and gas exploration industry is dependent on the availability of equipment and labour in the areas where such activities will be conducted. Demand for limited equipment and labour and restrictions imposed on access to equipment may affect the availability of such equipment to the Company which could delay exploration, development and production activities.

**Conflicts of Interest**

There are potential conflicts of interest to which the directors and officers of this Company may be subject to in connection with the Company's operations. Certain of the directors and officers of the Company are engaged in, and will continue to engage in, other business activities on their own behalf and on behalf of other companies and, as a result of these and other activities, such directors and officers may be in direct conflict with the Company. To the extent that conflicts of interest arise, such conflicts will be resolved in accordance with the provisions of the BCBCA and any other applicable corporate laws. The Company is developing and instituting policy that greatly reduces and in most cases eliminates potential conflicts. (Not sure the best way to say this but want the public to know we are instituting policy.

**Litigation**

The Company and/or its directors may become subject to a variety of civil or other legal proceedings, with or without merit.

## DISCLOSURE CONTROLS AND PROCEDURES

Management has assessed the effectiveness of the Company's disclosure controls and procedures used for the financial statements and MD&A as at March 31, 2015. Management has concluded that the disclosure controls are effective in ensuring that all material information required to be filed has been made known to them in a timely manner. The required information was effectively recorded, processed, summarized and reported within the time period necessary to prepare the annual filings. The disclosure controls and procedures are effective in ensuring that information required to be disclosed pursuant to applicable securities laws are accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. Additional disclosures pertaining to the Company's material change reports, press releases and other information are available on the SEDAR website at **www.sedar.com**

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TSX Venture Exchange: **HRH**
US Symbol: **HLRTF**

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