

**ACL International Ltd.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE QUARTER ENDED**

**JUNE 30, 2015**

August 29, 2015

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### FORWARD LOOKING STATEMENTS

*Certain of the statements in this MD&A about the Company's current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements or any other future events or developments constitute forward-looking statements. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other similar or comparable words or phrases, are intended to identify forward-looking statements.*

*Forward-looking statements are based on estimates and assumptions made by management based on management's experience and perception of historical trends, current conditions and expected future developments, as well as other factors that management believes are appropriate in the circumstances. Many factors could cause the Company's actual results, performance or achievements or future events or developments to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors: the Company's ability to implement its strategy or operate its business as management currently expects; unfavorable capital market developments or other factors which may affect the Company's capital and debt obligations; government regulations; litigation and regulatory actions; periodic negative publicity regarding the oil and gas industry; intense competition; the Company's reliance on information technology and telecommunications systems; the Company's dependence on key employees; general economic, financial and political conditions; the Company's dependence on the results of operations of its subsidiaries; the volatility of the stock market and other factors affecting the Company's share price.*

*All of the forward-looking statements included in this MD&A are qualified by these cautionary statements for the three months ended June 30, 2015. These factors are not intended to represent a complete list of the factors that could affect the Company; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein. The Company and management have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.*

This MD&A should be read in conjunction with the unaudited condensed interim consolidated financial statements for the three months ended June 30, 2015 and the audited consolidated financial statements for the year ended March 31, 2015 which are prepared in accordance with IFRS (International Financial Reporting Standards). These filings are available at [www.sedar.com](http://www.sedar.com).

All amounts are in Canadian Dollars unless otherwise indicated.

### OVERVIEW

ACL International Ltd. (the "Company") primary business activity involved the operation of general insurance brokerages in Canada and the United States. Shares of the Company traded on the TSX Venture Exchange ("Exchange") under the symbol "ACL". The Company, founded in 1989, expanded through internal growth and acquisitions. The Company operated in two economic environments and revenues were attributed to geographic areas based on the location of resources producing the revenues.

On May 1, 2014 the Company completed the sale of all of its shares (51%) in the Canadian subsidiary Anthony Clark Insurance Brokers Ltd. held by the Company, to an arm's length third party for cash consideration of approximately \$13,000,000, before repayment of certain senior debt and adjustments. As the transaction contemplated the sale of all or substantially all of the Company's assets shareholder approval was obtained on April 14, 2014 and TSX Venture Exchange approval on April 22, 2014. The Company paid certain liabilities in the amount of \$7,942,971 from the sale proceeds including debt settlement \$6,101,475, legal expenses \$277,221 and severance and outstanding compensation of \$1,564,275.

Subsequent to obtaining TSX Venture Exchange approval on April 29, 2014, the Company changed its name to ACL International Ltd. effective May 1, 2014 and transferred its common shares listing to the NEX Board of the TSX Venture Exchange effective May 2, 2014.

On May 26, 2014, the Board of Directors of the Company declared a capital distribution to the shareholders and set the record date for the distribution at June 9, 2014. The Company made an initial distribution of \$0.28 per common share to its shareholders on June 18, 2014.

On July 2, 2014, the Company received \$2,008,240 representing the balance of the sale proceeds for the sale of all of the shares of Anthony Clark Insurance Brokers Ltd.

On January 26, 2015, the Company entered into a letter of intent (“**LOI**”) with Blue Sky International Holdings, Inc. (“**BSIH**”) for the acquisition of oil and gas interests in the North Sumatra region of Indonesia. Under the terms of the LOI, the Company was to acquire 100% of the issued and outstanding shares of BSIH’s subsidiary Blue Sky Langsa Ltd. (“**BSL**”), effective January 1, 2015.

On April 30, 2015, the Company entered into an Amended and Restated Asset Purchase Agreement with Blue Sky Langsa Ltd. (“**BSL**”), pursuant to which the Company agreed to acquire, from BSL, a 50% interest in a Technical Assistance Contract for a block referred to as “**Langsa TAC**”. Located in the East Aceh Offshore contract area in North Sumatra, Indonesia the block covers an area of approximately 77 square kilometers. The purchase price of C\$9,924,600 was settled with C\$100,000 in cash and the issuance of 81,871,667 Common Shares in the capital of the Company at C\$0.12 per Common Share. The Effective Date of the transaction was January 1, 2015.

On June 8, 2015 the Exchange conditionally approved the proposed acquisition.

On June 11, 2015 the Company closed its Amended and Restated Asset Purchase Agreement dated April 30, 2015 with Blue Sky Langsa Ltd. with an effective date of January 1, 2015 for an aggregate purchase price of C\$9,924,600.

On June 30, 2015 the TSX Venture Exchange accepted the Company’s change of business from a general insurance brokerage issuer to an oil and gas issuer. The Company met the requirements to be listed as a TSX Venture Tier 1 issuer. Effective July 2, 2015, listing of the Company’s shares was transferred from the NEX to the TSX Venture exchange.

On June 29, 2015 the Company paid C\$762,786 (\$800,000 Australian) to acquire a 38.25% working interest in a Production Sharing Contract for the block referred to as “South Block A” (the “**Assets**”) located onshore, North Sumatra, Indonesia, from Peak Oil & Gas (Australia) Pty Ltd. (“**Peak**”). The acquisition had an effective date of May 1, 2015 and closed on July 2, 2015. The Company acquired of all of the issued and outstanding shares of Peak Oil & Gas SBA Pte Ltd., (“**POGSBA**”), a loan in the amount of US\$4,164,763 which was due to Peak from POGSBA. POGSBA owns 75% of the issued and outstanding shares of Renco Elang Energy Pte. Ltd. which owns a 51% working interest in the Assets and is the operator.

## **DISCONTINUED OPERATIONS**

On March 3, 2014 the Company sold the property and equipment and customer accounts of its U.S. operations for net sales proceeds of \$3,204,664 including transaction costs of \$178,396. The Company realized a loss from discontinued operations of \$2,804,844.

On May 1, 2014, the Company completed the sale of all of its shares (51%) in its Canadian subsidiary Anthony Clark Insurance Brokers Ltd, to an arm’s length third party for cash consideration of approximately \$13,000,000, before repayment of certain senior debt and adjustments. As the transaction contemplated the sale of all or substantially all of the Company’s assets shareholder approval was obtained on April 14, 2014 and TSX Venture Exchange approval on April 22, 2014. The Company paid certain liabilities in the amount of \$7,942,971 from the sale proceeds including debt settlement \$6,101,475, legal expenses \$277,221 and severance and outstanding compensation of \$1,564,275. The transaction resulted in a gain on sale of discontinued operations of \$12,095,558.

There were no activities in discontinued US operations, however a gain of \$4,756 resulted due to a reversal of consultancy fees accrual during the quarter ended June 30, 2015.

The gain (loss) from discontinued operations for the three month period ended June 30, 2015 and 2014 is summarized below:

	Three month period ended June 30, 2015			Three month period ended June 30, 2014		
	Canada	US	Total	Canada	US	Total
Revenue from discontinued operations	\$ -	\$ -	\$ -	\$ 455,290	\$ 101,483	\$ 556,773
Expenses of discontinued operations	-	4,756	4,756	(425,162)	(84,013)	(509,175)
Earnings (loss) from discontinued operations	-	4,756	4,756	30,128	17,470	47,598
Gain (loss) on sale of discontinued operations	-	-	-	12,065,430	-	12,065,430
Gain (loss) from discontinued operations	\$ -	\$ 4,756	\$ 4,756	\$ 12,095,558	\$ 17,470	\$ 12,113,028

## 2015 OPERATIONAL HIGHLIGHTS

- The Company acquired a 50% interest in a Technical Assistance Contract for a block referred to as “**Langsa TAC**” located offshore North Sumatra, Indonesia.
- The Company acquired a 38.25% interest in South Block A located onshore North Sumatra, Indonesia.

## RESULTS OF OPERATIONS

The Company earned revenue of \$757,037 for the 18 day period from June 12, 2015 through June 30, 2015 consisting of \$727,470 from its share of revenue from the Langsa TAC interest, \$29,056 from interest earned on a loan receivable and \$511 earned on foreign exchange adjustments for the quarter ending June 30, 2015.

The gross revenue and profit before income taxes for ACL’s 50% share of production from January 1, 2015 (the effective date of acquisition of the Langsa TAC interest) to June 11, 2015 is as follows (all figures in US dollars):

Operating Revenue	\$3,414,833
Operating Costs	(1,482,747)
G&A	(219,406)
Capital Expenditures	(882,407)
Earnings Before Tax	<u>\$830,473</u>

## PRODUCTION

At June 30, 2015 the Company has two producing wells (L3 and H4). The average combined production rate for both wells was approximately 1345 barrels per day for the month of June, 2015. The Company’s 50% share of this production is approximately 672 barrels per day. As at the date of this report combined daily production from both wells is approximately 1370 barrels per day.

## INTEREST AND FINANCING COSTS

	June 30, 2015	June 30, 2014
<b>Canadian operations</b>		
Interest on long-term debt	\$ -	\$ 34,129
Interest on notes payable	89	-
Amortization of deferred financing costs and loan discount	-	50,281
	-	84,410
<b>U.S. operations</b>		
Interest on long-term debt	\$ 13,381	\$ 12,179
	13,381	12,179
	\$ 13,381	\$ 96,589

## SUMMARY QUARTERLY INFORMATION

The following table summarizes the Company's key consolidated financial information for the last eight quarters.

Quarter ended	Revenue (\$)	EBITDA (\$)	Net earnings (\$)	EPS-Basic and Diluted (\$/share)
June 30, 2015	757,037	256,717	(280,917)	-
March 31, 2015	-	(197,629)	(170,961)	(0.05)
December 31, 2014	-	(147,306)	(200,102)	-
September 30, 2014	-	(40,997)	(41,253)	-
June 30, 2014	-	(1,581,449)	10,447,503	1.09
March 31, 2014	-	(494,783)	(555,913)	(0.07)
December 31, 2013	-	(182,084)	(1,893,282)	(0.22)
September 30, 2013	-	(254,817)	386,357	-

- EBITDA is defined as Earnings before interest, income taxes, and depreciation and amortization.
- EBITDA is discussed and presented here as a non-IFRS measure because it is management's major performance indicator.
- EBITDA is reconciled to Net earnings above.
- The Revenue and EBITDA exclude the results of the discontinued operations.
- The results reflect the sale of all its operating assets.

In the quarter ended June 30, 2014, the Company completed the sale of all of its shares (51%) in its Canadian subsidiary Anthony Clark Insurance Brokers Ltd. to an arm's length third party for cash consideration of approximately \$13,000,000, before repayment of certain senior debt and adjustments. As the transaction contemplated the sale of all or substantially all of the Company's assets shareholder

approval was obtained on April 14, 2014 and TSX Venture Exchange approval on April 22, 2014. The Company paid certain liabilities in the amount of \$7,942,971 from the sale proceeds including debt settlement \$6,101,475, legal expenses \$277,221 and severance and outstanding compensation of \$1,564,275. The transaction resulted in a gain on sale of discontinued operations of \$12,095,558.

## FINANCIAL CONDITION AND CHANGES IN FINANCIAL CONDITION

Comparing June 30, 2015 and March 31, 2015:

- **Working capital** decreased by \$622,278 as a result of the sale of the Company's Canadian subsidiary.
- **Property** increased by \$9,924,600 as a result of the oil and gas asset acquisition.
- **Long-term debt** decreased \$13,481 due to the effect of the foreign exchange rate.
- **Equity attributable to owners of the Company** increased by \$10,078,417 due to:
  - net earnings (loss) of (\$280,917);
  - Increase in exchange difference on translating foreign operations of \$6,004;
  - Shares issued for BSL acquisition of \$9,824,600 and Shares issued for finder's fees \$528,730.

## FINANCIAL RESOURCES AND LIQUIDITY

As at June 30, 2015, the Company has a working capital of \$1,104,350.

### Canadian Debt

The Company has short-term notes payable issued to a third party bearing interest of 12% per annum. Principal and interest are payable at maturity.

### U.S. Debt

The Company has short-term notes payable issued to a third party bearing interest of 12% per annum. Principal and interest are payable at maturity.

The Company has long term U.S. debt. Payments of interest only at 6.75% per annum continue on the unpaid balance until maturity of the loan.

The U.S. denominated debt is secured with a guarantee provided by the Company.

### Commitments

The Company's future contractual and long-term obligations as at June 30, 2015 is as follows:

U.S. Notes payable (Due 02/17)	\$	804,573	-
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## SHARE CAPITAL

### Authorized

Unlimited common shares without par value  
 Unlimited class B voting preferred shares without par value  
 Unlimited class C non-voting preferred shares without par value

**Issued** All common shares issued are fully paid, carry one vote per share and carry a right to dividends

Changes in share capital during the year ended March 31, 2015 and March 31, 2014 are as follows:

	Shares	Amount
Balance, April 1, 2013	9,694,684	\$ 9,561,719
Charge to capital on repurchase of shares through issuer bid	(89,500)	(88,272)
Balance, March 31, 2014	9,605,184	9,473,447
Distribution to shareholders	-	(2,689,452)
Balance, March 31, 2015	9,605,184	\$ 6,783,995
Common shares issued for property and equipment	81,871,667	9,824,600
Common shares issued in payment of finder's fee	4,406,083	528,730
Balance, June 30, 2015	95,882,934	\$ 17,137,325

## SHARE-BASED COMPENSATION

The Company has an incentive share option plan, which provides for the award of share options to directors, officers, employees and consultants. The terms and exercise prices of all share option awards are determined by the directors at the time of issue.

Changes in share options during the three month periods ended June 30, 2015 and the year ended March 31, 2015 are as follows:

	<u>June 30, 2015</u>		<u>March 31, 2015</u>	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of period	-	\$ -	-	\$ -
Issued	6,617,658	0.12	-	-
Expired	-	-	-	-
Outstanding, end of period	<u>6,617,658</u>	<u>\$ 0.12</u>	<u>\$ -</u>	<u>\$ -</u>

## RELATED PARTY TRANSACTIONS

The Company enters into transactions with related parties from time to time in the normal course of business, as well as key management personnel.

During the year ended June 30, 2015, the Company incurred \$nil (2014- \$nil) of consulting fees charged by a director.

**Summary Compensation Table of Amounts Paid or Payable to Directors and Officers during the quarter ended June 30, 2015:**

The following table sets forth details regarding compensation of officers for the quarter ended June 30, 2015:

Name and Principal Position	Salary	Bonus	All Other Compensation
Mo Fazil Chairman, President and C.E.O.	\$ 6,462	\$ Nil	\$ Nil
Harvey Lalach C.F.O	\$ 4,846	\$ Nil	\$ Nil
Mahesh Bhatia* V.P. Finance and C.F.O.	\$ 8,000	\$ Nil	\$ 8667

\*Mr. Bhatia, resigned as a V.P. Finance and C.F.O. on June 10, 2015.

The following table sets forth details regarding compensation of directors for the quarter ended June 30, 2015:

Name	Position	Compensation paid or payable for the quarter ended June 30, 2015
Robert Sadleir	Director	\$ 300
James Muraro	Director	\$ 300

**Compensation of Directors**

Each director who is not a full-time employee or officer of the Company receives director fees of \$6,000 per year. This amount is paid quarterly in arrears over the Company's fiscal year and is pro-rated if an individual resigns or is not re-elected. There are no other arrangements in addition to or in lieu of the above described fees under which directors of the Company were compensated by the Company during the most recently completed financial year for their services in their capacity as directors. The Company's directors who are also senior officers do not receive any cash payments for their services as directors.

**CAPITAL RISK MANAGEMENT**

The Company considers the capital it manages to be the amounts it has in cash, debt (long-term and short-term borrowings) and equity attributable to owners of the Company.

The Company's objectives when managing capital are to:

- safeguard the Company's ability to continue as a going concern
- ensure sufficient liquidity to support its financial obligations and execute its operating and strategic plans
- optimize the cost of its capital at an acceptable level in light of current and future industry, market and economic risks and conditions
- utilize the long-term funding sources to manage its working capital and restructure debt to minimize the cost of its capital
- acquire assets and dispose of non-performing assets

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, repurchase shares, issue debt, acquire or dispose of assets. The Company requires capital to repay existing obligations. There can be no certainty of the Company's ability to refinance its existing obligations. In order to facilitate the management of the Company's capital, the Company prepares annual cash flow forecasts that are updated as necessary depending on various factors and general industry conditions. There were no changes in the Company's approach to capital management.



The declaration and payment of dividends and the amount thereof are at the discretion of the Board. In order to maintain and maximize growth, maintain sufficient liquidity to support its financial obligations and optimize the cost of capital, the Company currently does not pay out dividends.

## FINANCIAL INSTRUMENTS

### a) **Overview**

The Company's activities expose it to a variety of financial risks that arise as a result of its operating and financing activities such as credit risk, liquidity risk, foreign currency risk and interest rate risk. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

### b) **Fair value of financial instruments**

The Company's financial instruments as at June 30, 2015 included cash, trade receivables, trade payables, accrued liabilities, notes payable, and long-term debt. The carrying amounts for short term financial assets and liabilities, which include trade receivables, trade payables and accrued liabilities approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash and trust cash are classified as fair value through profit and loss and therefore are recorded at fair value.

Management estimated the fair value of its long-term debt taking into account market rates of interest, the condition of any related collateral and the current conditions in credit markets applicable to the Company based on recent transactions. The estimated fair value of long-term debt approximates its carrying value.

For financial instruments measured at fair value, disclosure about the inputs to fair value measurements are required, including their classification within a fair value hierarchy that prioritizes the significance of inputs used in making fair value measurements.

Level 1 Fair Value Measurements – quoted prices in active markets for identical assets or liabilities;

Level 2 Fair Value Measurements – inputs other than quoted prices included in Level 1 that are observable for the asset or liabilities, either directly (i.e. as prices) or indirectly (i.e. from derived prices); and

Level 3 Fair Value Measurements– inputs for the asset or liability that are not based upon observable market data.

Cash and trust cash is based on Level 1 inputs of the fair value hierarchy.

### c) **Financial risk management**

The Company's financial instruments are exposed to certain financial risks, including credit risk, foreign currency risk, interest rate risk and liquidity risk.

#### *Credit risk*

The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations, or if there is a concentration of transactions carried out with the same counterparty or of financial obligations which have similar economic characteristics such that they could be similarly affected by changes in economic conditions.

The Company's financial instruments that are exposed to concentrations of credit risk relate primarily to cash, and trade receivables from clients. Cash is in place with major financial institutions.

As at June 30, 2015, the Company's maximum exposure to credit risk is through the following assets:

Receivables	\$	<u>727,481</u>
Net credit risk	\$	<u>727,481</u>

#### *Foreign currency risk*

The Company is exposed to the financial risk related to fluctuations of foreign exchange rates. The Company conducts business activities in Indonesia and has U.S. dollar denominated revenue, expenses and indebtedness and is therefore exposed to cash flow risks associated with fluctuations in the relative value of the Canadian and U.S. dollar. A significant change in the currency exchange rate of the Canadian dollar relative to the U.S. dollar could have a material effect on the

Company's results of operations, financial position and cash flows. The Company does not engage in hedging activities or use financial instruments to reduce its risk exposure.

At June 30, 2015, the Company is exposed to currency risk through the following assets and liabilities denominated in U.S. dollars:

Cash	\$ 658
Prepaid expense	83,239
Trade payables and accrued liabilities	(1,482)
Long-term debt	<u>(804,573)</u>
Net exposure	\$ <u>(722,158)</u>

Based on the above net exposure at June 30, 2015, and assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in a decrease or increase of \$72,215 in the Company's other comprehensive income (loss).

#### *Interest rate risk*

All of the Company's indebtedness bears interest at fixed rates and as a result the Company is not exposed to significant interest rate risk arising from long-term debt.

#### *Liquidity risk*

Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its short and long-term obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

The Company manages its liquidity risk through cash and debt management. The Company's objective in managing liquidity risk is to increase revenues, minimize operational costs and to maintain sufficient liquidity in order to meet these operational requirements at any point in time. The Company's ability to obtain funding from external sources may be restricted if the Company's financial performance and condition deteriorate. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's access and ability to fund its short-term and long-term debt requirements. The Company mitigates these risks by actively monitoring market conditions and diversifying its sources of funding and debt maturity.

The Company's trade payables are generally due within 60 days.

### **ADOPTION OF NEW ACCOUNTING STANDARDS**

The Company has adopted the following new accounting standards effective April 1, 2013. These changes were made in accordance with the applicable transitional provisions and had no impact on the financial statements.

- (i) IFRS 10 *Consolidated Financial Statements*. IFRS 10 defines a single concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of a parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess.
- (ii) IFRS 11 *Joint Arrangements*. IFRS 11 focuses on the rights and obligations of an arrangement rather than its legal form, as was previously the case. The standard distinguishes between joint operations, where the joint operator accounts for the assets, liabilities, revenues, and expenses relating to its involvement, and joint ventures, which must be accounted for using the equity method.
- (iii) IFRS 12 *Disclosure of Interests in Other Entities*. IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint operations, joint ventures, associates and unconsolidated structured entities.
- (iv) IFRS 13 *Fair Value Measurement*. IFRS 13 is a new standard that applies to both financial and non-financial items measured at fair value. It defines fair value, sets out a single framework for measuring fair value and requires disclosures about fair value measurements. Previously, a variety of fair value techniques and disclosures were possible under the requirements of separate applicable IFRS.

### **Accounting standards and interpretations issued but not yet adopted**

As at the date of these consolidated financial statements, the following standard has not been applied in these consolidated financial statements:

- (i) IFRS 9 *Financial Instruments*; effective for annual periods beginning on or after January 1, 2018. IFRS 9 replaces the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortized cost and fair value. IFRS 9 prohibits reclassifications except in rare circumstances when the entity's business model changes. The new standard removes the requirement to separate embedded derivatives from financial asset hosts. It requires a hybrid contract to be classified in its entirety at either amortized cost or fair value.

Management is currently assessing the impact of this new standard on the Company's accounting policies and financial statement presentation.

### **Use of Estimates and Judgments**

The preparation of these consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results could differ from these estimates.

Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In preparing these consolidated financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty are as follows:

#### *Use of Judgments*

##### **Income tax**

Management exercises judgment in estimating the provision for income taxes. The Company is subject to income tax laws in various jurisdictions where it operates. Various tax laws are potentially subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that the Company's interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience.

#### *Use of Estimates*

##### **Amortization and Depreciation**

Management is required to make certain estimates and assumptions when determining the depletion, amortization and depreciation methods and rates and residual values of property and equipment.

## **RISKS AND UNCERTAINTIES**

### **Exploration, Development and Production Risks**

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time, and the production there from, will decline over time as such existing reserves are exploited. A future increase in the Company's reserves will depend not only on its ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties and prospects. No assurance can be given that the Company will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, management of the Company may determine that current markets, terms of acquisitions and participation or pricing conditions make such acquisitions or participations uneconomic. There is no assurance that further commercial quantities of oil and natural gas will be discovered or acquired by the Company.

Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but also from wells that are productive but do not produce sufficient petroleum substances to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, 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. These conditions include delays in obtaining governmental approvals or consents; shut in of connected wells for various reasons including access issues resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical issues. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

## Global Financial Crisis

Recent market events and conditions, including disruptions in the international credit markets and to the financial systems, and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions are continuing in 2015, causing a loss of confidence in the broader Canadian and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate. These factors have negatively impacted corporate valuations and will impact the performance of the global economy going forward. Petroleum prices are expected to remain volatile for the near future as a result of the market uncertainties over the supply and demand of these commodities due to the current state of world economies, OPEC actions, regional conflicts and the ongoing global credit and liquidity concerns.

## Commodity Price Risk

The nature of the Company's operations results in exposure to commodity fluctuations. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company. A material change in prices of commodities affected the Company's borrowings and ultimately affecting the raising of equity financing. The Company does not hedge commodity price risk and has no physical forward price or financial derivative sales contracts as at or during the quarter ended June 30, 2015.

## Regulatory

Oil and natural gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Governments may regulate or intervene with respect to price, taxes, royalties and the exportation of oil and natural gas. Such regulations may be changed from time to time in response to economic or political conditions. The implementation of new regulations or the modification of existing regulations affecting the oil and natural gas industry could reduce demand for natural gas and crude oil and increase the Company's costs, any of which may have a material adverse effect on the Company's business, financial condition, results of operations and prospects. In order to conduct oil and gas operations, the Company will require licenses from various government authorities. There can be no assurance that the Company will be able to obtain all of the licenses and permits that may be required to conduct operations that it may wish to undertake.

## Environmental

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial 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 oil and natural gas 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 of applicable environmental legislation 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. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Company to incur costs to remedy such discharge. Although the Company believes that it will be in material compliance with current applicable environmental regulations no assurance can be given that environmental laws will not result in a curtailment of production or a material adverse effect on the Company's business, financial condition, results of operations and prospects. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact on the Company and its operations and financial condition.

## Substantial Capital Requirements

The Company anticipates making capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future in order to replace reserves. If the Company's revenues or reserves decline, it may not have access to the capital necessary to undertake or complete future drilling programs. In addition, uncertain levels of near term industry activity coupled with the recent global credit crisis exposes the Company to additional access to capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes including repayment of loan facilities when due or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations and capital requirements could have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

## Dilution

The Company may make future acquisitions or enter into financings or other transactions involving the issuance of securities of the Company which may be dilutive.