

ORCA EXPLORATION GROUP INC.

MANAGEMENT'S  
DISCUSSION  
& ANALYSIS

## Management's Discussion & Analysis

THIS MD&A OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2017 SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS AND NOTES FOR THE THREE MONTHS ENDED MARCH 31, 2017 AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES TOGETHER WITH THE MD&A FOR THE YEAR ENDED DECEMBER 31, 2016. THIS MD&A IS BASED ON THE INFORMATION AVAILABLE ON MAY 25, 2017.

### FORWARD LOOKING STATEMENTS

This management's discussion and analysis ("MD&A") contains forward-looking statements or information (collectively, "forward-looking statements") within the meaning of applicable securities legislation. More particularly, this MD&A contains, without limitation, forward-looking statements pertaining to the following: the Company's expectations regarding supply and demand of natural gas; anticipated power sector revenues; potential impact of Tanzanian Production Development Corporation ("TPDC") future back-in rights on the economic terms of the Production Sharing Agreement ("PSA"); ability to meet all conditions under the International Finance Corporation ("IFC") financing agreement; the Company's estimated spending for the planned Development Program for 2017 and 2018, which includes construction of the production platform for well SS-12, tie-in of well SS-12 to the production facilities and implementation of a refrigeration unit to enable production into the National Natural Gas Infrastructure Project ("NNGIP") which includes two gas processing facilities and pipelines supplying gas from the Mtwara Region of Tanzania and Songo Songo Island to Dar es Salaam; the potential impact of the Petroleum Act, 2015 ("Act") and the Finance Act, 2016 on the Company's business in Tanzania; the Company's belief that the parties to the unsigned Amended and Restated Gas Agreement ("ARGA") will continue to conduct themselves in accordance with the ARGA until the new Gas Sales Agreement ("NGSA") is signed; the Company's expectation that, despite the Re-Rating Agreement of the gas processing plant owned by Songas Limited ("Songas") having expired, the Songas gas processing plant will not be de-rated or production through the plant restricted; the risk that Songas and the Company will not agree on appropriate terms and sign the NGSA in a timely manner; the Company's expectation that it can expand and maintain the deliverability of gas volumes in excess of the existing Songas infrastructure; the forward-looking statements under "Contractual Obligations and Committed Capital Investment"; the Company's expectation that it will not have a shortfall during the term of the Protected Gas delivery obligation to July 2024; and the Company's expectations in respect of its appeal on the decision of the Tax Revenue Appeals Tribunal and other statements under "Contingencies – Taxation". In addition, statements relating to "reserves" are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. The recovery and reserve estimates of the Company's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Although management believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, operational, competitive, political and social uncertainties and contingencies.

These forward-looking statements involve substantial known and unknown risks and uncertainties, certain of which are beyond the Company's control, and many factors could cause the Company's actual results to differ materially from those expressed or implied in any forward-looking statements made by the Company, including, but not limited to: failure to receive payments from the Tanzanian Electric Supply Company Limited ("TANESCO"); risk that the planned financing solutions to resolve the TANESCO arrears are not implemented by the Tanzanian government; risk that planned financing provided by the World Bank will not be completed or funds will not be allocated to resolving TANESCO arrears; risk that TPDC, the Ministry of Energy and Minerals ("MEM") and the Company are unable to agree on commercial terms for future incremental gas sales and consequently the Company cannot expand the Songo Songo development beyond the existing Songas infrastructure and supply gas to the NNGIP; risk that additional gas volumes available to the NNGIP from third parties will replace all or a portion of the volumes currently nominated by TANESCO under the Portfolio Gas Sales Agreement ("PGSA") until additional gas-fired power generation is brought on-stream to consume all of the Company's available gas production; risk that the Development Program is not completed as planned and the actual cost to complete the Development Program exceeds the Company's estimates; risk that the remaining well workovers under the Development Program are unsuccessful or determined to be unfeasible; risk that the contingencies related to the development work for the full field development plan for Songo Songo are not satisfied; potential negative effect on the Company's rights under the PSA and other agreements relating to its business in Tanzania as a result of the recently approved Act, as well as the risk that such legislation will create additional costs and time connected with the Company's business in Tanzania; risk that, without extending or replacing the Re-Rating Agreement, the gas being processed through the Songas gas processing plant may be reduced back to its original capacity, resulting in a material reduction in the Company's sales volumes of Additional Gas; risk that the Company will not fully recover Songas' share of capital expenditures associated with the workovers of wells SS-5 and SS-9; risk that the Company will not be successful in appealing claims made by the Tanzanian Revenue Authority ("TRA") and may be required to pay additional taxes and penalties; the impact of general economic conditions in the areas in which the Company operates; civil unrest; industry conditions; changes in laws and regulations including the adoption of new environmental laws and regulations, impact of new local content regulations and changes in how they are interpreted and enforced; increased competition; the lack of availability of qualified personnel or management; fluctuations in commodity prices, foreign exchange or interest rates; stock market volatility; competition for, among other things, capital, drilling equipment and skilled personnel; failure to obtain required equipment for drilling; delays in drilling plans; failure to obtain expected results from drilling of wells; effect of changes to the PSA on the Company; changes in laws; imprecision in reserve estimates; the production and growth potential of the Company's assets; obtaining required approvals of regulatory authorities; risks associated with negotiating with foreign governments; inability to satisfy debt obligations and conditions; failure to successfully negotiate agreements; and risk that the Company will not be able to fulfil its contractual obligations. In addition, there are risks and uncertainties associated with oil and gas operations, therefore the Company's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurances can be given that any of the events anticipated by these forward-looking statements will transpire or occur, or if any of them do so, what benefits the Company will derive therefrom. Readers are cautioned that the foregoing list of factors is not exhaustive.

Such forward-looking statements are based on certain assumptions made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors the Company believes are appropriate in the circumstances, including, but not limited to, the TPDC, the MEM and the Company are able to agree on commercial terms for future incremental gas sales and the Company can expand Songo Songo development beyond the existing Songas infrastructure and supply gas to the NNGIP; the Development Program will be completed within the timing anticipated; the actual costs to complete the Development Program are in line with estimates; that there will continue to be no restrictions on the movement of cash from Mauritius or Tanzania; that the Company will have sufficient cash flow, debt or equity sources or other financial resources required to fund its capital and operating expenditures and requirements as needed; that the Company will have adequate funding to continue operations; that the Company will successfully negotiate agreements; receipt of required regulatory approvals; the ability of the Company to increase production at a consistent rate; infrastructure capacity; commodity prices will not further deteriorate significantly; the ability of the Company to obtain equipment and services in a timely manner to carry out exploration, development and exploitation activities; future capital expenditures; availability of skilled labour; timing and amount of capital expenditures; uninterrupted access to infrastructure; the impact of increasing competition; conditions in general economic and financial markets; effects of regulation by governmental agencies; that the Company's appeal of various tax assessments will be successful; that the enactment of the Act in Tanzania will not impair the Company's rights under the PSA to develop and market natural gas in Tanzania; current or, where applicable, proposed industry conditions, laws and regulations will continue in effect or as anticipated as described herein; and other matters.

The forward-looking statements contained in this MD&A are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

## NON-GAAP MEASURES

THE COMPANY EVALUATES ITS PERFORMANCE USING A NUMBER OF NON-GAAP (GENERALLY ACCEPTED ACCOUNTING PRINCIPLES) MEASURES. THESE NON-GAAP MEASURES ARE NOT STANDARDISED AND THEREFORE MAY NOT BE COMPARABLE TO SIMILAR MEASUREMENTS OF OTHER ENTITIES.

- CASH FLOWS FROM OPERATIONS REPRESENTS NET CASH FLOW FROM OPERATING ACTIVITIES LESS INTEREST PAID AND BEFORE CHANGES IN NON-CASH WORKING CAPITAL. THIS IS A PERFORMANCE MEASURE THAT MANAGEMENT BELIEVES REPRESENTS THE COMPANY'S ABILITY TO GENERATE SUFFICIENT CASH FLOW TO FUND CAPITAL EXPENDITURES AND REPAY DEBT.
- OPERATING NETBACKS REPRESENT THE PROFIT MARGIN ASSOCIATED WITH THE PRODUCTION AND SALE OF ADDITIONAL GAS AND IS CALCULATED AS REVENUES LESS PROCESSING AND TRANSPORTATION TARIFFS, GOVERNMENT PARASTATAL'S REVENUE SHARE, OPERATING AND DISTRIBUTION COSTS FOR ONE THOUSAND STANDARD CUBIC FEET OF ADDITIONAL GAS. THIS IS A KEY MEASURE AS IT DEMONSTRATES THE PROFIT GENERATED FROM EACH UNIT OF PRODUCTION, AND IS WIDELY USED BY THE INVESTMENT COMMUNITY.
- CASH FLOWS FROM OPERATIONS PER SHARE IS CALCULATED ON THE BASIS OF THE CASH FLOW FROM OPERATIONS DIVIDED BY THE WEIGHTED AVERAGE NUMBER OF SHARES.
- NET CASH FLOWS FROM OPERATING ACTIVITIES PER SHARE IS CALCULATED AS NET CASH FLOW FROM OPERATING ACTIVITIES DIVIDED BY THE WEIGHTED AVERAGE NUMBER OF SHARES.

ADDITIONAL INFORMATION REGARDING ORCA EXPLORATION IS AVAILABLE UNDER THE COMPANY'S PROFILE ON SEDAR AT [www.sedar.com](http://www.sedar.com).

## NATURE OF OPERATIONS

The Company's principal operating asset is its interest in the PSA with TPDC and the Government of Tanzania in the United Republic of Tanzania. This PSA covers the production and marketing of certain gas from the Songo Songo Block offshore Tanzania.

The PSA defines the gas produced from the Songo Songo field as "Protected Gas" and "Additional Gas". The Protected Gas is owned by TPDC and is sold under a 20-year gas agreement (until July 31, 2024) to Songas. Songas is the owner of the infrastructure that enables the gas to be treated and delivered to Dar es Salaam, which includes a gas processing plant on Songo Songo Island.

Songas utilizes the Protected Gas as feedstock for its gas turbine electricity generators at Ubungo and for onward sale to customers. The Company receives no revenue for the Protected Gas delivered to Songas and operates the original wells and gas processing plant on a 'no gain no loss' basis.

Under the PSA, the Company has the right to produce and market all gas in the Songo Songo Block in excess of the Protected Gas requirements ("Additional Gas") until the PSA expires in October 2026.

TANESCO is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the MEM. TANESCO is responsible for the generation, transmission and distribution of electricity throughout Tanzania. Natural gas has become an integral component of TANESCO's power generation fuel mix as a more reliable source of supply over seasonal hydro power and a more cost effective alternative to liquid fuels. The Company currently supplies gas directly to TANESCO by way of the PGSA and indirectly through the supply of Protected Gas and Additional Gas to Songas which in turn generates and sells power to TANESCO. TANESCO is the Company's largest customer and the gas supplied by the Company to Songas and TANESCO today fires approximately 35% of the electrical power generated in Tanzania and 55% of the gas utilized for power generation in the country.

In addition to gas supplied to Songas and TANESCO for the generation of power, the Company has developed and supplies an industrial gas market in the Dar es Salaam area consisting of some 38 industrial customers.

### Consolidation

The companies which are 100% owned that are being consolidated are:

<b>COMPANY</b>	<b>INCORPORATED</b>
Orca Exploration Group Inc.	British Virgin Islands
Orca Exploration Italy Inc.	British Virgin Islands
Orca Exploration Italy Onshore Inc.	British Virgin Islands
PAE PanAfrican Energy Corporation	Mauritius
PanAfrican Energy Tanzania Limited ("PAET")	Jersey
Orca Exploration UK Services Limited	United Kingdom

## Results for the three months ended March 31, 2017

### SUMMARY

The Company's operating revenue decreased by 15% to US\$12.0 million in the quarter ended March 31, 2017 (Q1 2016: US\$14.1 million). The decrease is primarily related to management of the Company modifying its approach to revenue recognition as it relates to TANESCO only. Commencing on October 1, 2016 the Company records a percentage of the amounts invoiced to TANESCO for revenue recognition purposes determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. This results in a reduction in revenue recognized from the effective date. Revenue decreased by only 2% to US\$15.5 million in the quarter ended March 31, 2017 (Q1 2016: US\$15.8 million) due to impact of the current tax adjustment to revenue as per the terms of the PSA, which increased to US\$3.8 million (Q1 2016: US\$2.0 million).

The Company's cash flows from operations decreased 33% to US\$5.9 million (Q1 2016: US\$8.8 million). The decrease was primarily the result of an increase in current income taxes during the quarter to US\$3.4 million from US\$2.0 million in Q1 2016, an increase in interest expense to US\$2.2 million from US\$1.0 million in Q1 2016 and an increase in cash payments based on the exercise of restricted stock units and stock appreciation rights to US\$1.0 million from US\$0.1 million in Q1 2016.

The increase in net cash flows from operating activities to US\$8.8 million (Q1 2016: credit US\$1.2 million) is primarily a consequence of the continued improved collections from TANESCO since the second half of 2016.

The Company recorded net income of US\$2.8 million in the quarter (Q1 2016: loss US\$5.6 million) the loss in Q1 2016 being primarily a consequence of recording a provision for doubtful accounts of US\$8.0 million against the TANESCO receivable.

The Company finished the quarter in a stable financial position with US\$68.1 million in working capital (Q4 2016: US\$72.0 million) and no change in the long-term debt of US\$58.4 million (Q4 2016: US\$58.4 million).

## OPERATING VOLUMES

The total volume of Protected Gas and Additional Gas delivered and sold for the quarter ended March 31, 2017 year was 7,536 MMcf (Q1 2016: 7,558 MMcf) or 83.7 MMcfd (Q1 2016: 83.1 MMcfd), net of approximately 0.3 MMcfd (Q1 2016: 0.3 MMcfd) consumed locally for fuel gas.

The Additional Gas sales volumes for the quarter ended March 31, 2017 were 3,914 MMcf (Q1 2016: 4,213 MMcf) or average daily volumes of 43.5 MMcfd (Q1 2016: 46.3 MMcfd). This represents a decrease in average daily volumes of 6% quarter over quarter.

The decrease in Additional Gas volumes quarter over quarter is primarily a result of reduced nominations of natural gas volumes by TANESCO arising from the cessation of a power generation contract with an independent power producer who was using the Company's Additional Gas. The decline in natural gas supplied to the power sector was partially offset by the increase in gas supplied to the industrial customers. The Company's gross sales volumes were split between the Industrial and Power sectors as detailed in the table below:

	THREE MONTHS ENDED MARCH 31	
	2017	2016
<b>Gross sales volume (MMcf)</b>		
Industrial sector	1,041	972
Power sector	2,873	3,241
<b>Total volumes</b>	<b>3,914</b>	4,213
<b>Gross average daily sales volume (MMcfd)</b>		
Industrial sector	11.6	10.7
Power sector	31.9	35.6
<b>Total daily sales volume</b>	<b>43.5</b>	46.3

### Industrial sector

Industrial sales volume for the quarter increased by 7% to 1,041 MMcf (11.6 MMcfd) from 972 MMcf (10.7 MMcfd) in Q1 2016.

The increased volumes are primarily the result of fewer days of unscheduled maintenance work by a cement plant and additional consumption by new customers connected during the first quarter of 2017.

### Power sector

Power sector sales volumes for the quarter decreased by 11% to 2,873 MMcf (31.9 MMcfd), from 3,241 MMcf (35.6 MMcfd) in Q1 2016.

The decrease in volumes is primarily a result of reduced nominations of natural gas volumes by TANESCO arising from the cessation of a power generation contract with an independent power producer who was using the Company's Additional Gas.

## SONGO SONGO DELIVERABILITY

As at March 31, 2017 the Company had a field productive capacity of approximately 155 MMcfd, with the ability to expand production capacity to 180 MMcfd with the tie-in of well SS-12. The SS-12 well was successfully completed in the first quarter of 2016 but is currently suspended awaiting tie-in. Production volumes are currently limited to 102 MMcfd, as only the Songas infrastructure is available to the Company. The Company now has significant redundant productive capacity. The well SS-3 is currently suspended and well SS-4 has been shut-in; it is the Company's intention to undertake workovers on both the wells in the future.

The SS-12 well has been identified for connection to the NNGIP infrastructure subject to the negotiation with TPDC for Additional Gas sales. Volumes sold to TPDC under this agreement would initially result in concomitant reduction in volumes through the existing Songas infrastructure. This would provide the Company the opportunity to increase sales volumes to industrial customers as production capacity would no longer be constrained by the Songas infrastructure.

## COMMODITY PRICES

The commodity prices achieved in the different sectors during the year is detailed in the table below:

<i>US\$/mcf</i>	THREE MONTHS ENDED MARCH 31	
	2017	2016
<b>Average sales price</b>		
Industrial sector	7.75	8.15
Power sector	3.57	3.55
<b>Weighted average price</b>	<b>4.68</b>	4.61

### Industrial sector

The average gas price achieved during the quarter was US\$7.75/mcf a decrease of 5% from US\$8.15/mcf in Q1 2016.

The decline in the average industrial price is the result of re-setting the floor price for a number of industrial customers at the end of the Q3 2016.

### Power sector

The average sales price to the Power sector was US\$3.57/mcf for the quarter, an increase of 1% from US\$3.55 mcf in Q1 2016. The increase is a consequence of the annual price rise at the start of Q3 2016.

## OPERATING REVENUE

Under the terms of the PSA, the Company is responsible for invoicing, collecting and allocating the revenue from Additional Gas sales.

The Company is able to recover all costs incurred on the exploration, development and operations of the project up to a maximum of 75% of the Net Revenue ("Cost Gas") prior to the distribution of Profit Gas. Any costs not recovered in any period are carried forward for recovery out of future revenues. Once the Cost Gas has been recovered, TPDC is able to recover any pre-approved marketing costs.

The Additional Gas sales volumes for 2016 were below 50 MMcfd and, as a consequence, the Company was entitled to a 40% share of Profit Gas revenue for the year compared to 55% for sales volumes above 50 MMcfd. See "Principal Terms of the Tanzanian PSA and Related Agreements."

The Company was allocated a total of 85% of the Songo Songo field net revenue in the quarter end March 31, 2017 and Q1 2016.

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2017	2016
Gross field revenue	16,422	19,437
Tariff for processing plant and pipeline infrastructure	(2,310)	(2,856)
Field net revenue	14,112	16,581
<i>Analysed as to:</i>		
Company Cost Gas	10,584	12,436
Company Profit Gas	1,411	1,658
Company operating revenue	11,995	14,094
TPDC share of revenue	2,117	2,487
	14,112	16,581

Revenue presented on the Consolidated Statements of Comprehensive Income may be reconciled to the operating revenue as follows:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2017	2016
Industrial sector	8,068	7,925
Power sector	8,354	11,512
<b>Gross field revenue</b>	<b>16,422</b>	<b>19,437</b>
Processing and transportation tariff	(2,310)	(2,856)
Field net revenue	14,112	16,581
TPDC share of revenue	(2,117)	(2,487)
<b>Company operating revenue</b>	<b>11,995</b>	<b>14,094</b>
Additional Profits Tax charge	(274)	(308)
Current income tax adjustment	3,821	2,024
<b>Revenue</b>	<b>15,542</b>	<b>15,810</b>

Prior to 2016 the Company had reached an understanding with TANESCO that it would continue to supply gas if TANESCO remained reasonably current with payments for gas deliveries. Up to September 30, 2016 the Company recorded revenue from TANESCO based on volumes delivered, however, TANESCO payments were inconsistent and not always in compliance with the agreed understanding resulting in the Company recording provisions for doubtful accounts for amounts outstanding from TANESCO for more than 60 days. As a result, commencing on October 1, 2016, the Company began recording revenues for sales to TANESCO based on the expected amount to be collected, which represents a percentage of the amounts invoiced to TANESCO determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The result of recording revenue from TANESCO based on the expected collectability approach for the first three months of 2017 was a decrease in revenue recognized of US\$1.6 million (Q1 2016: US\$ nil) and no increase in the provision for doubtful accounts (Q1 2016: US\$8.0 million increase).

The percentage used to recognize TANESCO revenue will be reviewed on at least a semi-annual basis, more frequently if circumstances require and if there is a significant difference between the amount of revenue recorded and amounts received, the percentage used to record revenue as well as any existing receivable or deferred revenue balance will be revised accordingly.

Company operating revenue for the quarter ended March 31, 2017 decreased 15% to US\$12.0 million compared to US\$14.1 million in the Q1 2016. The 15% decrease is primarily due to the impact of the change in the TANESCO revenue recognition estimate as described above.

## PROCESSING AND TRANSPORTATION TARIFF

The processing and transportation tariff charge for the quarter was US\$2.3 million for the quarter compared to US\$2.9 million in Q1 2016. The reduction in the tariff for the quarter is a consequence of the cessation of paying the additional compensation on production volumes in excess of 70 MMcf in Q2 2016.

## PRODUCTION AND DISTRIBUTION EXPENSES

Well maintenance costs are allocated between Protected Gas and Additional Gas in proportion to their respective sales during the period. The total cost of maintenance for the quarter was US\$0.2 million (Q1 2016: US\$0.2 million). Amounts allocated for Additional Gas for the quarter was US\$0.1 million (Q1 2016: US\$0.1 million).

Other field and operating costs include an apportionment of the annual PSA licence costs, regulatory fees, insurance, some costs associated with the evaluation of the reserves, and the cost of personnel which are not recoverable from Songas.

Distribution costs represent the direct cost of maintaining the ring main distribution pipeline and pressure reduction stations (security, insurance and personnel). Ring main distribution costs for the quarter was US\$0.6 million (Q1 2016: US\$0.7 million). The production and distribution costs are detailed in the table below:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2017	2016
Share of well maintenance	96	128
Other field and operating costs	188	308
	284	436
Ringmain distribution costs	564	684
<b>Production and distribution expenses</b>	<b>848</b>	1,120

## OPERATING NETBACKS

The netback per mcf before general and administrative costs, overhead, tax and Additional Profits Tax ("APT") is detailed in the table below:

US\$/mcf	THREE MONTHS ENDED MARCH 31	
	2017	2016
Gas price – Industrial	7.75	8.15
Gas price – Power	3.57	3.55
<b>Weighted average price for gas</b>	<b>4.68</b>	4.61
Tariff	(0.59)	(0.68)
TPDC share of revenue	(0.54)	(0.59)
<b>Net selling price</b>	<b>3.55</b>	3.34
Well maintenance and other operating costs	(0.07)	(0.10)
Ring main distribution costs	(0.14)	(0.16)
<b>Operating netbacks</b>	<b>3.34</b>	3.08

<sup>(1)</sup> The weighted average share price is stated before the decrease in TANESCO revenue due to the modified approach used for revenue recognition purposes and represents the weighted average price of the volumes invoiced and delivered.

The operating netback increased by 8% from US\$3.08/mcf in Q1 2016 to US\$3.34/mcf in Q1 2017. The increase is a consequence of the following factors: i) a 2% increase in the weighted average gas price; ii) a 13% fall in the gas processing tariff as a consequence of the cessation of additional compensation to Songas for total production volumes over 70 MMcfd in Q3 2016; and (iii) savings associated with lower insurance premiums.

## GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses are detailed in the table below:

US\$'000	THREE MONTHS ENDED MARCH 31	
	2017	2016
Employee and related costs	1,546	1,949
Stock based compensation	841	2,858
Office costs	751	692
Marketing and business development costs	152	82
Reporting, regulatory and corporate	226	465
<b>General and administrative expenses</b>	<b>3,516</b>	6,046

General and administrative expenses include the costs of running the natural gas distribution business in Tanzania which is recoverable as Cost Gas and is relatively fixed in nature. Excluding stock based compensation and other expenses, general and administrative expenses averaged US\$0.9 million (Q1 2016: US\$1.1 million) per month during the quarter.

## STOCK BASED COMPENSATION

The breakdown of the costs incurred in relation to stock based compensation is detailed in the table below:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2017	2016
Stock appreciation rights ("SARs")	67	2,097
Restricted stock units ("RSUs")	774	761
<b>Stock based compensation</b>	<b>841</b>	2,858

As at March 31, 2017 a total of 2,470,000 SARs, were outstanding compared to 2,430,000 as at December 31, 2016. A total of 325,000 SARs with exercise prices ranging from CDN\$2.12 to CDN\$2.70 were exercised during the quarter resulting in a total cash payout of US\$0.4 million. A total of 365,000 with an exercise price of CDN\$3.87 were granted during the quarter. The newly issued SARs have a five-year term and vest equally over the term, the first fifth vesting on the anniversary of the grant date.

As at March 31, 2017 a total of 289,107 RSUs were outstanding compared to 239,361 at December 31, 2016. During the quarter 259,067 RSUs were issued, the RSUs vested in full on the date of grant have an exercise price of CDN\$0.001 and have a five-year term. A total of 209,321 RSUs were exercised during the quarter resulting in a total cash payout of US\$0.6 million.

As SARs and RSUs are settled in cash, they are re-valued at each reporting date using the Black-Scholes option pricing model with the resulting liability being recognized in trade and other payables. In the valuation of stock appreciation rights and restricted stock units at the reporting date, the following assumptions have been made: a risk free rate of interest of 0.5%; stock volatility of 26.15% to 49.47%; 0% dividend yield; 5% forfeiture; and a closing price of CDN\$3.85 per Class B share.

As at March 31, 2017 a total accrued liability of US\$3.0 million (Q4 2016: US\$3.2 million) has been recognized in relation to SARs and RSUs. The Company recognized an expense of US\$0.8 million (Q1 2016: US\$2.9 million) for the quarter.

## NET FINANCE EXPENSE

The movement in net finance expense is detailed in the table below:

US\$'000	THREE MONTHS ENDED MARCH 31	
	2017	2016
Finance income	81	49
Interest expense	(1,518)	(1,005)
Participatory interest	(731)	–
Net foreign exchange loss	(70)	(28)
Indirect tax	(205)	–
Provision for doubtful accounts	–	(7,986)
Finance expense	(2,524)	(9,019)
<b>Net finance expense</b>	<b>(2,443)</b>	(8,970)

Total amount of interest paid during the quarter was US\$1.5 million (Q1 2016: US\$1.0 million). The interest relates to the long-term loan with the IFC and is payable quarterly in arrears. The participatory interest paid annually in arrears is an accrual equating to 7% of the net cash flow from operating activities of PAET net of net cash flows used in investing activities for the three months ending March 31, 2017 (see long-term loan).

The foreign exchange loss reflects the impact of movements in the value of the Tanzanian shilling against the US dollar during the period on outstanding customer/supplier balances and bank accounts in Tanzanian shillings.

During the quarter the Company billed TANESCO US\$1.3 million (Q1 2016: US\$0.9 million) of interest for late payments. The interest income is not recorded in the financial statements because it does not meet the revenue recognition criteria with respect to assurance of collectability. The Company is pursuing collection and amounts will be recognized in earnings when collected. The provision for doubtful accounts in Q1 2016 of US\$8.0 million is in relation to overdue TANESCO receivables.

The US\$0.2 million is in relation to indirect tax associated with trade receivables not recognized in the financial statements due to IFRS revenue recognition criteria with respect to assurance of collectability.

### TANESCO

At March 31, 2017 TANESCO owed the Company US\$76.2 million, excluding interest, (of which arrears were US\$74.4 million) compared to US\$80.1 million (including arrears of US\$74.4 million) as at December 31, 2016. Current TANESCO receivables as at March 31, 2017 amounted to US\$1.8 million (Q4 2016: US\$5.7 million). Since the quarter-end, TANESCO has paid the Company US\$6.5 million, and as at the date of this report the total TANESCO receivable is US\$74.4 million (of which US\$74.4 million has been provided for). The amounts owed do not include interest or invoiced amounts billed to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability.

## TAXATION

### Income Tax

Under the terms of the PSA with TPDC and the Government of Tanzania, the Company is liable for income tax in Tanzania at the corporate tax rate of 30%. However, the PSA provides a mechanism by which income tax payable is recovered from TPDC by reducing TPDC's share of Profit Gas and increasing the allocation to the Company. This is reflected in the accounts by increasing the Company's share of revenue by an amount equivalent to income taxes payable.

As at March 31, 2017 there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes under the Income Tax Act 2004. Applying the 30% Tanzanian tax rate, the Company has recognized a deferred tax liability of US\$13.2 million (Q4 2016: US\$13.0 million). During the quarter, there was a deferred tax charge of US\$0.2 million (Q1 2016: US\$0.9 million). The deferred tax has no impact on cash flow until it becomes current, at which point the tax is paid and recovered from TPDC's share of Profit Gas.

### Additional Profits Tax

Under the terms of the PSA, in the event that all costs have been recovered with an annual return of 25% plus the percentage change in the United States Industrial Goods Producer Price Index ("PPI"), an Additional Profits Tax is payable.

The timing and the effective rate of APT depends on the realized value of Profit Gas which in turns depends of the level of expenditure. The Company provides for APT by forecasting annually the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA. The forecast takes into account the timing of future development capital spending.

The effective APT rate of 19.4% (Q1 2016: 18.6%) has been applied to Profit Gas of US\$1.4 million (Q1 2016: US\$1.7 million) for the quarter. Accordingly, APT of US\$0.3 million (Q1 2016: US\$0.3 million) has been netted off against revenue for the quarter. There is no forecasted APT payable until 2019.

US\$'000	THREE MONTHS ENDED MARCH 31	
	2017	2016
<b>Additional Profits Tax</b>	<b>274</b>	308

## DEPLETION AND DEPRECIATION

Natural gas properties are depleted using the unit of production method based on the production for the period as a percentage of the total future production from the Songo Songo proven reserves. As at December 31, 2016 the proven reserves estimated to have been produced over the term of the PSA licence were 341 Bcf (2015: 368 Bcf). A depletion expense of US\$2.3 million for the quarter (Q1 2016: US\$2.4 million) has been recorded in the accounts at an average depletion rate to US\$0.57/mcf (Q1 2016: US\$0.56/mcf).

Non-natural gas properties are depreciated as follows:

Leasehold improvements:	Over remaining life of the lease
Computer equipment:	3 years
Vehicles:	3 years
Fixtures and fittings:	3 years

## CARRYING AMOUNT OF ASSETS

Capitalized costs are periodically assessed to determine whether it is likely that such costs will be recovered in the future. To the extent that these capitalized costs are unlikely to be recovered in the future, they are impaired and recorded in earnings.

## CASH FLOW FROM OPERATIONS

Cash flow from operations was US\$5.9 million for the quarter (Q1 2016: US\$8.8 million) and is detailed in the table below:

US\$'000	THREE MONTHS ENDED MARCH 31	
	2017	2016
<b>Operating activities</b>		
<b>Net income (loss)</b>	<b>2,840</b>	(5,638)
Non-cash adjustments	<b>3,086</b>	14,486
<b>Cash flows from operations <sup>(1)</sup></b>	<b>5,926</b>	8,848
Interest paid	<b>1,518</b>	1,005
Participatory interest	<b>731</b>	–
Change in non-cash working capital <sup>(2)</sup>	<b>612</b>	(11,007)
<b>Net cash flows from operating activities</b>	<b>8,787</b>	(1,154)
Net cash used in investing activities	<b>(216)</b>	(19,062)
Net cash (used in) from financing activities	<b>(1,518)</b>	38,746
Increase in cash	<b>7,053</b>	18,530
Effect of change in foreign exchange on cash	<b>(127)</b>	(27)
<b>Net increase in cash</b>	<b>6,926</b>	18,503

(1) See non-GAAP measures

(2) See Consolidated Statements of Cash Flows

## CAPITAL EXPENDITURES

During the quarter, the Company incurred US\$0.1 million (Q1 2016: US\$14.0 million) in capital expenditures. The expenditures in Q1 2016 relating primarily to the drilling of well SS-12.

US\$'000	THREE MONTHS ENDED MARCH 31	
	2017	2016
Geological and geophysical and well drilling	<b>27</b>	13,639
Pipelines and infrastructure	<b>93</b>	356
Other <sup>(1)</sup>	<b>7,352</b>	2
	<b>7,472</b>	13,997

(1) In Q1 2017, based on agreement with TPDC, the Songas share of workover costs incurred in 2015 were transferred to the cost pool to recover the costs via the PSA cost recovery mechanism. This resulted in US\$7.4 million of the Songas receivable being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism.

## WORKING CAPITAL

Working capital as at March 31, 2017 was US\$68.1 million (December 31, 2016: US\$72.0 million) and is detailed in the table below:

US\$'000	AS AT	
	MARCH 31, 2017	DECEMBER 31, 2016
Cash	<b>87,821</b>	<b>80,895</b>
Trade and other receivables	<b>14,111</b>	<b>27,638</b>
TANESCO	1,821	5,749
Songas	3,366	2,218
Industrial customers	6,723	7,463
Songas gas plant operations	6,807	6,601
Songas well workover program <sup>(1)</sup>	–	14,458
Other receivables	860	1,516
Provision for doubtful accounts <sup>(1)</sup>	(5,466)	(10,367)
Tax recoverable	<b>6,324</b>	<b>5,402</b>
Prepayments	<b>946</b>	<b>651</b>
	<b>109,202</b>	<b>114,586</b>
Trade and other payables	<b>37,630</b>	<b>39,707</b>
TPDC share of Profit Gas <sup>(2)</sup>	27,416	28,319
Songas	1,644	1,893
Other trade payables	2,691	3,245
Accrued liabilities	5,879	6,250
Tax payable	<b>3,460</b>	<b>2,890</b>
<b>Working capital <sup>(3)</sup></b>	<b>68,112</b>	<b>71,989</b>

<sup>(1)</sup> In Q1 2017, the receivable related to the Songas workovers was adjusted to reflect that the costs had been transferred to the cost pool in order to recover the costs via the PSA cost recovery mechanism based on agreement with TPDC. This resulted in the receivable being adjusted by: i) US\$7.4 million being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism; ii) the write-off of the US\$4.9 million portion of the Songas receivable that had been previously provided for; and iii) US\$2.2 million relating to VAT on the workovers that had already been paid being reclassified as a long-term receivable.

<sup>(2)</sup> The balance of US\$27.4 million payable to TPDC represents their share of profit gas reflects the total accrued liability based on gas delivered to TANESCO which has not been paid for. Settlement of this liability is dependent on receipt of payment from TANESCO for the arrears.

<sup>(3)</sup> Working capital as at March 31, 2017 includes a TANESCO receivable (excluding interest) of US\$1.8 million (Q4 2016: US\$5.7 million). Management has recorded a provision for doubtful accounts against the long-term receivables totaling US\$74.4 million (Q4 2016: US\$74.4 million). The total of long and short-term TANESCO receivables as at March 31, 2017, including interest and unrecorded revenue as a result of issued invoices not meeting revenue recognition criteria, was US\$100.1 million. The financial statements do not recognize the interest receivable from TANESCO as it does not meet revenue recognition criteria. The Company is actively pursuing the collection of all the receivables including the interest that has been charged to TANESCO.

The following table reconciles the total amount recorded as receivable from TANESCO which includes amounts not meeting revenue recognition criteria reconciled to the amounts recorded in the consolidated financial statements:

<i>USD'000</i>	AS AT	
	MARCH 31, 2017	DECEMBER 31, 2016
Total TANESCO receivable	100,101	100,776
Less unrecognized amounts for not meeting revenue recognition criteria:		
Interest charges	(12,247)	(10,900)
Invoices issued pursuant to contractual volume requirements	(7,842)	(7,842)
Invoiced amounts reduced based on TANESCO's payment history for the previous three years	(3,831)	(1,925)
Total TANESCO receivable per consolidated financial statements	76,182	80,110
Current receivable	1,821	5,749
Long-term receivable	74,361	74,361
	76,182	80,110
Less provision for doubtful accounts	(74,361)	(74,361)
Net TANESCO receivable per consolidated financial statements	1,821	5,749

Working capital as at March 31, 2017 increased by 8% over December 31, 2016. The increase is primarily a result of successful collection of revenue from TANESCO and Industrial customers during the quarter. Other significant points are:

- There are no restrictions on the movement of cash from Mauritius or Tanzania, and currently the majority of cash is outside of Tanzania. As at the date of this report, approximately 86% of the Company's cash is held outside of Tanzania.
- Of the US\$6.7 million relating to other trade debtors, US\$4.4 million had been received as at the date of this report

## LONG-TERM LOAN

On October 29, 2015 the Company entered into an agreement with the IFC, a member of the World Bank Group, to provide financing of up to US\$60 million for the Company's operating subsidiary, PAET. The Company has drawn the US\$60 million Loan facility in full, with an initial drawdown of US\$20 million in 2015 followed by the final draw down of US\$40 million on February 9, 2016.

The term of the Loan is 10-years, with no required repayment of principal for the first seven years, followed by a three-year amortization period. The Loan is to be paid out through six semi-annual payments of US\$5 million and one final payment of US\$30 million. The Company may voluntarily prepay all or part of the Loan but must simultaneously pay any accrued base interest costs related to the principal amount being prepaid. If any portion of the Loan is prepaid prior to the fourth anniversary of the first drawdown, the Company would be required to pay the accrued base interest as if the prepaid portion of the Loan had remained outstanding for the full four years. The Loan is an unsecured subordinated obligation of PAET and is guaranteed by the Company to a maximum of US\$30 million. The guarantee may only be called upon by IFC at maturity in 2025. Subject to receipt of the IFC approval and required regulatory approvals, the Company may issue shares in fulfillment of all or part of the guarantee obligation in 2025.

Base interest on the Loan is payable quarterly at 10% per annum on a 'pay-if-you-can-basis' using a formula to calculate the net cash available for such payments as at any given interest payment date. The Company must provide notice to the IFC of the amount of any interest which is not to be paid on any interest payment date the unpaid interest is added to the principal outstanding and may be paid out before or at the time of principal repayment. In addition, an annual variable participatory interest equating to 7% of the net cash flow from operating activities of PAET net of net cash flows used in investing activities in respect of any given year. Such participatory interest will continue until October 15, 2026 regardless whether the Loan is repaid prior to its contract maturity date. An accrual of US\$0.7 million was made for the participatory interest for the three months ended March 31, 2017. Dividends and distributions from PAET to the Company are restricted at any time that any amounts of unpaid interest, principal or participating interest are outstanding.

## SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

There were 34,856,432 shares outstanding as at March 31, 2017 as detailed in the table below:

<i>Number of shares ('000)</i>	AS AT	
	<b>MARCH 31, 2017</b>	DECEMBER 31, 2016
<b>Shares outstanding</b>		
Class A shares	<b>1,751</b>	1,751
Class B shares	<b>33,106</b>	33,106
Class A and Class B shares outstanding	<b>34,857</b>	34,857
<b>Weighted average</b>		
Class A and Class B shares	<b>34,857</b>	34,857
<b>Convertible securities</b>		
Options	-	-
<b>Weighted average diluted Class A and Class B shares</b>	<b>34,857</b>	34,857

As at the date of this report, there were a total of 1,750,517 Class A common voting shares ("Class A shares") and 33,105,915 Class B subordinated voting shares ("Class B shares") outstanding.

## RELATED PARTY TRANSACTIONS

One of the non-executive Directors is counsel with a law firm that provides legal advice to the Company and its subsidiaries. For the quarter ended March 31, 2017 US\$0.1 million (Q1 2016: US\$0.1 million) was incurred from this firm for services provided.

As at March 31, 2017 the Company has a total of US\$0.1 million (Q1 2016: US\$0.1 million) recorded in trade and other payables in relation to the related party.

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## CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

### **Protected Gas**

Under the terms of the original Gas Agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, the Company is liable to pay the difference between the price of Protected Gas (US\$0.55/MMbtu escalated) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (165.1 Bcf as at March 31, 2017). The Company did not have a shortfall during the reporting period and does not anticipate a shortfall arising during the term of the Protected Gas delivery obligation to July 2024.

### **Re-Rating Agreement**

In 2011 the Company signed a re-rating agreement with TANESCO, TPDC and Songas (the "Re-Rating Agreement") which evidenced an increase to the gas processing capacity of the Songas facilities to a maximum of 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 102 MMcfd). Under the terms of the Re-Rating Agreement, the Company paid additional compensation of US\$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US\$0.40/mcf for volumes above 90 MMcfd by issuing credit notes to TANESCO. This was in addition to the tariff of US\$0.59/mcf payable to Songas as set by the energy regulator, EWURA.

In May 2016 the Company notified TANESCO and Songas that the additional compensation for sales over 70 MMcfd would no longer be paid effective June 2016. The additional compensation was always intended to be temporary in nature until the expansion of the Songas infrastructure, at which time Songas would apply to EWURA to obtain approval of a new tariff for the processing of volumes over 70 MMcfd. The PGSA provides for passing on to TANESCO any tariff to be charged to the Company in the event that a new tariff is approved.

The parties are seeking to resolve the status of the re-rating agreement. The processing capacity at the Songas facilities remain unaltered and are fully available for utilization by the Company. Without a new agreement, there are no assurances that Songas will continue to allow the gas plant to operate above 70 MMcfd.

### **Capital Commitments**

#### **Tanzania**

There are no contractual commitments for exploration or development drilling or other field development either in the PSA or otherwise agreed which would give rise to significant capital expenditure at Songo Songo. Any significant additional capital expenditure in Tanzania is discretionary.

Given the completion of the Offshore component of Phase I of the Development Program in February 2016 which has improved field deliverability and provides sufficient natural gas production to fill the Songas plant and pipeline to capacity for the greater portion of the remaining life of the production licence, the Company does not expect to commit to further significant capital expenditures until: (i) agreeing commercial terms with TPDC for the supply of gas to the NNGIP regarding the sale of incremental gas volumes from Songo Songo; and/or (ii) TANESCO arrears have been substantially reduced, guaranteed or other arrangements for payment made that are satisfactory to the Company; and/or (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any new sales contracts with Government entities.

When conditions are deemed appropriate and there is justification to further improve the reliability/capacity of field deliverability, the Company may contemplate undertaking the remaining part or all of the Phase I Development Program. The additional costs are estimated to be approximately US\$30 million.

At the date of this report, the Company has no significant outstanding contractual commitment, and has no outstanding orders for long lead items related to any capital programs.

## Italy

The Company has an agreement to farm in on Central Adriatic B.R268.RG Permit offshore Italy. Changes in Italian environmental legislation in late 2015 have resulted in the development of this permit being postponed until the development plan is approved. As at the date of this report, the Company has no further capital commitments in Italy.

## CONTINGENCIES

### **Petroleum Act, 2015**

The Act repeals earlier legislation, provides a regulatory framework over upstream, mid-stream and downstream gas activity, and consolidates and puts in place a comprehensive legal framework for regulating the oil and gas industry in the country. The Act also provides for the creation of an upstream regulator, the Petroleum Upstream Regulatory Authority ("PURA"). The mid and downstream oil and gas activities are proposed to be regulated by the current authority, the Energy and Water Utilities Regulatory Authority ("EWURA"). The Act also confers upon on TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in petroleum operations as well as mid and downstream natural gas activities. The Act vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Act does provide grandfathering provisions upholding the rights of the Company under their PSA as it was signed prior to passing of the Act. However, it is still unclear how the provisions of the Act will be interpreted and implemented regarding upstream and downstream activities and the Company is uncertain regarding the potential impact on its business in Tanzania.

On October 7, 2016 the Government of Tanzania issued the Petroleum (Natural Gas Pricing) Regulation made under Sections 165 and 258 (I) of the Act. Under the Act, Article 260 (3) preserves the Company's pre-existing right with TPDC to market and sell Additional Gas together or independently on terms and conditions (including prices) negotiated with third party natural gas customers. The impact of the Natural Gas Pricing Regulation, if any, cannot be determined at this time.

### **Cost recovery**

TPDC conducted an audit of the historic Cost Pool and in 2011 disputed approximately US\$34 million of costs that had been recovered from the Cost Pool from 2002 through to 2009. In 2014 TPDC and the Company agreed to remove approximately US\$1.0 million from the Cost Pool. Since 2014 there have been no further developments. Under the dispute mechanism outlined in the PSA, TPDC were to appoint an independent specialist to assist the parties in reaching agreement on costs that are still subject to dispute. At the time of writing this report no such specialist has been appointed. If the matter is not resolved to the Company's satisfaction, the Company intends to proceed to arbitration via the International Centre for Settlement of Investment Disputes ("ICSID") pursuant to the terms of the PSA.

## Taxation

Area	Period	Tax dispute Reason for dispute	Disputed amount US\$' million		
			Principal	Interest	Total
PAYE tax	2008-10	Pay-As-You-Earn ("PAYE") tax on grossed-up amounts in staff salaries which are contractually stated as net.	0.3	–	0.3 <sup>(1)</sup>
Withholding Tax ("WHT")	2005-10	WHT on services performed outside of Tanzania by non-resident persons.	1.1	0.7	1.8 <sup>(2)</sup>
Income Tax	2008-13	Deductibility of capital expenditures and expenses (2009 and 2012), additional income tax (2008, 2010, 2011 and 2012), tax on repatriated income (2012), foreign exchange rate application (2013 and 2015) and underestimation of tax due (2014).	18.1	9.7	27.8 <sup>(3)</sup>
Value Added Tax ("VAT")	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.8	5.5 <sup>(4)</sup>
			22.2	13.2	35.4

- (1) In 2015 PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE tax on grossed-up amounts in staff salaries. TRAB waived interest assessed thereon. PAET is awaiting ruling of the Tax Revenue Appeals Tribunal ("TRAT");
- (2) (a) 2005-2009 (US\$1.7 million): In 2016 the TRA filed an application for review of the Court of Appeal decision in favour of PAET and later filed another application for leave to amend its earlier application to which PAET filed a Preliminary Objection against. TRA withdrew their second application for review. On April 27, 2017 the Court of Appeal heard PAET Preliminary Objection. PAET are awaiting the Court ruling;
- (b) 2010 (US\$0.1 million): TRAB is awaiting a ruling from the review by the Court of Appeal on the 2005-2009 case, which would influence TRAB decision on this matter accordingly;
- (3) (a) 2009 (US\$1.8 million): In 2015 TRAT ruled against PAET with respect to the deductibility of capital expenditures and other expenses. PAET appealed to TRAT and subsequent to the quarter end, TRAT ruled against PAET. PAET is preparing to appeal to the Court of Appeal;
- (b) 2008 and 2011 (US\$1.8 million): In 2015 PAET filed objections against TRA assessments with respect to the deductibility of capital expenditures and other expenses as well as underestimation of interest and is awaiting a response. The 2008 assessment was issued late and is time-barred;
- (c) 2010 and 2011 (US\$4.2 million): PAET filed appeals with TRAB against TRA assessments with respect to the deductibility of capital expenditures and other expenses as well as underestimation of interest and penalty amounts. PAET is awaiting a hearing date to be scheduled;
- (d) 2013 (US\$ 0.2 million): In 2016 PAET filed objections to TRA assessment with respect to foreign exchange rate application and is awaiting a response;
- (e) 2012 (US\$16.0 million): In 2016 TRA issued two assessments with respect to understated revenue, deductibility of capital expenditures and expenses, and tax on repatriated income. PAET filed an appeal with TRAB against the TRA decision to deny PAET a waiver required for its objection to be admitted and is awaiting a hearing date to be scheduled;
- (f) 2014 (US\$3.4 million): In 2016 TRA issued an-assessment with respect to underestimation of tax due based on the provisional quarterly payments made by PAET, delayed filings of returns and late payments. PAET filed objections to the assessments and is awaiting a response;
- (g) 2015 (US\$0.4 million): In 2016 TRA issued a self-assessment. PAET filed an objection to the assessment with respect to foreign exchange rate application and is awaiting a response;
- (4) In 2016 TRA responded to PAET's objection filed in 2014 and issued an assessment in respect of output VAT on imported services and SSI Operatorship services. PAET filed an appeal with TRAB against TRA assessment and is awaiting a hearing date to be scheduled.
- (5) On March 29, 2017 management received a tax audit findings report from the TRA for the years 2012-14. The report requests the Company to elaborate on the corporation tax, repatriated income, VAT and withholding tax. Subsequent to the quarter end, management submitted its response to the TRA audit findings report and is awaiting further correspondence from the TRA.

Management, with the advice from its legal advisors, has reviewed the Company's position on the above objections and appeals and has concluded that no provision is required with regard to the above matters.

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## NEW ACCOUNTING POLICIES

At the date of these financial statements the standards and interpretations listed below were issued but not yet effective. The adoption of these standards may result in future changes to existing accounting policies and disclosures. The Company is currently evaluating the impact that these standards will have on results of operations and financial position.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2018, with earlier adoption permitted. The Company has commenced the process of identifying and reviewing sales contracts with customers to determine the extent of the impact, if any, that this standard will have on the consolidated financial statements.

In July 2014, the IASB finalized the remaining elements of IFRS 9 – Financial Instruments, which includes new requirements for the classification and measurement of financial assets, amends the impairment model and outlines a new general hedge accounting standard. The mandatory effective date of IFRS 9 is for annual periods on or after January 1, 2018 and must be applied retrospectively with some exemptions. Early adoption is permitted. The Company is evaluating the impact of this standard on the consolidated financial statements and does not anticipate material changes to the valuation of its financial assets.

In January 2016, the IASB issued IFRS 16 Leases, which replaces IAS 17 Leases. For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 Revenue from Contracts with Customers. The Company is currently identifying contracts that will be identified as leases and evaluating the impact of the standard on the consolidated financial statements.

There are no other standards and interpretations in issue but not yet adopted that are expected to have a material effect on the reported earnings or net assets of the Company.

## SUMMARY QUARTERLY RESULTS OUTSTANDING

The following is a summary of the results for the Company for the last eight quarters:

	2017	2016				2014		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
<i>Figures in US\$'000 except where otherwise stated</i>								
<b>Financials</b>								
Revenue	<b>15,542</b>	16,533	17,744	14,572	15,810	15,872	15,943	12,553
Net income (loss)	<b>2,840</b>	1,048	5,302	1,452	(5,638)	(6,468)	6,112	3,566
Earnings (loss) per share – basic and diluted (US\$)	<b>0.08</b>	0.03	0.15	0.04	(0.16)	(0.19)	0.18	0.10
Cash flows from operations <sup>(1)</sup>	<b>5,926</b>	6,211	10,024	6,772	8,848	8,391	9,462	4,889
Cash flows from operations per share – basic and diluted (US\$)	<b>0.17</b>	0.18	0.29	0.19	0.25	0.24	0.27	0.14
Net cash flows from (used in) operating activities	<b>8,787</b>	8,345	6,540	6,237	(1,154)	5,450	(2,963)	(2,844)
Net cash flows (utilized) per share – basic and diluted (US\$)	<b>0.25</b>	0.24	0.19	0.18	(0.03)	0.16	(0.09)	(0.08)
Operating netback (US\$/mcf) <sup>(1)</sup>	<b>3.31</b>	3.35	3.31	3.32	3.08	3.03	2.65	2.68
Working capital	<b>68,112</b>	71,989	67,635	58,395	56,340	32,521	39,660	38,067
Shareholders' equity	<b>82,982</b>	80,023	79,153	73,887	72,482	78,154	84,476	78,480
<b>Capital expenditures</b>								
Geological and geophysical and well drilling	<b>27</b>	32	26	2,558	13,639	23,099	7,578	4,135
Pipeline and infrastructure	<b>93</b>	99	(71)	181	356	1,382	547	275
Other	<b>7,352</b>	–	–	102	2	59	150	47
<b>Operating</b>								
Additional Gas sold								
– industrial (MMcfd)	<b>1,041</b>	1,226	1,238	1,151	972	1,089	1,137	1,015
– industrial (MMcfd)	<b>11.57</b>	13.30	13.50	12.60	10.70	11.80	11.90	11.10
Additional Gas sold								
– power (MMcfd)	<b>2,873</b>	2,895	3,047	2,521	3,241	3,483	3,127	3,041
– power (MMcfd)	<b>31.92</b>	31.50	33.10	27.70	35.60	37.90	34.50	33.40
Average price per mcf								
– industrial (US\$)	<b>7.75</b>	7.52	7.60	7.64	8.15	7.62	7.67	7.45
Average price per mcf								
– power (US\$)	<b>3.57</b>	3.57	3.57	3.55	3.55	3.56	3.62	3.47

<sup>(1)</sup> See non-GAAP measures

## PRIOR EIGHT QUARTERS

The Company's revenue for the last seven quarters has been reasonably consistent. The increase in revenue from Q2 2015 has been the consequence of the Offshore Development Program which commenced in Q3 2015 and was completed at the end of Q1 2016. The capital costs associated with the program entitle the Company to a higher proportion of field net revenue. The fall in revenue from Q3 2016 to Q4 2016 and Q1 2017 is the consequence of the Company only recognizing a percentage of the TANESCO invoiced amounts for revenue recognition purposes in Q4 2016 and Q1 2017. The fall in revenue from Q4 2016 to Q1 2017 is a consequence of the fall in the volume of Additional Gas sold to the industrial sector, primarily a consequence of planned maintenance work at a cement plant.

Changes in net income over the last two years were negatively impacted by the impairment provisions relating to TANESCO. In Q4 2015, Q1 2016, Q2 2016 and Q3 2016 doubtful debt provisions of US\$9.8 million, US\$8.0 million, US\$3.5 million and US\$0.9 million respectively were provided against increased TANESCO arrears. Other significant factors affecting the results were:

- In Q1 2016 the Company took a charge of US\$2.8 million for stock based compensation as a consequence of the share price closing at CDN\$4.14 compared to CDN\$2.75 at the end of Q4 2015 together with the issuance of new Restrictive Stock Units.
- In Q2 2016 the Company had a decrease in the stock based compensation charge of US\$0.7 million as the share price closed at CN\$3.40 at the end of the quarter.
- In Q3 2016 the Company recorded a credit of US\$0.1 million for stock based compensation compared to a credit of US\$1.1 million in Q3 2015.
- In Q4 2016 the Company recorded a stock based compensation charge of US\$0.6 million, as a consequence of an increase in the closing share price to CDN\$3.82 from CDN\$3.41 at the end of Q3 2016.
- In Q1 2017 the Company recorded a stock based compensation charge of US\$0.8 million predominately a consequence of the issuance of 259,067 RSUs which vested fully on the date of grant.
- Commencing in Q4 2016 the Company recognized a percentage of the TANESCO invoiced amount for revenue recognition purposes in accordance with the new estimation procedure which resulted in a net revenue reduction of US\$1.6 million.
- In Q1 2017 the Company recognized a percentage of the TANESCO invoiced amount for revenue recognition purposes in accordance with the revised estimation procedure which resulted in a net revenue reduction of US\$1.6 million (see "Operating Revenue").
- The Company recorded an interest expense of US\$2.2 million in Q1 2017, US\$1.5 million in Q2 to Q4 of 2016 and US\$1.0 million in Q1 2016.

Differences in cash flows from operations for the last seven quarters were primarily a result in changes in revenue during the periods. The decrease in cash flow from operations in Q4 2016 is a consequence of expensing indirect taxes associated with sales invoices that have not been recorded in the financial statements because they do not meet the revenue recognition criteria with respect to assurance of collectability. The increase in the cash flow from operations to US\$10.0 million in Q3 2016 from US\$6.7 million in Q2 2016 is primarily the result of the US\$3.3 million increase in revenue over the quarter. The increase in cash flow from operations between Q2 2015 and Q3 2015 reflects the increase in the Company's share of revenue due to higher Cost Pool levels due to the commencement of the 2015 workover and drilling program. The difference in cash flow from operations between in Q1 2016 and Q1 2017 is primarily a consequence of the US\$2.0 million reduction in stock based compensation between the two quarters.

Changes in net cash flows from operating activities between quarters were primarily a result of the timing of receipt of payments from TANESCO.

The decrease in working capital from Q3 2015 to Q4 2015 was a consequence of the increase in creditors associated with the workover and drilling program together with the additional bad debt provision against TANESCO, both of which were offset by the initial draw down of US\$18.6 million from the IFC (net of expenses). The second draw down from the IFC of US\$40 million in Q1 2016 has offset the decrease in working capital associated with the completion of the workover and drilling program from Q4 2015 to Q1 2016. The progressive increase in working capital from Q1 2016 is mainly the result of US\$30.0 million in net cash flows from operating activities being offset by US\$3.0 million of capital expenditure over the same period.

The capital expenditures for the last four quarters Q1 2017 to Q2 2016 amounted to US\$10.5 million compared to US\$51.2 million from Q2 2015 to Q1 2016. The capital additions in Q1 2017 were primarily a result of the transfer of the Songas share of workover costs incurred in 2015 to property, plant & equipment. The 2015 workover and drilling program commenced in Q3 2015 with some preliminary expenditure in Q2 2015 and was completed at the end of the second quarter 2016 with the demobilization of the rig.

The level of Industrial sales volumes increased in the four quarters ending Q1 2017 to an average of 1,164 MMcf (Q1 2016: 1,053 MMcf). Industrial sales volume for the four quarters ending Q1 2017 increased by 10% to 4,656 MMcf (12.7 MMcfd) compared to 4,213 MMcf (11.4 MMcfd) in the four quarters ending Q1 2016. The increased volumes are primarily the result of fewer days of unscheduled maintenance work by cement, textile and edible oil companies and consumption by new customers connected during the first half of 2016.

The level of Power sales volumes decreased by 11% in the in the four quarters ending Q1 2017 to an average of 2,833 MMcf (Q1 2016: 3,223 MMcf). Power sector sales volumes for the four quarters ending Q1 2017 decreased by 11% to 11,336 MMcf (31.0 MMcfd) compared to 12,892 MMcf (35.4 MMcfd) in the four quarters ending Q1 2016. The decline is mainly the consequence of the decision by TANESCO not to renew a contract with an emergency power plant, unscheduled maintenance at the Songo Ubungo Power generation facility and the increased competition from gas suppliers within Tanzania.

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## BUSINESS RISKS

See "Business Risks" in the MD&A for the year ended December 31, 2016 for a complete discussion of the business risks of the Company.

### **Financing**

The ability of the Company to meet its financing obligations or to arrange financing in the future will depend in part upon the prevailing capital market conditions as well as the business performance of the Company. There can be no assurance that the Company would be successful in its efforts to meet its current commitments or arrange additional financing on terms satisfactory to the Company. If additional financing is raised by the issuance of shares from treasury of the Company, control of the Company may change and shareholders may suffer additional dilution.

From time to time the Company may enter into transactions to acquire assets or the shares of other companies. These transactions may be financed partially or wholly with debt, which may temporarily increase the Company's debt levels above industry standards.

### Collectability of Receivables

The Company evaluates the collectability of its receivables on the basis of payment history, frequency and predictability, as well as Management's assessment of the customer's willingness and ability to pay. The Company has been impacted by TANESCO's inability to pay for current deliveries and pay down arrears.

Prior to 2016 the Company had reached an understanding with TANESCO that it would continue to supply gas if TANESCO remained reasonably current with payments for gas deliveries. Up to September 30, 2016 the Company recorded revenue from TANESCO based on volumes delivered, however, TANESCO payments were inconsistent and not always in compliance with the agreed understanding resulting in the Company recording provisions for doubtful accounts for amounts outstanding from TANESCO for more than 60 days. As a result, commencing on October 1, 2016, the Company began recording revenues for sales to TANESCO based on the expected amount to be collected, which represents a percentage of the amounts invoiced to TANESCO determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The result of recording revenue from TANESCO based on the expected collectability approach for the first three months of 2017 was a decrease in revenue recognized of US\$1.6 million (Q1 2016: US\$ nil) and no increase in the provision for doubtful accounts (Q1 2016: US\$8.0 million increase).

The percentage used to recognize TANESCO revenue will be reviewed on at least a semi-annual basis, more frequently if circumstances require and if there is a significant difference between the amount of revenue recorded and amounts received, the percentage used to record revenue as well as any existing receivable or deferred revenue balance will be revised accordingly.

At March 31, 2017 TANESCO owed the Company US\$76.2 million, excluding interest, (of which arrears were US\$74.4 million) compared to US\$80.1 million (including arrears of US\$74.4 million) as at December 31, 2016. Current TANESCO receivables as at March 31, 2017 amounted to US\$1.8 million (Q4 2016: 2015 US\$5.7 million). Since the quarter-end, TANESCO has paid the Company US\$6.5 million, and as at the date of this report the total TANESCO receivable is US\$74.4 million (of which US\$74.4 million has been provided for). The amounts owed do not include interest billed or invoices issued to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability.

As at March 31, 2017 Songas owed the Company US\$10.2 million (Q4 2016: US\$23.3 million), while the Company owed Songas US\$2.1 million (Q4 2016: US\$2.3 million); there is no contractual right to offset these amounts. In Q1 2017, based on agreement with TPDC, the Songas share of workover costs were transferred to the cost pool to recover the costs via the PSA cost recovery mechanism. This resulted in: i) US\$7.4 million of the Songas receivable being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism; ii) the write-off of the US\$4.9 million portion of the Songas receivable that had been previously provided for; and iii) US\$2.2 million relating to VAT on the workovers that had already been paid being reclassified as a long-term receivable. The Company is continuing to pursue the collection of the US\$14.5 million of workover costs from Songas.

As at March 31, 2017 the net amount owed by Songas to the Company was US\$8.1 million (Q4 2016: US\$21.0 million). A doubtful debt provision of US\$4.9 million (Q4 2016: US\$9.8 million) is necessary recognizing the overdue operatorship charges. Any significant amounts not agreed will be pursued through the mechanisms provided in the agreements with Songas.

The "Tax Recoverable" figure carried on the balance sheet arises from the revenue sharing mechanism within the PSA which entitles the Company to recover from TPDC, by way of a deduction from TPDC's Profit Gas share, an amount "the adjustment factor" equal to the actual income taxes payable by the Company. Recovery, by offset against TPDC's share of revenue is dependent on payment of income taxes relating to prior period adjustment factors as they are assessed.

### **Access to Songas processing and transportation**

Although the Company operates the Songo Songo gas processing plant, Songas is the owner of plant and pipeline system which transports natural gas from Songo Songo to Dar es Salaam. The Company's ability to deliver gas to its customers in Dar es Salaam is dependent upon it having access to the Songas infrastructure. Although there are agreements with Songas to allow the Company to process and transport gas, there is no assurance that these rights could not be challenged or curtailed by Songas. The inability to access Songas plant and processing facilities would materially impair the Company's ability to realize revenue from natural gas sales.

As a result of the Ubungu power plant re-rating that occurred in 2011 pursuant to the Re-Rating Agreement, the capacity of the Songas gas processing plant was increased to a maximum of 110 MMcfd (restricted to 102 MMcfd because of pipeline and pressure requirements). The Re-Rating Agreement expired in 2013 and no new agreement is currently in place. Without the Re-Rating Agreement Songas, the owner of the gas processing plant, may require the plant to be operated at 70 MMcfd (the capacity originally agreed to), which would result in a material reduction in the Company's sales volumes of Additional Gas.

### **The Petroleum Act, 2015**

In the third quarter of 2015 the Tanzania Parliament passed the Petroleum Act, 2015. The Act repeals earlier legislation, provides a regulatory framework over mid-stream and downstream gas activity and as well consolidates and puts in place a single, effective and comprehensive legal framework for regulating the oil and gas industry in the country. The Act also provides for the creation of an upstream regulator, the PURA. The mid and downstream petroleum as well as gas activities are proposed to be regulated by the current authority, EWURA.

The Act also confers upon on TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in the petroleum operations as well as mid and downstream natural gas activities. The Act vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of the National Oil Company does not extended to mid and downstream petroleum supply operations.

The Act does provide grandfathering provisions upholding the rights of the Company under the PSA as it was signed prior to passing of the Act. However, it is still unclear how the provisions of the Act will be interpreted and implemented regarding upstream and downstream activities and related impact on the Company.

On October 7, 2016, the Government of Tanzania issued the Petroleum (Natural Gas Pricing) Regulation made under Sections 165 and 258 (I) of the Act. Article 260 (3) preserves the Company's pre-existing right with TPDC to market and sell Additional Gas together or independently on terms and conditions (including prices) negotiated with third party Natural Gas customers. The impact of the Natural Gas Pricing Regulation, if any, cannot be determined at this time.

### **Amended and Restated Gas Agreement**

The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and contract terms dealing with the consequences of any insufficiency were to be dealt with in a proposed Insufficiency Agreement ("IA"). As at the date of this report, the ARGA remains an initialed agreement only and the IA is unsigned. In certain respects, the parties thereto are conducting themselves as though the ARGA is in effect however no formal agreement has been reached on providing additional security in the event of an insufficiency of Protected Gas. The Company is actively monitoring the reservoir and, supported by the report of its independent engineers, does not anticipate that a liability will occur in this respect. Management does not foresee a material risk with the conduct of the Company's business with an unsigned ARGA or IA at this time.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of the Company's unaudited condensed consolidated interim financial statements requires management to make critical judgements assumptions and estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ materially from these estimates. In preparing the unaudited condensed consolidated interim financial statements, the significant judgements made by the management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2016. See "Critical Accounting Estimates and Judgements" in the MD&A for the year ended December 31, 2016 for a complete discussion

### **Critical judgements in applying accounting policies:**

#### **Collectability of receivables**

The Company evaluates the collectability of its receivables on the basis of payment history, frequency and predictability, as well as Management's assessment of the customer's willingness and ability to pay. Management performs impairment tests each period on the Company's current and long-term receivables. As a result of TANESCO's inability to fully pay all amounts invoiced by the Company for the past few years, management of the Company has modified its approach to revenue recognition as it relates to TANESCO only. Commencing on October 1, 2016 the Company records a percentage of the amounts invoiced to TANESCO for revenue recognition purposes determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. This results in a reduction in revenue recognized from the effective date.

The percentage used to recognize TANESCO revenue will be reviewed on at least a semi-annual basis, more frequently if circumstances require and if there is a significant difference between the amount of revenue recorded and amounts received, the percentage used to record revenue as well as any existing receivable or deferred revenue balance will be revised accordingly.

### **Key sources of estimation of uncertainty**

#### **Financial instrument classification and measurement**

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including expected interest rate, share prices, and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuation in this level are those with inputs for the asset or liabilities that are not based on observable market data.