



Interim Report

**For the three and six months ended
June 30, 2019 and 2018**

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 and six months ended June 30, 2019 (the "Financial Statements") and the audited annual consolidated financial statements, including the notes related thereto and MD&A for the year ended December 31, 2018. This MD&A has been prepared as of August 27, 2019.

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 in the Western Canadian Sedimentary Basin. The Company is focused on its Rycroft core property in the Peace River Arch area of 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.

Operations Update

The Board of Directors of the Company believes that the current trading price of its common shares does not adequately reflect the underlying value of the Company and its assets, in particular its Upper Charlie Lake light oil development project at Rycroft, Alberta. The Board has appointed an independent committee (the "Special Committee") to undertake a broad review of potential alternatives to enhance shareholder value. Such strategic alternatives may include, but are not limited to, a sale or merger of the Company or other form of business combination; a sale or joint venture involving all or a portion of the assets; a recapitalization of the Company or other form of strategic investment; or the purchase of assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Petroleum and Natural Gas Production

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Production volumes				
Crude oil (bbls)	2,204	2,829	4,927	6,021
Natural gas liquids (bbls)	1,165	1,670	2,654	3,412
Natural gas (mcf)	109,149	109,017	204,579	217,565
Oil equivalent (boe @ 6:1)	<u>21,561</u>	<u>22,669</u>	<u>41,678</u>	<u>45,694</u>
Average production per day				
Crude oil (bbls)	24	31	27	33
Natural gas liquids (bbls)	13	18	15	19
Natural gas (mcf/d)	1,199	1,198	1,130	1,202
BOE/d	<u>237</u>	<u>249</u>	<u>230</u>	<u>252</u>

For the three months ended June 30, 2019, petroleum and natural gas production averaged 237 boe/d, a decrease of 5% over the comparative quarter. During the six months ended June 30, 2019, petroleum and natural gas production averaged 230 boe/d a 10% decrease over the comparative period. The decreases are primarily a result of a sale of noncore production and certain wells being shut in at the Company's Gordondale property due to low natural gas prices.

Oil and Natural Gas Revenue

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
REVENUE				
Crude oil	\$ 148,851	\$ 212,824	\$ 318,368	\$ 426,152
Natural gas liquids	65,602	121,789	150,201	226,886
Natural gas	81,764	107,014	328,645	315,799
Total petroleum and natural gas sales	<u>\$ 296,217</u>	<u>\$ 441,627</u>	<u>\$ 797,214</u>	<u>\$ 968,837</u>
Average Sales Price				
Crude oil (\$/bbls)	\$ 67.54	\$ 75.23	\$ 64.62	\$ 70.78
Natural gas liquids (\$/bbl)	56.31	72.93	56.59	66.50
Natural gas (\$/mcf)	0.75	0.98	1.61	1.45
Oil equivalent (\$/boe)	<u>\$ 13.74</u>	<u>\$ 19.48</u>	<u>\$ 19.13</u>	<u>\$ 21.20</u>

During the three months ended June 30, 2019 oil and natural gas revenue decreased 33% over the three months ended June 30, 2018. This decrease is primarily the result of a 5% decrease in production volumes and a decrease in realized commodity prices of 29% compared to the three months ended June 30, 2018. During the six months ended June 30, 2019 oil and natural gas revenue decreased 18% from the comparative period as a result of a 10% decrease in production volumes and 10% decrease in commodity prices realized.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Royalties

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Royalties				
Crude oil	\$ 3,915	\$ 8,925	\$ 3,915	\$ 14,513
Natural gas liquids	41,124	13,687	41,124	52,286
Natural gas	(73,105)	(181,350)	(72,014)	(167,328)
Total royalties	\$ (28,066)	\$ (158,738)	\$ (26,975)	\$ (100,529)

Average Royalty Rate (% of sales)

Crude oil	2.63%	4.19%	1.23%	3.41%
Natural gas liquids	62.69%	11.24%	27.38%	23.05%
Natural gas	(89.41%)	(169.46%)	(21.91%)	(52.99%)
Total	(9.47%)	(35.94%)	(3.38%)	(10.38%)

During the three months ended June 30, 2019 and six months ended June 30, 2019 the Company recovered royalties of (\$28,066) and (\$26,975), respectively. Under the Gas Cost Allowance ("GCA"), a company producing natural gas from Crown lands in Alberta is allowed to deduct certain gas gathering and processing costs in calculating royalties. During the period from January 1, 2018 – December 31, 2018 the Company underestimated its gas gathering and processing costs which resulted in a lower GCA and therefore a higher royalty. During the three months ended June 30, 2019 the Company submitted its actual gas gathering and processing costs which resulted in the Company receiving a recovery for the prior year royalties paid.

A similar situation occurred for the three and six months ended June 30, 2018 which resulted in recoveries of (\$158,738) and (\$100,529), respectively. During the period from January 1, 2017 – December 31, 2017 the Company underestimated its gas gathering and processing costs which resulted in a lower GCA and therefore a higher royalty. During the three months ended June 30, 2018 the Company submitted its actual gas gathering and processing costs which resulted in the Company receiving a recovery for prior years royalties paid.

Operating Costs

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Operating costs	\$ 516,759	\$ 522,570	\$ 915,645	\$ 1,008,585
\$ per boe	\$ 23.97	\$ 23.05	\$ 21.97	\$ 22.07

For the three months ended June 30, 2019 operating costs decreased by 1% compared to the three months ended June 30, 2018. For the six months ended June 30, 2019 operating costs decreased by 9% compared to the comparative 2018 period. These decreases are a result of lower variable costs due to lower production and a lowering of contract operating fees.

On a per boe basis, operating costs increased slightly to \$23.97 per boe for the three months ended June 30, 2019 compared to \$23.05 per boe for the three months ended June 30, 2018, an increase of 4% per boe largely due to more fixed costs being spread over a lower production base. Conversely, operating costs per boe decreased by \$0.10 for the six months ended June 30, 2019 compared to the six months ended June 30, 2018.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Netback

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Netback (\$/boe)				
Revenue	\$ 13.74	\$ 19.48	\$ 19.13	\$ 21.20
Royalties	1.30	7.00	0.65	2.20
Operating	(23.97)	(23.05)	(21.97)	(22.07)
Operating Netback	\$ (8.93)	\$ 3.43	\$ (2.19)	\$ 1.33

During the three and six months ended June 30, 2019 the Company had operating netback losses of (\$8.93) and (\$2.19) respectively. The operating netback loss is primarily a result of lower prices received for the Company's petroleum and natural gas.

Processing and other revenue

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Processing and other	\$ 32,950	\$ 17,185	\$ 62,164	\$ 60,238

Processing and other revenue is primarily made up of gas processing and transportation fees from third party gas. This revenue is dependent on how much third party gas is processed at the Company's Rycroft gas plant and varies from quarter to quarter.

General and administrative

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
General and administrative	\$ 344,374	\$ 359,614	\$ 625,420	\$ 780,519

General and administrative costs for three months ended June 30, 2019 decreased 4% over the three months ended June 30, 2019. General and administrative costs for six months ended June 30, 2019 decreased 20% over the six months ended June 30, 2019 primarily due to lower professional fees.

Depletion and depreciation

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Depletion and depreciation	\$ 260,423	\$ 240,711	\$ 529,241	\$ 522,252
\$ per boe	\$ 12.08	\$ 10.62	\$ 12.70	\$ 11.43

Depletion and depreciation was higher for the three and six months ended June 30, 2019 compared to the comparative periods primarily due to a higher depletable base, primarily from an increase in future development costs, than the comparative periods.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Share-based compensation

Share-based compensation costs for the three and six months ended June 30, 2019 amounted to \$28,175 and \$56,350, respectively. Share-based compensation costs for the three and six months ended June 30, 2018 amounted to \$80,967 and \$167,808, respectively. The decrease in share-based compensation costs is attributable to a lower number of share options being amortized over the vesting period.

Share-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.

Capital Expenditures

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Capital expenditures				
Exploration and evaluation	\$ -	\$ 25,234	\$ -	\$ 62,022
Property plant and equipment	500	847,053	3,963	2,727,098
Total expenditures	\$ 500	\$ 872,287	\$ 3,963	\$ 2,789,120

During the three and six months ended June 30, 2019, the Company had limited capital expenditures compared to \$0.9 million and \$2.8 million spent during the three and six months ended June 30, 2018 related to the drilling and completion of two development wells at Rycroft.

Share capital

During the three and six months ended June 30, 2019, there were no changes to the Company's share capital.

A total of 110,551,648 common shares, 66,666,666 warrants, and 7,100,000 stock options of the Company are outstanding as of the date hereof.

In addition to the above, 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. No conversions of Preferred Shares may occur within 30 days of a prior conversion, and no conversion of Preferred Shares may occur when, after such conversion the Vendor would own (including shares owned prior to the conversion) 10% or more of the outstanding Common Shares after conversion.

MANAGEMENT'S DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2019, the Company had working capital of \$400,000. The Company has not committed to any future capital expenditures other than \$35,000 in decommissioning liabilities.

The Company's operating cash requirements 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 2019 operations based on its best estimates of projected business activity and estimated future cash flows.

The Company will need to carry out some form of sale of assets, financing, merger, farmout or other transaction to ensure the Company has the capital resources necessary to carry out its planned activities. This creates material uncertainty which casts significant doubt upon the Company's ability to continue as a going concern.

If the going concern basis of accounting is no longer appropriate, adjustments may be necessary to the carrying amounts and classification of the Company's assets and liabilities. The consolidated financial statements do not include any adjustments that might result if the Company is unable to continue as a going concern, and such adjustments could be material.

SUMMARY OF QUARTERLY INFORMATION

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

	Quarter ended							
	June 30 2019	Mar 31 2019	Dec 31 2018	Sept 30 2018	June 30 2018	Mar 31 2018	Dec 31 2017	Sep 30 2017
Average Daily Production								
Oil and NGLs (bbls/d)	37	47	41	56	49	54	57	55
Natural gas (mcf/d)	1,199	1,060	1,129	1,208	1,198	1,206	1,432	1,527
Combined (boe/d)	237	224	229	257	249	256	296	310
Total revenue, net of royalties	\$ 357,233	\$ 529,120	\$ 345,151	\$ 559,073	\$ 617,550	\$ 512,054	\$ 451,784	\$ 429,053
Net loss	\$ (820,297)	\$ (427,366)	\$ (1,496,741)	\$ (237,375)	\$ (623,582)	\$ (798,398)	\$ (995,041)	\$ (942,399)
Per share - basic and diluted								
Net income (loss)	\$ (0.01)	\$ -	\$ (0.01)	\$ -	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.02)

The decline in production from the fourth quarter 2017 through the second quarter 2019 is primarily due to the following: the Company shutting in certain wells as they are uneconomic in the current price environment; the sale of certain non-core assets; and natural production declines. During the quarters ended September 30, 2017 through to March 31, 2019 the Company generated losses primarily due to the sustained low natural gas price. In the quarter ended December 31, 2018, the Company recorded a \$595,000 impairment on certain of its non-core properties.

CRITICAL ACCOUNTING ESTIMATES

There have been no changes to the Company's critical accounting policies and estimates as of the period ended in the financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS

BUSINESS RISKS AND UNCERTAINTIES

The Company, like all oil and gas corporations, operates in environments subject to inherent risks. Many such uncertainties are beyond the ability of the Company to control – particularly those associated with exploring for, and developing, economic quantities of hydrocarbons; volatile commodity prices; foreign exchange rates; issues related to global supply and demand; governmental regulations; and environmental matters.

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; and costs related to development of oil and gas properties will remain consistent with historical experience.

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; ability to carry out some form of sale of assets, financing, merger, farmout or other transaction; 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 and six months ended
June 30, 2019 and 2018**

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 and six months ended June 30, 2019.

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

<u>ASSETS</u>	As at	
	June 30, 2019	December 31, 2018
CURRENT		
Cash	\$ 784,743	\$ 974,813
Accounts receivable	261,157	254,620
Prepaid expenses and deposits	33,605	73,023
	<u>1,079,505</u>	<u>1,302,456</u>
EXPLORATION AND EVALUATION (note 3)	352,666	352,666
PROPERTY, PLANT AND EQUIPMENT (note 4)	10,196,048	10,619,438
TOTAL ASSETS	<u>\$ 11,628,219</u>	<u>\$ 12,274,560</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
CURRENT		
Accounts payable and accrued liabilities	\$ 618,031	\$ 387,518
Decommissioning liabilities (note 5)	35,000	100,000
	<u>653,031</u>	<u>487,518</u>
DECOMMISSIONING LIABILITIES (note 5)	7,122,558	6,743,099
CONVERTIBLE PREFERRED SHARES (note 6)	2,000,000	2,000,000
	<u>9,122,558</u>	<u>8,743,099</u>
TOTAL LIABILITIES	<u>9,775,589</u>	<u>9,230,617</u>
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 7b)	30,968,189	30,968,189
WARRANTS (note 7c)	2,200,000	2,200,000
CONTRIBUTED SURPLUS	6,425,318	6,368,968
DEFICIT	(37,740,877)	(36,493,214)
TOTAL SHAREHOLDERS' EQUITY	<u>1,852,630</u>	<u>3,043,943</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 11,628,219</u>	<u>\$ 12,274,560</u>

Going Concern (note 2b)
Commitments (note 11)

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

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF NET LOSS AND COMPREHENSIVE LOSS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30
(UNAUDITED, Expressed in Canadian dollars)

	Three months ended June 30		Six months ended June 30	
	2019	2018	2019	2018
REVENUE				
Oil and gas sales, net of royalties (note 8)	\$ 324,283	\$ 600,365	\$ 824,189	\$ 1,069,366
Processing and other	32,950	17,185	62,164	60,238
	<u>357,233</u>	<u>617,550</u>	<u>886,353</u>	<u>1,129,604</u>
EXPENSES				
Operating costs	516,759	522,570	915,645	1,008,585
General and administrative	344,374	359,614	625,420	780,519
Share-based compensation (7d)	28,175	80,967	56,350	167,808
Depletion, depreciation and impairment (note 4)	260,423	240,711	529,241	522,252
Accretion of decommissioning liabilities (note 5)	27,799	37,270	57,360	72,420
Gain on sale of exploration and evaluation assets (note 3)	-	-	(50,000)	-
	<u>1,177,530</u>	<u>1,241,132</u>	<u>2,134,016</u>	<u>2,551,584</u>
NET LOSS AND COMPREHENSIVE LOSS	<u>\$ (820,297)</u>	<u>\$ (623,582)</u>	<u>\$ (1,247,663)</u>	<u>\$ (1,421,980)</u>
LOSS PER SHARE (note 7e)				
Basic and diluted				
Loss per share	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>

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

RETURN ENERGY INC.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOW
FOR THE SIX MONTHS ENDED JUNE 30
(UNAUDITED, Expressed in Canadian dollars)

	2019	2018
OPERATING ACTIVITIES		
Net Loss	\$ (1,247,663)	\$ (1,421,980)
Add (subtract) items not requiring cash		
Depletion, depreciation and impairment (note 4)	529,241	522,252
Gain on sale of exploration and evaluations assets (note 3)	(50,000)	-
Accretion of decommissioning liabilities (note 5)	57,360	72,420
Share-based compensation (note 7d)	56,350	167,808
Settlement of decommissioning liabilities (note 5)	(59,582)	(578,104)
Change in non-cash working capital items (note 9)	263,394	(204,967)
Cash flow used in operations	<u>(450,900)</u>	<u>(1,442,571)</u>
INVESTING ACTIVITIES		
Exploration and evaluation expenditures	-	(62,022)
Property, plant and equipment expenditures (note 4)	(3,963)	(2,727,098)
Property disposition (note 4)	214,793	-
Exploration and evaluations asset disposition (note 3)	50,000	-
Change in non-cash working capital items (note 9)	-	831,319
Cash flow used in investing activities	<u>260,830</u>	<u>(1,957,801)</u>
DECREASE IN CASH	(190,070)	(3,400,372)
CASH, BEGINNING OF PERIOD	974,813	5,785,294
CASH, END OF PERIOD	<u>\$ 784,743</u>	<u>\$ 2,384,922</u>

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

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

	Number of shares	Share Capital	Warrants	Contributed Surplus	Deficit	Total
Balance December 31, 2018	110,551,648	\$ 30,968,189	\$ 2,200,000	\$ 6,368,968	\$ (36,493,214)	\$ 3,043,943
Share-based compensation	-	-	-	56,350	-	56,350
Comprehensive loss for the period	-	-	-	-	(1,247,663)	(1,247,663)
Balance June 30, 2019	<u>110,551,648</u>	<u>\$ 30,968,189</u>	<u>\$ 2,200,000</u>	<u>\$ 6,425,318</u>	<u>\$ (37,740,877)</u>	<u>\$ 1,852,630</u>

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

RETURN ENERGY INC.

Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements (Unaudited, All amounts in Canadian dollars unless otherwise stated)

1. GENERAL INFORMATION

Return Energy Inc. and its subsidiary (“Return”, the “Company” or the “Group”) are engaged in the exploration for and development and production of petroleum and natural gas in 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. The Company’s head office is located at Suite 1220, 407 – 2nd Street S.W., Calgary, Alberta T2P 2Y3. The registered office of the Company is located at 1000, 250 - 2nd Street S.W., Calgary, Alberta T2P 0C1. Return Energy Inc. has one 100% owned subsidiary, Winslow Resources Inc.

2. BASIS OF PREPARATION

a) Statement of compliance

These Unaudited Condensed Consolidated Interim Financial Statements for the three and six months ended June 30, 2019 (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, 2018 which have been prepared in accordance with IFRS.

b) Going concern

The Financial Statements have been prepared on the basis that the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. For the six months ended June 30, 2019, the Company reported a net loss of \$1.2 million and negative cash flow used in operations of \$0.5 million. The above factors result in a material uncertainty which casts significant doubt upon the Company’s ability to continue as a going concern. If the going concern basis of accounting is no longer appropriate, adjustments may be necessary to the carrying amounts and classification of the Company’s assets and liabilities. The Financial Statements do not include any adjustments that might result if the Company is unable to continue as a going concern, and such adjustments could be material. The Company’s ability to continue as a going concern is dependent on the ability to carry out some form of sale of assets, financing, merger, farmout or other transaction.

c) Historical cost

The Financial Statements have been prepared using the historical cost basis.

RETURN ENERGY INC.

Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

2. BASIS OF PREPARATION (continued)

d) Adopted accounting pronouncements

IFRS 16 “Leases”

As of January 1, 2019, the Company adopted IFRS 16 which introduces a single lease accounting model for lessees which requires the recognition of a right of use asset (“ROU”) and a lease liability on the statement of financial position for contracts that are a lease.

The Company adopted IFRS 16 using the modified retrospective approach. Under this method of adoption, the ROUs recognized were measured at amounts equal to the present value of the lease obligations. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effective of IFRS 16 as an adjustment to opening retained earnings and applies the standard prospectively. The Company elected to not apply lease accounting to leases for which the lease term ends within 12 months of the date of initial adoption. The Company did a complete evaluation of the contracts it has entered into, and it was determined that there is no material impact as a result of adopting IFRS 16. In addition, as a result of this adoption, the Company has included an accounting policy for leases as follows:

Leases

Leases or contractual obligations are capitalized as ROUs with a corresponding right of use lease obligation using the present value of future lease payments on the statement of financial position. The discount rate used to determine the ROU is disclosed in the lease contract or the Company’s incremental borrowing rate, if none is provided. Lease payments equal to or less than twelve months will continue to be expensed in the statement of net loss and comprehensive loss.

e) 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, 2018, except for leases, which are described in note 2d above.

3. EXPLORATION AND EVALUATION ASSETS

Balance, December 31, 2018 and June 30, 2019	<u>\$ 352,666</u>
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During the three months ended March 31, 2019, the Company sold undeveloped land for cash proceeds of \$50,000. The undeveloped land had a net book value of \$nil and as a result a gain on sale of \$50,000 was recorded.

RETURN ENERGY INC.

Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements (Unaudited, All amounts in Canadian dollars unless otherwise stated)

4. PROPERTY, PLANT AND EQUIPMENT (“PP&E”)

Cost	Oil and gas properties	Natural gas processing plant and equipment	Office equipment and other	Total PP&E
Balance December 31, 2018	\$ 12,304,452	\$ 1,205,154	\$ 20,615	\$ 13,530,221
Additions	3,963	-	-	3,963
Disposition	(412,376)	-	-	(412,376)
Decommissioning liabilities (note 5)	514,264	-	-	514,264
Balance June 30, 2019	<u>\$ 12,410,303</u>	<u>\$ 1,205,154</u>	<u>\$ 20,615</u>	<u>\$ 13,636,072</u>
Accumulated depletion, depreciation and impairment				
Balance December 31, 2018	\$ (2,744,677)	\$ (153,888)	\$ (12,218)	\$ (2,910,783)
Depletion, depreciation and impairment	(463,111)	(61,930)	(4,200)	(529,241)
Balance June 30, 2019	<u>\$ (3,207,788)</u>	<u>\$ (215,818)</u>	<u>\$ (16,418)</u>	<u>\$ (3,440,024)</u>
Net Book Value				
Balance December 31, 2018	<u>\$ 9,559,775</u>	<u>\$ 1,051,266</u>	<u>\$ 8,397</u>	<u>\$ 10,619,438</u>
Balance June 30, 2019	<u>\$ 9,202,515</u>	<u>\$ 989,336</u>	<u>\$ 4,197</u>	<u>\$ 10,196,048</u>

During the six months ended June 30, 2019, the Company sold non-core oil assets for cash proceeds of \$214,793. The non-core assets sold had a book value of \$412,376 and decommissioning liabilities of \$197,583.

For the six months ended June 30, 2019, future development costs of \$13.7 million (June 30, 2018 - \$4.7 million) were included in the depletion calculation.

5. DECOMMISSIONING LIABILITIES

Decommissioning liabilities, December 31, 2018	\$ 6,843,099
Liabilities divested	(197,583)
Change in estimated future cash outflows	514,264
Settlement	(59,582)
Accretion	57,360
Decommissioning liabilities, June 30, 2019	<u>\$ 7,157,558</u>
Expected to be incurred within one year	\$ 35,000
Expected to be incurred beyond one year	<u>7,122,558</u>
	<u>\$ 7,157,558</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 June 30, 2019 is \$9.3 million. Payments to settle the decommissioning liabilities occur over the operating lives of the underlying assets, estimated to be from 1 – 40 years. The estimated future cash flows have been discounted at risk free rates of between 1.4% and 1.7% and reflect an inflation rate of 2%.

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Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements
(Unaudited, All amounts in Canadian dollars unless otherwise stated)

6. 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. No conversion of Preferred Shares may occur within 30 days of a prior conversion, and no conversion of Preferred Shares may occur when, after such conversion the Vendor would own (including shares owned prior to the conversion) 10% or more of the outstanding common shares after conversion.

The conversion feature does not meet the definition of an embedded derivative and as such the entire investment is deemed to be a financial liability. Therefore, the Preferred Shares 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.

7. 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) Issued and outstanding

	Number of Shares	Amount
Common Shares		
Balance December 31, 2018 and June 30, 2019	<u>110,551,648</u>	<u>\$ 30,968,189</u>

(c) Warrants

	Number of Warrants	Value	Average Exercise Price
Warrants outstanding December 31, 2018 and June 30, 2019	<u>66,666,666</u>	<u>\$ 2,200,000</u>	<u>0.10</u>

RETURN ENERGY INC.

Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements
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7. SHARE CAPITAL (continued)

(d) Share-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 of Directors 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 December 31, 2017 vest 1/3 per year on the anniversary date of the grant for the next three years. Options awarded in 2018 vest 1/2 per year on the anniversary date of the grant for the next two years.

	Number of Options	Weighted Average Exercise Price
Ousting December 31, 2018 and June 30, 2019	<u>7,100,000</u>	<u>0.16</u>

The following summarizes outstanding stock options as at June 30, 2019.

Date of Grant	Number Outstanding	Average Exercise Price	Remaining Contractual Life in Years	Options Exercisable
02-Sep-14	105,000	\$ 2.30	0.17	105,000
05-Jan-17	1,995,000	\$ 0.185	2.50	1,330,000
10-Jan-18	5,000,000	\$ 0.100	3.50	2,500,000
	<u>7,100,000</u>	<u>\$ 0.16</u>	<u>3.17</u>	<u>3,935,000</u>

The Company determined the value of the options granted using a Black Scholes option pricing model with the following assumptions:

	2018	2017
Risk free rate	1.9%	1.1%
Expected life	5 years	5 years
Expected volatility	100%	100%
Expected dividend	0%	0%
Forfeiture rate	10%	10%
Fair value of option	\$0.07	\$0.14

(e) Loss per share

The weighted average number of shares outstanding for the three and six months ended June 30, 2019 and three and six months ended June 30, 2018 is 110,551,648. No options or warrants were included in the computation of diluted loss per share as they have an anti-dilutive effect on loss per share.

RETURN ENERGY INC.

Notes to June 30, 2019 Condensed Consolidated Interim Financial Statements (Unaudited, All amounts in Canadian dollars unless otherwise stated)

8. OIL AND GAS SALES, NET OF ROYALTIES

	Three months ended June 30		Six months ended June 30	
	2019	2018	2019	2018
Oil and gas sales				
Crude oil	\$ 148,851	\$ 212,824	\$ 318,368	\$ 426,152
Natural gas	81,764	107,014	328,645	315,799
Natural gas liquids	65,602	121,789	150,201	226,886
	<u>296,217</u>	<u>441,627</u>	<u>797,214</u>	<u>968,837</u>
Less royalties				
Crown	(29,241)	(159,968)	(29,241)	(103,187)
Freehold and gross overriding royalties	1,175	1,230	2,266	2,658
	<u>(28,066)</u>	<u>(158,738)</u>	<u>(26,975)</u>	<u>(100,529)</u>
Oil and gas sales, net of royalties	<u>\$ 324,283</u>	<u>\$ 600,365</u>	<u>\$ 824,189</u>	<u>\$ 1,069,366</u>

9. SUPPLEMENTAL CASH FLOW INFORMATION

	As at June 30	
	2019	2018
Change in non-cash working capital related to operating activities		
Accounts receivable	\$ (6,537)	\$ (167,027)
Prepaid expenses and deposits	39,418	(72,245)
Accounts payable and accrued liabilities	230,513	34,305
	<u>\$ 263,394</u>	<u>\$ (204,967)</u>
Change in non-cash working capital related to investing activities		
Accounts receivable	\$ -	\$ 831,319
	<u>\$ -</u>	<u>\$ 831,319</u>

10. FINANCIAL INSTRUMENTS

The Company's financial instruments recognized in the condensed consolidated interim statement of financial position consist of cash, accounts receivable, deposits, accounts payable and accrued liabilities, and Preferred Shares. Cash is classified as fair value through profit and loss. 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.

11. COMMITMENTS

The Company entered into a lease agreement whereby the Company will lease office space until December 31, 2019. The Company has committed to future payments under this lease of \$34,700.

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

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

Roy H. Hudson, LLB
Calgary, AB
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Bradley B. Porter
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Independent Businessman

Robb D. Thompson, CA
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