



Interim Report

**For the three months ended
March 31, 2017**

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of Return Energy Inc. ("Return" or the "Company") should be read in conjunction with the unaudited Condensed Consolidated Interim Financial Statements for the three months ended March 31, 2017 (the "Financial Statements") and the audited annual consolidated financial statements and MD&A for the year ended December 31, 2016. This MD&A has been prepared as of May 16, 2017.

Basis of Presentation

The Financial Statements and comparative information have been prepared in accordance with International Financial Reporting Standards. (IFRS)

Non-IFRS Measures

This MD&A includes references to financial measures commonly used in the oil and gas industry that do not have standardized meanings prescribed by IFRS including operating netback. Operating netback has been defined by the Company as "petroleum and natural gas sales less royalties and operating costs".

Other Measurements

All figures in this MD&A have been reported in Canadian dollars unless otherwise stated.

Where amounts are expressed on a barrel of oil equivalent (boe) basis, one thousand cubic feet (mcf) has been converted at a ratio of six thousand cubic feet to one barrel of oil. Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet to one barrel of oil is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

THE COMPANY

Return is engaged in the exploration for and development and production of petroleum and natural gas properties in the Western Canadian Sedimentary Basin. The Company is focused on the Peace River Arch area in Northwest Alberta. Return's shares are publicly traded on the TSX Venture Exchange under the symbol "RTN". The Company was incorporated under the Alberta Business Corporations Act on March 20, 2006 and is domiciled in Calgary, Canada.

Highlights:

The following highlights the significant events during the period:

- The Company closed a non-brokered private placement for total gross proceeds of \$2,104,148. The proceeds of this issuance will be used by Return to further its development activities in the Rycroft, Gordondale, Valhalla areas of Alberta.
- On April 20, 2017, the Company acquired production of approximately 60 BOE/day (80% natural gas), and the remaining 50% interest in the Company's operated Rycroft gathering system and gas plant for \$750,000 in cash, subject to closing adjustments. All of the acquired production is processed through the Rycroft gas plant. Based on the Company's existing independent reserve report prepared by Sproule Associates Limited dated effective December 31, the acquisition includes prorated proved developed producing reserves of 171,600 BOE and proved plus probable reserves of 228,400 BOE. Before tax net present value of future net revenue discounted at 10% equals \$989,000 for proved developed producing reserves and \$1,266,000 for proved plus probable reserves. Sole ownership of the gas plant provides Return greater flexibility and control over plant through-put and increases third party processing revenue.

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Petroleum and Natural Gas Production

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Production			
Oil and natural gas liquids (bbls)	5,251	3,366	-
Natural gas (mcf)	109,134	95,075	3,620
Oil equivalent (boe @ 6:1)	23,440	19,212	603
Average production per day			
Oil and natural gas liquids (bbls/d)	58	37	-
Natural gas (mcf/d)	1,213	1,033	40
BOE/d	260	209	7

For the three months ended March 31, 2017, petroleum and natural gas production averaged 260 boe/d. The increase over the three months ended March 31, 2016 is a result of the acquisitions the Company finalized on October 21, 2016, significantly increasing the Company's production. The increase in production during the three months ended March 31, 2017 over the three months ended December 31, 2016 is a result of having a full quarter of production from the October acquisitions.

Oil and Natural Gas Revenue

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
REVENUE			
Oil and natural gas liquids	\$ 293,562	\$ 194,078	\$ -
Natural Gas	279,972	322,947	5,670
Total petroleum and natural gas sales	\$ 573,534	\$ 517,025	\$ 5,670
Average Sales Price			
Oil and natural gas liquids (\$/bbls)	\$ 55.91	\$ 57.66	\$ -
Natural gas (\$/mcf)	2.57	3.40	1.57
Oil equivalent (\$/boe)	\$ 24.47	\$ 26.91	\$ 9.40

During the three months ended March 31, 2017 revenue increased 11% over the three months ended December 31, 2016. This increase is primarily a result of a full quarter of production offset by a 9% lower average sales price for the quarter.

Royalties

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Royalties			
Oil and natural gas liquids	31,333	14,413	-
Natural Gas	23,022	11,097	534
Total petroleum and natural gas sales	54,355	25,510	534
Average Royalty Rate (% of sales)			
Oil and natural gas liquids	10.67%	7.43%	-
Natural gas	8.22%	3.44%	9.42%
Oil equivalent	9.48%	4.93%	9.42%

MANAGEMENT'S DISCUSSION AND ANALYSIS

Royalties as a percentage of revenue averaged 9.48% for the three months ended March 31, 2017. Royalties for the three months ended December 31, 2016 were lower primarily due to a higher gas cost allowance credit during the quarter.

Operating Costs

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Operating Costs	\$ 500,704	\$ 494,695	\$ 5,270
\$ per boe	\$ 21.36	\$ 25.75	\$ 8.73

Operating costs averaged \$21.36 per boe for the three months ended March 31, 2017 a decrease of 17% over the three months ended December 31, 2016 primarily as a result of lower surface and mineral rentals.

Operating Netback

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Netback (\$/boe)			
Revenue	\$ 24.47	\$ 26.91	\$ 9.40
Royalties	(2.32)	(1.33)	(0.89)
Operating	(21.36)	(25.75)	(8.73)
Operating Netback	\$ 0.79	\$ (0.17)	\$ (0.22)

During the three months ended March 31, 2017 the Company had an operating netback of \$0.79 per boe compared to a negative operating netback of \$0.17 for the three months ended December 31, 2016. The increase in the operating netback is primarily a result of lower operating costs per boe partially offset by higher royalties and lower prices per boe.

Other revenue

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Other	\$ 60,383	\$ 34,239	\$ 31

Other revenue is primarily made up of gas processing and transportation fees and land use fees. The increase over the three months ending December 31, 2016 is primarily due to increased gas processing and transportation fees from third party gas.

MANAGEMENT'S DISCUSSION AND ANALYSIS

General and administrative

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
General and administrative	\$ 187,150	\$ 262,238	\$ 94,892

General and administrative costs for three months ended March 31, 2017 decreased over the three months ended December 31, 2016, primarily due to acquisitions costs recorded during the three months ended December 31, 2016. The increase in general and administrative costs over the three months ended March 31, 2016 is primarily due to the increase in activity.

Depletion and depreciation

	Three months ended March 31 2017	Three months ended December 31 2016	Three months ended March 31 2016
Depletion and depreciation	\$ 216,966	\$ 176,156	\$ 1,825
\$ per boe	\$ 9.26	\$ 9.17	\$ 3.02

Depletion and depreciation increased for the three months ended March 31, 2017 due to the increase in production compared to the three months ended March 31, 2016 and three months ended December 31, 2016.

Stock based compensation

Stock-based compensation costs for the three months ended March 31, 2017 amounted to \$43,450 (three months ended March 31, 2016 – \$10,749). The increase in stock-based compensation costs during the three months ended March 31, 2017 over the comparative period is attributable to a stock option grant in January 2017.

Stock-based compensation costs attributable to share options granted were measured at their fair value at the grant date and amortized over the vesting period with a corresponding increase to contributed surplus. The fair value of stock options granted was calculated using the Black-Scholes option pricing method.

Discontinued Operations

In June 2016 the Company relinquished its interest in the Bouhajla block in Tunisia and discontinued its operations in Tunisia.

Operating results related to discontinued operations have been included in the loss from discontinued operations on the condensed consolidated interim statements of loss. Comparative period balances have been restated. During the three months ended March 31, 2017 \$nil have been incurred in Tunisia (three months ended March 31, 2016 - \$17,265).

Share capital

During the three months ended March 31, 2017 the Company completed an equity financing and issued a total of 17,415,399 common shares and 16,883,959 warrants for total gross proceeds of \$2,104,148. Each warrant issued pursuant to the above mentioned financing, is exercisable by the holder to purchase one Common Share for a period of 12 months from March 14, 2017 at a price of \$0.15. The Company may redeem the warrants upon providing the holder notice. Such notice may be given by the Company, in its sole discretion, if the volume-weighted average price of the Common Shares on the

MANAGEMENT'S DISCUSSION AND ANALYSIS

TSX Venture Exchange exceeds the Warrant Exercise Price by at least 200% for a minimum of 10 consecutive trading days (whether or not trading of Common Shares occurs on all such days, provided that the Common Shares trade on at least five of such trading days.

In addition during the first quarter, the Company granted 2,070,000 stock options with an exercise price of \$0.185 per share to certain officers, directors, employees and consultants.

A total of 42,424,293 common shares, 23,686,459 warrants, and 2,190,000 stock options of the Company are outstanding as of the date hereof.

LIQUIDITY AND CAPITAL RESOURCES

As at March 31, 2017, the Company had working capital of \$2.9 million. The Company has a commitment to spend a minimum of \$100,000 by December 31, 2018 to meet its flow through obligation.

The Company's operating cash requirements including amounts projected to complete the Company's existing capital commitments are continuously monitored and adjusted as variables change. These variables include but are not limited to, oil and natural gas production, commodity prices, and expenditures on capital projects. Management has planned 2017 and 2018 operations based on their best estimates of projected business activity and estimated future cash flows.

SUMMARY OF QUARTERLY INFORMATION

The following table summarizes quarterly financial information for the previous quarters:

	Quarter ended							
	Mar 31 2017	Dec 31 2016	Sept 30 2016	Jun 30 2016	Mar 31 2016	Dec 31 2015	Sep 30 2015	Jun 30 2015
Average Daily Production								
Oil and NGLs (bbls/d)	58	37	-	-	-	-	-	-
Natural gas (mcf/d)	1,213	1,033	19	37	40	40	48	38
Combined (boe/d)	260	209	3	6	7	7	8	6
Total revenue, net of royalties	\$ 579,562	\$ 524,863	\$ 4,438	\$ 2,743	\$ 5,167	\$ 8,558	\$ 9,844	\$ 8,022
Loss from continuing operations	\$ (399,394)	\$ (424,037)	\$ (89,375)	\$ (62,975)	\$ (74,206)	\$ (85,243)	\$ (109,274)	\$ (117,183)
Gain (loss) from discontinued operations	-	293,058	(7,844)	(8,680)	(17,265)	(44,150)	(13,071)	(103,111)
Loss	\$ (399,394)	\$ (130,979)	\$ (97,219)	\$ (71,655)	\$ (91,471)	\$ (129,393)	\$ (122,345)	\$ (220,294)
Per share - basic and diluted								
Loss from continuing operations	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Gain (loss) from discontinued operation	-	0.01	-	-	-	-	-	(0.01)
Loss	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.02)

On October 21, 2016 the Company acquired producing oil and gas assets in the Peace River Arch area of northwest Alberta which accounts for the increase in both production and revenue compared to prior quarters. Production and revenue increased during the first quarter 2017 primarily due to having a full quarter of production compared to the prior quarter which only included production from October 21, 2016 from the Peace River Arch assets. The increase in the loss from continuing operations in the fourth quarter 2016 and first quarter 2017 is primarily a result of increased general and administrative and depletion and depreciation due to the previous mentioned acquisition. The gain from discontinued operations in the fourth quarter 2016 is a result of a reversal of previously accrued liabilities.

ACCOUNTING STANDARDS ISSUED BUT NOT YET APPLIED

There are no updates to future changes in accounting standards for the three months ended March 31, 2017. Further information on future changes in accounting standards can be found in the notes to the annual consolidated financial statements and annual MD&A for the year ended December 31, 2016.

BUSINESS RISKS AND UNCERTAINTIES

The Company, like all oil and gas corporations, operates in environments subject to inherent risks. These risks have not materially changed from December 31, 2016. Further information on business risks and uncertainties can be found in the annual MD&A for the year ended December 31, 2016.

Forward looking statements

Certain statements contained in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements, other than statements of historical fact, may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "propose", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors as actual results may vary. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

With respect to forward-looking statements listed above and contained in the MD&A, the Company has made assumptions regarding, among other things: the legislative and regulatory environment; commodity prices; estimated recoverable reserves; costs related to development of oil and gas properties will remain consistent with historical experience; and the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward looking-statements as a result of the risk factors set forth below and elsewhere in this MD&A; changes in oil and natural gas prices; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks, inherent in oil and natural gas operations; reservoir performance; labour, equipment and material costs; access to capital markets; interest; and economic conditions.

Additional information related to the Company can be found on SEDAR at www.sedar.com.



**Condensed Consolidated Interim
Financial Statements
(Unaudited)**

**For the three months ended
March 31, 2017**

Notice of No Auditor Review of Interim Financial Statements

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed these unaudited condensed consolidated interim financial statements as at and for the three months ended March 31, 2017.

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
(UNAUDITED, expressed in Canadian dollars)

<u>ASSETS</u>	As at	
	March 31, 2017	December 31, 2016
CURRENT		
Cash	\$ 2,690,246	\$ 602,848
Accounts receivable	562,017	780,647
Prepaid expenses and deposits	173,856	429,226
	3,426,119	1,812,721
PROPERTY, PLANT AND EQUIPMENT (note 3)	7,943,468	8,030,376
TOTAL ASSETS	\$ 11,369,587	\$ 9,843,097
 <u>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</u> 		
CURRENT		
Accounts payable and accrued liabilities	\$ 570,568	\$ 686,414
DECOMMISSIONING LIABILITIES (note 4)	6,305,425	6,236,420
CONVERTIBLE PREFERRED SHARES (note 5)	2,000,000	2,000,000
	8,305,425	8,236,420
TOTAL LIABILITIES	8,875,993	8,922,834
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 6c)	28,294,853	26,908,948
WARRANTS (note 6d)	724,417	180,417
CONTRIBUTED SURPLUS	4,961,866	4,918,416
ACCUMULATED OTHER COMPREHENSIVE INCOME	349,715	350,345
DEFICIT	(31,837,257)	(31,437,863)
TOTAL SHAREHOLDERS' EQUITY	2,493,594	920,263
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 11,369,587	\$ 9,843,097

See accompanying notes

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY (DEFICIT)
(UNAUDITED, expressed in Canadian dollars, except for number of shares outstanding)

	Number of shares	Share Capital	Warrants	Contributed Surplus	Accumulated Other Comprehensive Income (Loss)	Deficit	Total
Balance December 31, 2015	11,403,894	\$ 25,737,888	\$ -	\$ 4,884,019	\$ 342,087	\$ (31,046,539)	\$ (82,545)
Stock-based compensation		-	-	10,749	-	-	10,749
Comprehensive income (loss) for the period		-	-	-	14,052	(91,471)	(77,419)
Balance March 31, 2016	11,403,894	25,737,888	-	4,894,768	356,139	(31,138,010)	(149,215)
Private company acquisitions	5,500,000	477,064	72,936	-	-	-	550,000
Equity financing	8,105,000	693,996	107,481	-	-	-	801,477
Stock-based compensation	-	-	-	23,648	-	-	23,648
Comprehensive loss for the period		-	-	-	(5,794)	(299,853)	(305,647)
Balance December 31, 2016	25,008,894	26,908,948	180,417	4,918,416	350,345	(31,437,863)	920,263
Equity financing (note 6e)	17,415,399	1,385,905	544,000	-	-	-	1,929,905
Stock-based compensation	-	-	-	43,450	-	-	43,450
Comprehensive loss for the period		-	-	-	(630)	(399,394)	(400,024)
Balance March 31, 2017	42,424,293	\$ 28,294,853	\$ 724,417	\$ 4,961,866	\$ 349,715	\$ (31,837,257)	\$ 2,493,594

All references to common shares and per share amounts have been retroactively restated to reflect the share consolidation as outlined in note 6b.

See accompanying notes

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF LOSS
FOR THE THREE MONTHS ENDED MARCH 31
(UNAUDITED, expressed in Canadian dollars)

	2017	2016
REVENUE		
Petroleum and natural gas sales	\$ 573,534	\$ 5,670
Royalties	(54,355)	(534)
Other	60,383	31
	<u>579,562</u>	<u>5,167</u>
EXPENSES		
Operating costs	500,704	5,270
General and administrative	187,150	94,892
Stock-based compensation	43,450	10,749
Depletion and depreciation (note 3)	216,966	1,825
Accretion of decommissioning liabilities (note 4)	30,686	138
Gain on sale (note 3)	-	(35,000)
Foreign exchange loss	-	1,499
	<u>978,956</u>	<u>79,373</u>
LOSS FROM CONTINUING OPERATIONS	(399,394)	(74,206)
LOSS FROM DISCONTINUED OPERATIONS (note 7)	-	(17,265)
NET LOSS	<u>\$ (399,394)</u>	<u>\$ (91,471)</u>
LOSS PER SHARE		
Basic and diluted		
Loss per share from continuing operations	\$ (0.01)	\$ -
Gain (loss) per share from discontinued operations	-	-
Loss per share	<u>\$ (0.01)</u>	<u>\$ -</u>

See accompanying notes

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF LOSS
FOR THE THREE MONTHS ENDED MARCH 31
(UNAUDITED, expressed in Canadian dollars)

	2017	2016
NET LOSS	\$ (399,394)	\$ (91,471)
Other comprehensive income to be reclassified to income in subsequent periods		
Foreign currency translation adjustment	(630)	14,052
COMPREHENSIVE LOSS	<u>\$ (400,024)</u>	<u>\$ (77,419)</u>

See accompanying notes

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED MARCH 31
(UNAUDITED, expressed in Canadian dollars)

	2017	2016
OPERATING ACTIVITIES		
Loss from continuing operations	\$ (399,394)	\$ (74,206)
Add (subtract) items not requiring cash		
Depletion and depreciation	216,966	1,825
Gain on sale (note 3)	-	(35,000)
Accretion of decommissioning liabilities	30,686	138
Stock-based compensation	43,450	10,749
Unrealized foreign exchange gain (loss)	(630)	2,828
Settlement of decommissioning liabilities	(9,323)	-
Change in non-cash working capital items	214,535	29,802
Cash flow from (used in) continuing operations	96,290	(63,864)
Cash flow used in discontinued operations	-	(17,265)
Cash flow from (used in) operations	96,290	(81,129)
INVESTING ACTIVITIES		
Property, plant and equipment additions	(82,416)	-
Proceeds from disposition	-	35,000
Change in non-cash working capital items	-	(1,725)
Cash flow from (used in) continuing investing activities	(82,416)	33,275
FINANCING ACTIVITIES		
Proceeds from equity financing, net (note 6e)	1,929,905	-
Change in non-cash working capital items	143,619	-
Cash flow from continuing financing activities	2,073,524	-
Foreign exchange gain on cash held in a foreign currency	-	(1,536)
INCREASE (DECREASE) IN CASH	2,087,398	(49,390)
CASH, BEGINNING OF PERIOD	602,848	166,218
CASH, END OF PERIOD	\$ 2,690,246	\$ 116,828

See accompanying notes

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

1. GENERAL INFORMATION

Return Energy Inc. ("Return", the "Company" or the "Group") is engaged in the exploration for and development and production of petroleum and natural gas properties in Alberta. Return's shares are widely held and publicly traded on the TSX Venture Exchange under the symbol "RTN". The Company was incorporated under the Alberta Business Corporations Act on March 20, 2006 and is domiciled in Calgary, Canada. The Company's head office is located at Suite 950, 800 – 6th Avenue S.W., Calgary, Alberta T2P 3G3. The registered office of the Company is located at 1000, 250 - 2nd Street S.W., Calgary, Alberta T2P 0C1.

2. BASIS OF PREPARATION

a) Statement of compliance

These Unaudited Condensed Consolidated Interim Financial Statements for the three months ended March 31, 2017 (the "Financial Statements") have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* following accounting policies in accordance with International Financial Reporting Standards ("IFRS"). The Financial Statements do not include all of the information required for annual financial statements and should be read in conjunction with the Audited Consolidated Financial Statements for the year ended December 31, 2016, which have been prepared in accordance with IFRS.

b) Historical cost and fair value

The Financial Statements have been prepared using the historical cost basis with the exception of financial instruments designated at fair value through profit or loss.

c) Functional and presentation currency

The Financial Statements are presented in Canadian dollars, which is the functional currency of Return and its domestic subsidiaries. The functional currency of the Company's foreign subsidiary is US dollars.

d) Significant accounting policies

The accounting policies adopted in the Financial Statements are consistent with those described in Note 3 of the Audited Consolidated Financial Statements for the year ended December 31, 2016.

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements (Unaudited, All amounts in Canadian dollars unless otherwise stated)

3. PROPERTY, PLANT AND EQUIPMENT

	Oil and Gas Properties	Natural gas processing plant and equipment	Total PP&E
Cost			
Balance December 31, 2016	\$ 7,894,242	\$ 350,000	\$ 8,244,242
Additions	7,104	75,312	82,416
Change in estimate of decommissioning liabilities	47,642	-	47,642
Balance March 31, 2017	<u>\$ 7,948,988</u>	<u>\$ 425,312</u>	<u>\$ 8,374,300</u>
Accumulated depletion, depreciation and impairment			
Balance December 31, 2016	\$ (210,366)	\$ (3,500)	\$ (213,866)
Depletion and depreciation	(211,133)	(5,833)	(216,966)
Balance March 31, 2017	<u>\$ (421,499)</u>	<u>\$ (9,333)</u>	<u>\$ (430,832)</u>
Net Book Value			
Balance December 31, 2016	\$ 7,683,876	\$ 346,500	\$ 8,030,376
Balance March 31, 2017	<u>\$ 7,527,489</u>	<u>\$ 415,979</u>	<u>\$ 7,943,468</u>

At March 31, 2017, future development costs of \$4.7 million were included in the depletion calculation.

During the three months ended March 31, 2016, the Company sold mineral claims for \$35,000. The Company had a book value of \$nil, and as a result recorded a gain on sale of \$35,000.

4. DECOMMISSIONING LIABILITIES

The Company's decommissioning liabilities are based on the Company's net ownership in wells and facilities and management's estimate of costs to abandon and reclaim those wells and facilities as well as an estimate of the future timing of these costs.

	Three months ended March 31, 2017
Decommissioning liabilities, December 31, 2016	\$ 6,236,420
Change in estimated future cash outflows	47,642
Disposition	-
Settlement	(9,323)
Accretion	30,686
Decommissioning liabilities, March 31, 2017	<u>\$ 6,305,425</u>
Expected to be incurred within one year	\$ -
Expected to be incurred beyond one year	6,305,425
	<u>\$ 6,305,425</u>

The Company's decommissioning liabilities result from its ownership interest in oil and natural gas assets. The decommissioning liabilities are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities, and the estimated timing of the costs to be incurred in future years. The undiscounted amount of the estimated future cash flows required to settle the obligations as at March 31, 2017 is \$9,239,000. Payments to settle the decommissioning liabilities occur over the operating lives of the underlying assets, estimated to be from 5 – 41 years. The estimated future cash flows have been discounted at a risk free rates between 1.1% and 2.3% and reflect an inflation rate of 2%.

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

5. CONVERTIBLE PREFERRED SHARES

The Company has two million non-interest bearing, non-voting Series I Convertible Preferred Shares (the "Preferred Shares") outstanding. The holder may, at any time and at its option, convert all or part of the Preferred Shares into units ("Units") of Return. Each Unit is comprised of one (1) common share of Return and one-half (1/2) of a common share purchase warrant. The number of Units issuable upon the conversion of the Preferred Shares is equal to the number of Preferred Shares to be converted multiplied by \$1.00 and divided by the average of the trading price of the common shares on the TSX Venture Exchange (the "TSXV") during the immediately prior twenty (20) consecutive day period prior to conversion (the "Market Price"). Each whole common share purchase warrant entitles the holder to purchase one (1) common share until October 21, 2021 upon payment of the Common Share purchase warrant exercise price which is equal to the Market Price. The Company may at its sole discretion redeem the Preferred Shares at any time upon cash payment of one dollar per Preferred Share.

The Preferred Shares meet the definition of a financial liability, and therefore are recorded as a debt instrument, due to the Company's obligation to deliver a variable number of its own common shares to the holder upon conversion.

6. SHARE CAPITAL

(a) Authorized

The Company is authorized to issue an unlimited number of common shares with no par value and an unlimited number of first preferred shares with no par value. The first preferred shares may be issued in series, with the directors determining the terms of the preferred shares on a series by series basis.

(b) Share consolidation

On December 20, 2016 the Company consolidated its outstanding shares on a 10 for 1 basis. The share consolidation was approved by shareholders at the Company's annual shareholder meeting held on December 15, 2016. The Company had 250,088,939 common shares issued and outstanding prior to the share consolidation. Post consolidation the number of issued and outstanding shares is 25,008,894. The exercise price and number of common shares issuable pursuant to all outstanding stock options and warrants have been adjusted in accordance with the consolidation ratio.

All references to common shares and per share amounts have been retroactively restated to reflect the share consolidation.

(c) Issued and outstanding

	Number of Shares	Amount
Common Shares		
Balance December 31, 2016	25,008,894	\$ 26,908,948
Equity financing	17,415,399	1,385,905
Balance March 31, 2017	<u>42,424,293</u>	<u>\$ 28,294,853</u>

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

6. SHARE CAPITAL (continued)

(d) Warrants

	Number of Warrants	Value	Weighted Average Exercise Price
Warrants outstanding December 31, 2016	6,802,500	\$ 180,417	\$ 0.15
Issuance of Warrants			
on equity financing (note 6e)	16,883,959	544,000	0.15
Warrants outstanding March 31, 2017	<u>23,686,459</u>	<u>\$ 724,417</u>	<u>\$ 0.15</u>

(e) March 2017 financing

On March 14, 2017, the Company closed a non-brokered private placement comprised of common share units (the "Units") and Canadian exploration expense flow-through shares ("CEE FTS") (collectively, the "Offering"). Return issued 16,700,399 Units at a price of \$0.12 per Unit for gross proceeds of \$2,004,048, as well as 715,000 CEE FTS at a price of \$0.14 per CEE FTS for gross proceeds of \$100,100 for total gross proceeds of \$2,104,148. The CEE FTS were issued pursuant to the Income Tax Act (Canada) in respect of Canadian exploration expenses.

Each Unit issued consisted of one Return common share ("Common Share") and one full Common Share purchase warrant ("Warrant"). Each whole Warrant is exercisable by the holder to purchase one Common Share for a period of 12 months from March 14, 2017 ("Warrant Exercise Period") at a price of \$0.15 ("Warrant Exercise Price"). Each Warrant will entitle the holder thereof to purchase one Common Share at any time on or before the earlier of the date that is: (a) one year from the completion of the Offering; and (b) 30 days after the giving of notice of early termination by Return. Such notice may be given by the Company, in its sole discretion, if the volume-weighted average price of the Common Shares on the TSX Venture Exchange exceeds the Warrant Exercise Price by at least 200% for a minimum of 10 consecutive trading days (whether or not trading of Common Shares occurs on all such days, provided that the Common Shares trade on at least five of such trading days).

Finders received \$22,027 in cash and 183,560 Warrants as compensation. Total costs in connection with the financing amounted to \$174,243.

The Warrants have been assigned a value of \$544,000 using a Black-Scholes model with the following assumptions: expected life one year, expected volatility 100%, risk-free interest rate of 0.86%, and a zero dividend yield.

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

6. SHARE CAPITAL (continued)

(f) Stock based compensation

The Company has a stock option plan under which options to purchase common shares may be granted to officers, directors, employees and consultants. The Board has approved a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. Under the plan, all options have a maximum term of five years. All options awarded to date vest 1/3 per year on the anniversary date of the grant for the next three years. During the three months ended March 31, 2017 the following stock options were issued:

	Number of Options	Weighted Average Exercise Price
Outstanding December 31, 2016	120,000	\$ 2.26
Issued	2,070,000	0.185
Outstanding March 31, 2017	<u>2,190,000</u>	<u>\$ 0.30</u>

(g) Loss per share

The weighted average number of shares outstanding for the three months ended March 31, 2017 is 28,685,478 (three months ended March 31, 2016 – 11,403,834). Due to the loss in the three months ended March 31, 2017 and 2016 no options were included in the computation of diluted loss per share as they have an anti-dilutive effect on loss per share.

7. DISCONTINUED OPERATIONS

In June 2016 the Company relinquished its interest in the Bouhajla block in Tunisia and discontinued its operations in Tunisia.

Operating results related to discontinued operations have been included in net income (loss) from discontinued operations on the consolidated statements of loss. Comparative period balances have been restated. During the three months ended March 31, 2017 \$nil have been incurred in Tunisia (three months ended March 31, 2017 - \$17,265).

8. FINANCIAL INSTRUMENTS

The Company's financial instruments recognized in the consolidated statement of financial position consist of cash, accounts receivable, deposits, accounts payable and accrued liabilities, and Preferred Shares. Cash is classified as held for trading. The carrying value of cash, accounts receivable, and accounts payable and accrued liabilities approximate their respective fair values due to their short-term to maturity. The carrying value of the Preferred Shares approximate their fair value as they are convertible at the Market Price.

Carrying value and fair value of financial assets and liabilities are summarized as follows:

	March 31, 2017	
	<u>Carrying Value</u>	<u>Fair Value</u>
Cash	\$ 2,690,246	\$ 2,690,246
Accounts receivable	562,017	562,017
Deposits	139,286	139,286
Accounts payable and accrued liabilities	(570,568)	(570,568)
Convertible preferred shares	(2,000,000)	(2,000,000)

RETURN ENERGY INC.

Notes to the March 31, 2017 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

9. SUBSEQUENT EVENTS

On April 20, 2017, the Company acquired production of approximately 60 BOE/day (80% natural gas), and the remaining 50% interest in the Company's operated Rycroft gathering system and gas plant for \$750,000 in cash, subject to closing adjustments. All of the acquired production is processed through the Rycroft gas plant. The Company acquired this to further consolidate its position in the Peace River Arch. The allocations and determinations of the purchase price are preliminary and subject to change upon final adjustments.

The fair market value of the assets acquired are as follows:

Fair Value of net assets acquired:

Accounts Receivable	\$	75,000
Property, Plant and Equipment		1,140,000
Decommissioning Liabilities		(25,000)
Net Assets Acquired	\$	<u>1,190,000</u>

Consideration:

Cash	\$	<u>750,000</u>
Gain on acquisition	\$	<u>440,000</u>

Had the business combinations occurred on January 1, 2017, additional pro-forma revenue of approximately \$138,000 and net income of \$63,000 would have been recognized over the three months ended March 31, 2017.

The fair value of the decommissioning obligation at April 20, 2017 was based on the estimated future cash flows to decommission the acquired property, plant and equipment at the end of its useful life. The discount rate used to determine the net present value of the decommissioning obligation was the credit adjusted risk-free rate of 10%.

The Company entered into a lease agreement whereby the Company will lease office space until June 30, 2019. The Company has committed to future payments under this lease of \$37,600 in 2017, \$75,200 in 2018 and \$37,600 in 2019.

CORPORATE INFORMATION

OFFICERS

Kenneth M. Tompson, P. Geol
President and Chief Executive Officer

Garry T. Hides, P. Land
Executive Vice President

Jason Schoenfeld, P. Eng
VP Engineering and Chief Operating Officer

Lorne A. Morozoff, CA
VP Finance and Chief Financial Officer

DIRECTORS

Kenneth M. Tompson, P. Geol
Calgary, AB
President and Chief Executive Officer

Garry T. Hides, P. Land
Chestermere, AB
Executive Vice President

Roy H. Hudson, LLB
Calgary, AB
Partner
DLA Piper LLP

Bradley B. Porter
Okotoks, AB
Independent Businessman

Robb D. Thompson, CA
Calgary, AB
Chief Financial Officer
Bonterra Energy Corp.

HEAD OFFICE

950, 800 – 6th Avenue SW
Calgary, Alberta T2P 3G3
Main (403) 265-8011
www.returnenergyinc.com
info@ returnenergyinc.com

STOCK LISTING

TSX Venture Exchange
Trading Symbol “RTN”

AUDITORS

MNP LLP
1500, 640 – 5th Avenue SW
Calgary, Alberta T2P 3G4

LEGAL COUNSEL

DLA Piper LLP
1000, 250 – 2nd Street SW
Calgary, Alberta T2P 0C1

BANKERS

TD Canada Trust
2 Calgary Place, 340 – 5th Ave. SW
Calgary, Alberta T2P 0L3

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada
2300, 125 – 9th Avenue SW
Calgary, Alberta T2G OP6