

# EASTCOAST Energy



INTERIM REPORT  
FOR THE PERIOD ENDED  
30 SEPTEMBER 2004

# Financial and Operating Highlights

Period ended  
30 September 2004

## Financial

### Financial (US\$'000)

Revenue	50
Loss for the period	(84)
Working Capital	2,289
Shareholders' Equity	11,857

### Outstanding Shares ('000s)

Class A shares	1,751
Class B Shares	19,386
Options	2,000

## Operating

### Natural Gas Reserves (bcf) *(based on McDaniel & Associates reserves report as at 31 Dec 2003)*

Proved	85.3
Probable	174.3
Proved plus probable	259.6

## FORWARD-LOOKING STATEMENTS

THIS DISCLOSURE CONTAINS CERTAIN FORWARD-LOOKING ESTIMATES THAT INVOLVE SUBSTANTIAL KNOWN AND UNKNOWN RISKS AND UNCERTAINTIES, CERTAIN OF WHICH ARE BEYOND EASTCOAST'S CONTROL, INCLUDING: THE IMPACT OF GENERAL ECONOMIC CONDITIONS IN THE AREAS IN WHICH THE GROUP OPERATES, CIVIL UNREST, INDUSTRY CONDITIONS, CHANGES IN LAWS AND REGULATIONS INCLUDING THE ADOPTION OF NEW ENVIRONMENTAL LAWS AND 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 AND OBTAINING REQUIRED APPROVALS OF REGULATORY AUTHORITIES. IN ADDITION THERE ARE RISKS AND UNCERTAINTIES ASSOCIATED WITH GAS OPERATIONS. THEREFORE, EASTCOAST'S ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENT COULD DIFFER MATERIALLY FROM THOSE EXPRESSED IN, OR IMPLIED BY, THESE FORWARD-LOOKING ESTIMATES AND, ACCORDINGLY, NO ASSURANCES CAN BE GIVEN THAT ANY OF THE EVENTS ANTICIPATED BY THE FORWARD-LOOKING ESTIMATES WILL TRANSPIRE OR OCCUR, OR IF ANY OF THEM DO SO, WHAT BENEFITS, INCLUDING THE AMOUNTS OF PROCEEDS, THAT EASTCOAST WILL DERIVE THEREFROM.

## GLOSSARY

mcf	Thousands of cubic feet
mmcf	Millions of cubic feet
bcf	Billions of cubic feet
mmd/d	Millions of cubic feet per day
\$	US dollars
C\$	Canadian dollars

## Highlights

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- *Listing of EastCoast Energy on the TSX Venture Exchange under the symbols ECE.A and ECE.B*
- *Completion of the Company's 14 km ring main distribution pipeline in Dar es Salaam, Tanzania. Five connections have been constructed to industrial customers and one additional connection is currently under construction.*
- *Commencement of natural gas sales to two industrial customers, Kioo Limited and Tanzanian Breweries Limited. The two customers purchased 13.5 mmcf in September at an average price of US\$5.41 per mcf and are forecast to consume an average of 1.4 mmcf/d.*
- *Signing of four additional industrial gas sale contracts totalling 1.3 mmcf/d. These contracts are expected to lead to Additional Gas sales revenues by the end of the first quarter of 2005.*
- *Operated production and processing of gas from the Songo Songo field. Initial indications, based on 1.79 bcf of gas production to September 30, 2004, are that the reservoir is performing in line with expectations.*

# Chairman's Message to Shareholders



Welcome to EastCoast Energy's ("EastCoast" or the "Company") first interim report to shareholders.

On 31 August 2004 EastCoast was spun out from PanOcean Energy Corporation ("PanOcean") and commenced trading on the TSX Venture Exchange ("TSXV"). We are an independent natural gas production and marketing company with operations in Tanzania and a focus on developing and marketing natural gas from Tanzania's offshore Songo Songo field.

The spinout of PanOcean's Tanzanian natural gas assets to EastCoast has provided our company with a solid foundation for future growth. EastCoast is well positioned to be the leading company in operating natural gas production and building natural gas markets in East Africa. The Company is the operator of the natural gas field at Songo Songo Island, which was brought onstream in mid-2004 to provide fuel for a gas fired power plant in Dar es Salaam and to make natural gas available, as a cleaner, more cost-effective alternative fuel for industrial customers who are currently using fuel oil. Gas production from the Songo Songo field is processed on Songo Songo Island by EastCoast and then shipped by marine and land pipeline to Dar es Salaam approximately 200 kilometres to the North.

There are two categories of gas production. Gas required primarily by the Ubungo Power Plant and Wazo Hill cement plant is categorized as "Protected Gas" and is owned by the Tanzanian Petroleum Development Corporation ("TPDC"). Natural gas production that is over and above the volumes required by these operations is categorized as "Additional Gas" and is available to be marketed by EastCoast under a Production Sharing Agreement with TPDC.

To deliver that Additional Gas production from Songo Songo, EastCoast has initially constructed a ring main distribution system that will meet the needs of industrial customers in the area. Gas marketed by EastCoast is already flowing to two industrial customers – Kioo Limited and Tanzanian Breweries Limited. Four more industrial customers have signed contracts with EastCoast and have been or will be connected to the ring main distribution system over the next few months. By the end of the first quarter of 2005, EastCoast estimates that its sale of Additional Gas to industrial customers in the Dar es Salaam area will total 2.7 million cubic feet per day (mmcf/d).

The first revenue to the Company from gas sales to industrial customers was booked in September. Since our sale of natural gas to industrial customers is priced at a 20 - 25% discount to the price of Heavy Fuel Oil in Dar es Salaam, higher world oil prices are providing a significant benefit to EastCoast. Gas prices to our industrial customers averaged \$5.41 per mcf in September.

The development of the Songo Songo gas field has brought a new measure of energy self-sufficiency to Tanzania. By 30 September approximately 1.4 billion cubic feet (bcf) of natural gas had been shipped to Dar es Salaam to be used as feedstock in the turbine generators at Ubungo and for the Wazo Hill cement plant.

Production from the Songo Songo field is being closely monitored. By the end of September 1.79 bcf of natural gas had been produced, primarily from three wells. Production and pressure tests confirm that the reservoir is performing in line with expectations. The Company intends to contract Gaffney Cline Associates to re-certify the reserves in January 2005, once the downhole pressure gauges are pulled.

Your Board of Directors and the Company's management are committed to developing EastCoast's full potential. We are vigorously pursuing new markets for the sale of Additional Gas and strategies for adding new reserves that can be marketed to customers in East Africa. We have an experienced, disciplined and motivated employee team in place and, through predecessor companies, over a decade of experience working in Tanzania.

The first six months of operating a new field can be challenging. But early indications are that the gas production levels and infrastructure performance are in line with expectations. We are already delivering gas to new customers and have gas delivery contracts with additional customers that will come on-line shortly.

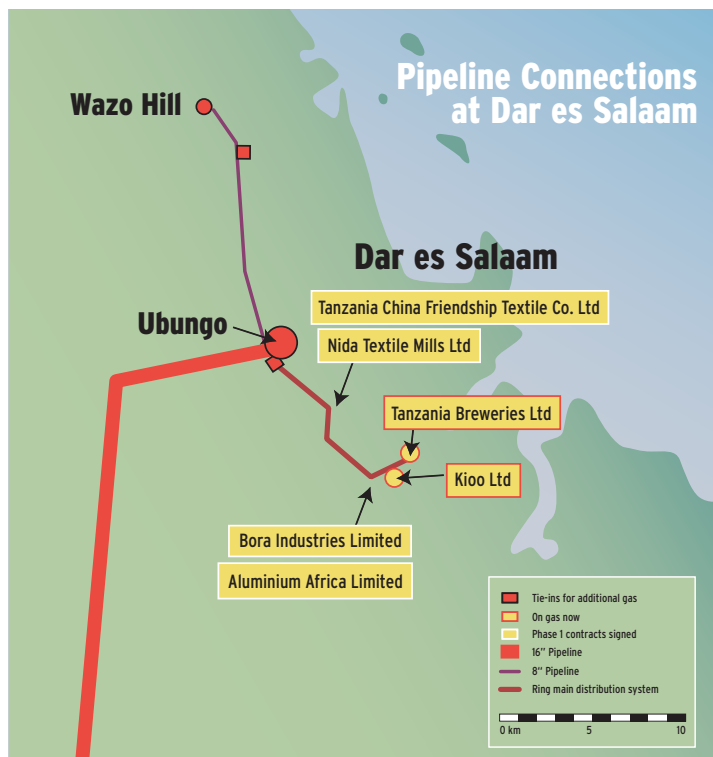
EastCoast's directors and management appreciate the very positive response support of the investment community. We are excited about the Company's future prospects and are working to create sustainable value for our shareholders.



W. David Lyons

November 8, 2004

## Operational Review



### Background

The Company's operations at the Songo Songo gas field in Tanzania provide for EastCoast to operate five producing wells and a 70 mmcf/d dehydration and refrigeration gas processing plant on Songo Songo Island. Gas processed by EastCoast is then transported to Dar es Salaam through a 25-kilometre 12-inch offshore pipeline and a 207-kilometre 16-inch onshore pipeline.

Gas produced and sold from the Songo Songo field is classified as either Protected Gas or Additional Gas.

The Protected Gas is 100% owned by the Tanzanian Petroleum Development Corporation ("TPDC") and is sold to Songas Limited ("Songas") under a 20 year Gas Agreement either for use at the Ubungo Power Plant or for onward sale. At a 100% utilisation rate, the Protected Gas consumption is 44.8 mmcf/d. However, over a twenty year period it is forecast that a 75% utilisation rate would be more likely.

Songo Songo gas production in excess of that required by the Protected Gas users is categorized as Additional Gas and may be developed and marketed by EastCoast and TPDC under the terms of the Production Sharing Agreement ("PSA") until October 2026.

### Protected Gas Users

Customer	Theoretical max 100% load factor (mmcf/d)	Most likely (mmcf/d)
<b>Ubungo</b>		
Two ABB turbines	10.97	8.23
Two GE turbines	18.55	13.91
GE - fifth turbine	8.40	6.30
	<b>37.92</b>	<b>28.44</b>
<b>Wazo Hill Cement Plant</b>		
Kiln 1	3.40	2.55
Kiln 2	2.47	1.85
	<b>5.87</b>	<b>4.40</b>
<b>Village Programme</b>		
	1.00	0.75
<b>Total daily gas demand (mmcf/d)</b>	<b>44.79</b>	<b>33.59</b>
<b>Reserves over 20 years (bcf)</b>	<b>327.0</b>	<b>245.2</b>



# Operational Review



## Operatorship

The Company is the operator of the wells and gas processing plant on Songo Songo Island on behalf of Songas. Operatorship is on a 'no gain/no loss' basis. Two internationally experienced staff manage the site operations on a rotational basis with back up support from the Company's head office personnel in Dar es Salaam. Twenty-six Tanzanian technicians operate and maintain the wells, processing and refrigeration plant.

As at 30 September, the gas processing facilities had performed in line with management's expectations. There have been no unplanned shutdowns on Songo Songo Island that had impacted the supply of gas to Dar es Salaam.



## Production

Commercial production commenced from the Songo Songo field on 20 July when the Ubungo Power Plant was commissioned.

By the end of September, 1.6 bcf of Protected Gas had been produced from the field since commercial start up as follows:

(Top)

The gas processing plant on Songo Songo Island is operated by EastCoast for Songas.

(Bottom)

Tanzania technicians control Songo Songo gas flow with state-of-the-art systems.

### Protected and Additional Gas Production

Gas produced mmcf	July	August	September	Total
Protected & Additional Gas Production	<b>367.6</b>	<b>611.6</b>	<b>632.8</b>	<b>1,612.0</b>
<i>Analysed between:</i>				
Protected Gas sales	190.1	591.9	589.6	1,371.6
Additional Gas sales	–	–	13.5	13.5
Line pack and other	177.5	19.7	29.7	226.9
	<b>367.6</b>	<b>611.6</b>	<b>632.8</b>	<b>1,612.0</b>

The maximum production rate achieved in September amounted to 28 mmscf/d and the average production 21 mmscf/d.

These relatively low Protected Gas rates have increased with the commissioning of the two ABB turbines and the second kiln at Wazo Hill in October and will increase further with the introduction of the GE fifth turbine in December 2004.

Small levels of Additional Gas sales commenced on 18 September with the completion of the 14 km ring main pipeline distribution system and pressure reduction station.



## Well capacity testing

With these initial production rates, the Company commenced well capacity tests on 17 September utilising Keller well head gauges. As at 30 September, tests had been performed on three of the wells, namely the two onshore wells, SS-3 and SS-4, and the offshore well SS-7. The results were as follows:

### Songo Songo Well Flow Rates

mmcf/d	1997 well tests	September 2004
<b>Tested</b>		
SS-3	10.0	17.4
SS-4	10.0	13.6
SS-7	20.0	22.6
	<b>40.0</b>	<b>53.6</b>
<b>Not tested</b>		
SS-5	60.0	Not tested
SS-9	40.0	Not tested
	<b>140.0</b>	<b>53.6</b>

Capacity testing on the onshore wells SS-3 and SS-4 recorded a higher capacity than was expected. SS-7 was slightly better than expected with a similar level of water production as that recorded at the time of the 1997 well test (circa 2.5 barrels of water/mmcf). The reason for this water production is being evaluated.

SS-5 remained shut in during September as a reservoir observation well. The limited production from the well in October indicates that it is performing near to the conditions observed during the 1997 testing. Testing of this well is expected to be completed during November.

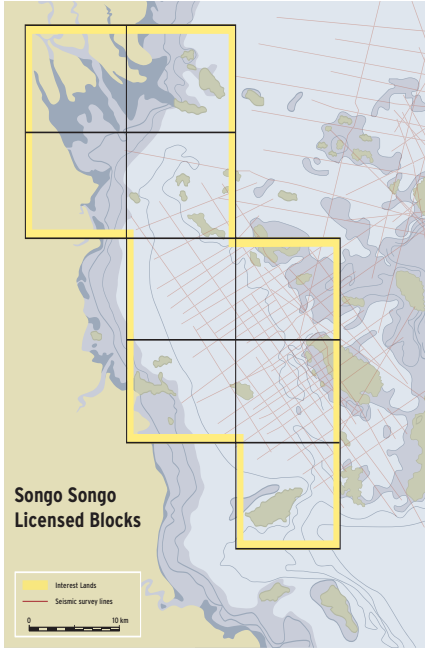
When commissioning the wells, the Company was unable to pull the back pressure valve located in the tubing hanger on SS-9. As a consequence, crews were unable to remove the fishes consisting of two sets of gauges and a length of wireline that were left downhole at the time of the 1997 extended well program. The back pressure valve is due to be milled in Q4 2004 and it is now intended to run some perforated tubing to prevent any debris in the well causing operational problems. The SS-9 well will then be tested, but it is forecast that the rates will be lower than those tested in 1997. With the better than anticipated well results to date, the Company is not considering an immediate workover.

Downhole pressure gauges were installed in four of the wells before the start-up of the field and these will be pulled out of the wells in November for evaluation. The Company plans to install new pressure gauges at that time.



Songo Songo gas production flows to Dar es Salaam for power plant and industrial use.

# Operational Review



EastCoast's Production Sharing Agreement includes two discovery blocks and seven adjoining blocks.

## Reserves

There are nine licences included in the Company's PSA with TPDC, namely two discovery blocks within the Songo Songo field and seven blocks in adjacent areas ("Adjoining Blocks").

## Certification for project sponsors

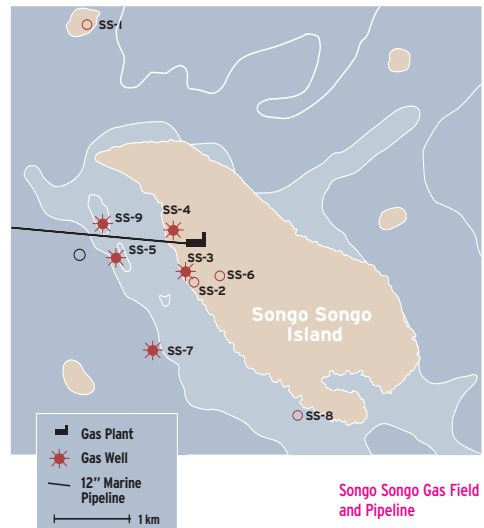
EastCoast intends to contract Gaffney Cline Associates ("GCA") to prepare a revised certified reserve report in January 2005 utilising the surface and subsurface well flow and pressure data obtained since production commenced in June 2004. The objective of the report is to demonstrate to the Government of Tanzania, TPDC, Songas and the World Bank that there are sufficient reserves for other gas-to-electricity projects.

GCA initially prepared a certified report in January 2001 to support the development of the Songo Songo project by the World Bank and other sponsors. This original report certified that there was 595 bcf of gas initially in place with 297 bcf of proved recoverable reserves and 580 bcf of proven and probable reserves from the five Songo Songo wells. However, this report limited the proven reserves to the volumes required for the Protected Gas users. In 2003, GCA reviewed the

Company's improved data set and their report specified that there was 444 bcf of technically recoverable reserves in the Songo Songo field on a 'low case' basis (for Protected and Additional Gas users). The report was not certified.

## Certification for shareholders

In accordance with National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities, McDaniel and Associates Consultants Ltd ("McDaniels"), independent petroleum engineering consultants prepared a report on the EastCoast natural gas reserves, dated 24 March 2004, based on available information on the Songo Songo field as at 31 December 2003.



Songo Songo Gas Field and Pipeline

The reserves summary to the end of the license period (October 2026) for the Additional Gas was as follows:

### Additional Gas Reserves

	2003 BCF	NPV10 Forecast Price Case US\$ million
Proved producing	–	–
Proved non producing	85.3	7.6
Total proved	85.3	7.6
Proven and probable	259.6	46.4

McDaniels will be contracted to update their reserve report as at 31 December 2004 for the purposes of the annual report, based on the latest well performance, sales contracts and field economics.

### Infrastructure and markets

The infrastructure that transports the gas from the field to Dar es Salaam was commissioned in June and July 2004. The current infrastructure configuration has a capacity of approximately 70 mmcf/d, limited by the two gas processing trains that have a design specification of 35 mmcf/d each. Of this infrastructure capacity, up to 44.8 mmcf/d has to be made available for the Protected Gas users.

The Company's 14 km ring main distribution system and pressure reduction station was commissioned during September 2004. This system enables Additional Gas to be transported from the main Songo Songo pipeline to industrial customers in the Dar es Salaam area. The ring main will have an initial capacity of 10 mmcf/d. However, it is forecast that it will only be able to operate at 50% of capacity if it is to meet peak demand requirements.

Gas sales commenced with Kioo limited and Tanzania Breweries Limited in the latter half of September. These two customers are expected to take an average of 1.4 mmcf/d.

The Company has signed four new five year interruptible contracts with customers adjacent to the ring main distribution pipeline. These four customers are expected to purchase an additional 1.3 mmcf/d from EastCoast once they have completed the conversion of their boilers to burn natural gas (forecast to be completed by the end of Q1 2005). Three of the connections to these customers have been constructed and the fourth is currently under construction.

Songas is in the process of installing a fifth GE turbine (34 MW) at Ubungo. This turbine will use Protected Gas in accordance with the terms of the Project Agreements. In addition, management understands that a sixth turbine (33 MW) is forecast to be operational at Ubungo by the end of Q2 2005. However, the Government power utility, Tanesco, has not commenced negotiations with EastCoast for the supply of gas for this turbine and therefore no Additional Gas sales can be forecast.



(top)

EastCoast has constructed its own gas distribution system in Dar es Salaam to connect industrial customers

(bottom)

Bottom: EastCoast's industrial customers in Dar es Salaam include the Kioo Limited glass manufacturing plant.

# Management's Discussion & Analysis

## Consolidation

Pursuant to a Scheme of Arrangement which was approved by the shareholders of PanOcean Energy Corporation ("PanOcean") on 9 June 2004, the Company and its Tanzanian assets were spun off from PanOcean on 31 August 2004. Accordingly, the financial results contained herein are for the period ended 30 September 2004. The results prior to 31 August 2004 are consolidated within PanOcean's 3rd Quarter report.

Three companies are being consolidated within the results:

<u>Company</u>	<u>Incorporated</u>
EastCoast Energy Corporation	British Virgin Islands
PAE PanAfrican Energy Corporation	Mauritius
PanAfrican Energy Tanzania Limited	Jersey

## Opening Balance Sheet

The opening balance sheet of EastCoast Energy Corporation ("EastCoast" or the "Company") as at 31 August 2004 was as follows:

<u>US\$'000</u>	<u>As at 31 Aug</u>
<b>Assets</b>	
Cash and cash equivalents	1,997
Trade and other receivables	2,403
Natural gas properties	9,411
	<b>13,811</b>
<b>Liabilities</b>	
Current liabilities	
Trade and other payables	1,949
<b>Shareholders' Equity</b>	
Capital Stock	11,862
Reserves	—
	<b>11,862</b>
	<b>13,811</b>

As part of the reorganisation, PanOcean undertook to:

- Finance the remaining costs of constructing the ring main distribution system (\$1.7 million included in Trade and other receivables above); and
- Contribute minimum working capital of \$2 million to the Company less 50% of the legal fees associated with the spin off (included in Cash and cash equivalents above).

As at 31 August, the Company had working capital of \$2.4 million, and this may be analysed as follows:

<b>US\$'000</b>	<b>As at 31 Aug</b>
<b>Cash and cash equivalents</b>	1,997
<b>Trade and other receivables</b>	
PanOcean Energy Corporation	1,682
Songas Limited	434
Other receivables	287
	<b>2,403</b>
<b>Total current liabilities</b>	
Terasen International	1,417
Songas Limited	247
PanOcean Energy Corporation	132
Accruals	153
	<b>1,949</b>
<b>Total Working Capital</b>	<b>2,451</b>

# Management's Discussion & Analysis

## Results for the period 31 August to 30 September 2004

### Revenue and operating costs

The sales of Additional Gas commenced on 18 September 2004. Under the terms of the Production Sharing Agreement ("PSA") with the Tanzanian Petroleum Development Corporation ("TPDC"), EastCoast is responsible for invoicing, collecting and allocating the revenue.

EastCoast is able to recover all costs incurred on the development and administration of Additional Gas from the Songo Songo gas field, out of 75% of the gross sales revenues less the tariff paid to Songas for the use of the gas processing plant and pipeline infrastructure ("Net Revenues"). Any costs not recovered in any period are carried forward to be recovered out of future revenues. Revenue less cost recovery is allocated 75% to TPDC and 25% to EastCoast.

EastCoast had \$5.6 million of costs to be recovered at 30 September and accordingly was allocated 81.25% of the Net Revenues in September as follows:

<b>Period ended (US\$'000 except production and per mcf data)</b>	<b>30 Sept</b>
Gross sales volume (mcf)	13,524
Average sales price (\$/mcf)	5.41
Gross sales revenue	73
Gross tariff for processing plant and pipeline infrastructure	11
Gross net revenue after tariff	<b>62</b>
<i>Analysed as to:</i>	
Company Cost Recovery	46
Company Profit Gas	4
	50
TPDC Profit Gas	12
	<b>62</b>
<b>Operating costs:</b>	
Ring main distribution pipeline	5
Well maintenance	1

The tariff is calculated as 17.5% of the price of the gas at the Songas main pipeline in Dar es Salaam ("Songas Outlet Price"). In calculating the Songas Outlet Price, 74 cents/mcf has been deducted from the achieved sales price of \$5.41/mcf to reflect the gas price that would be achievable at the Songas main pipeline. The 74 cents/mcf ("Ringmain Tariff") represents the amount that would be required to compensate a third party distributor of the gas for constructing the connections from the Songas main pipeline to the industrial customers.

The well maintenance costs are allocated between Protected and Additional Gas based on forecast sales for each year. A reconciliation will be performed at the year end to re-allocate the costs on an actual basis.

## Pricing

The price of gas in September was at a 25% discount to the price of Heavy Fuel Oil in Dar es Salaam. This resulted in gas prices of \$5.41 per mcf in September.

The gas price achieved will fluctuate with world oil prices and the discount agreed with the customers. It is anticipated that a significantly greater discount will be required to secure gas sales to the power sector.

## Netbacks

The netback per mcf before general and administrative costs and overheads may be analysed as follows:

Period ended (US\$/mcf)	30 Sept
Average price for gas	5.41
Tariff (after allowance for the Ringmain Tariff)	(0.82)
TPDC profit share	(0.86)
Net selling price	<b>3.73</b>
Well maintenance	(0.07)
Ring main distribution costs	(0.15)
Net Back	<b>3.51</b>

## General and Administrative Expenses

All general and administrative expenses, with the exception of stock-based compensation, were capitalised until commercial production of Additional Gas commenced on 18 September 2004. The general and administrative costs for the period may be analysed as follows:

Period ended (US\$'000)	30 Sept
Employee costs	55
Stock-based compensation	79
Travel & accommodation	4
Communications	3
Office	18
Consultants	36
Insurance	4
Other corporate	14
	<b>213</b>
Capitalised pre-operating costs	(87)
Total general and administrative expenses	<b>126</b>

# Management's Discussion & Analysis

## **Taxes**

Under the terms of the PSA, the Company is liable to Tanzanian income tax, but this is paid through the profit sharing arrangements with TPDC. Where income tax is payable the Company's revenue will be grossed up by the tax due and the tax will be shown as a current tax.

The Company has taxable losses brought forward and therefore is not liable to income tax in the period under review.

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, an Additional Profits Tax is payable.

As at 30 September 2004, there were un-recovered costs of \$5.6 million and therefore no Additional Profits Tax is payable.

## **Depletion**

The 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 (85.3 bcf to the end of the licence).

## **Recoverable costs**

As at 30 September, the Company had \$5.6 million of costs that are recoverable out of 75% of the future Net Revenues.

## **Carrying Value of Assets**

Capitalised costs are periodically assessed to determine whether it is likely that such costs will be recovered in the future. To the extent that these capitalised costs are unlikely to be recovered in the future, they are written off and charged to earnings.

Management has reviewed the current carrying value of the Tanzanian natural gas properties and has concluded that there should not be a write off of these assets. An independent valuation will be performed at the year end to take account of the latest economic and reservoir data.



## Cash flow

The components of the Company's cash flow for September were as follows.

Period ended (US\$'000)	30 Sept
Net loss before taxation	(84)
Adjustment for non cash items	80
Pre tax cash flows from operations	(4)
Working capital adjustments	384
Acquisition of natural gas properties	(158)
<b>Net increase in cash and cash equivalent</b>	<b>222</b>

## Capital expenditure

Gross capital expenditure amounted to \$0.2 million in September. The capital expenditure may be analysed as follows:

Period ended (US\$'000)	30 Sept
Geological and geophysical	10
Pipelines and infrastructure	1
Business development	147
	<b>158</b>

## Working capital

Working capital as at 30 September was \$2.3 million and may be analysed as follows:

US\$'000	As at 30 Sept
Cash and cash equivalents	2,219
Trade and other receivables	1,472
	<b>3,691</b>
Total current liabilities	1,402
<b>Working capital</b>	<b>2,289</b>

Included in cash and cash equivalents is \$213,000 of cash advanced by Songas for the payments of the operating expenses. This amount is also shown in current liabilities.

Trade and other receivables includes an amount of \$1.0 million that is due from PanOcean for the ring main pipeline distribution system. A similar amount is included in creditors as due to the pipeline contractor, Terasen International.

# Management's Discussion & Analysis

## Outstanding share capital

There were 21.1 million shares outstanding at 30 September and may be analysed as follows:

No of shares ('000)	As at 30 Sept
<b>Shares outstanding</b>	
Class A Shares	1,751
Class B Shares	19,386
	<b>21,137</b>
<b>Convertible securities:</b>	
Options	2,000
<b>Fully diluted Class A and Class B shares</b>	<b>23,137</b>
<b>Weighted average</b>	
Class A and Class B Shares	21,137
Options	2,000
<b>Weighted average diluted Class A and Class B Shares</b>	<b>23,137</b>

No new Class A or Class B Shares were issued between 31 August and 30 September 2004.

2,000,000 options were awarded to certain Directors, Officers and Consultants on 1 September 2004. For further information on the allocation and the terms of the option scheme, please see the notes to the consolidated financial statements.

## Reserve replacement

There were no additions or revisions to estimates of reserves during the period.

## Contractual Obligations and Committed Capital Investment

The Company's rights regarding the seven licences adjoining the Songo Songo field ("Adjoining Blocks") are for the period until October 2005. If the Company wishes to retain the Adjoining Blocks, it must incur a minimum of \$2.1 million on seismic pre October 2005 and commit to drill one well on the Adjoining Blocks before October 2006. This has not been shown as a commitment in the accounts as the Company has not yet determined whether to conduct any operations on the Adjoining Blocks.

Under the terms of the contracts with Kioo Limited and Tanzania Breweries Limited, the Company is liable to pay penalties in the event that there is a shortfall in the gas supply in excess of 5% of the contracted quantity. The penalties equate to the difference between the price of gas and an alternative feedstock multiplied by the notional daily quantities. The maximum penalty for shortfall gas is \$800,000 for these two contracts and the remedy is payable as a credit against future monthly revenue. There have been no shortfalls in the gas supply as at 30 September 2004 and no shortfalls are foreseen. Therefore, no provision has been incorporated in these financial statements.

Under the terms of the PSA, in the event that there is a shortfall in Protected Gas as a consequence of the sale of Additional Gas, then the Company is liable to pay the difference between the price of Protected Gas (\$0.55 per mmbtu) 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. Songas has the right to request reasonable security on all Additional Gas sales. No security has been requested for the initial industrial gas sales, but Songas still retains this right and may require security for larger volumes.

#### **Off-Balance sheet transactions**

As at 30 September 2004, the Company had no off-balance sheet arrangements.

#### **Operating leases**

The Company has entered into a five year rental agreement for the use of the offices in Dar es Salaam at a cost of approx \$92,000 per annum.

#### **Related party transactions**

The Company did not enter into any transactions with related parties during the period ended 30 September 2004.

The Company was spun off from PanOcean through a Scheme of Arrangement on 31 August 2004. W. David Lyons is the Chairman and controlling shareholder of both PanOcean and EastCoast. As part of the spin off, PanOcean provided the Company with certain working capital and other funding as more fully described under 'Opening Balance Sheet' in this Management's Discussion & Analysis.

# Management's Discussion & Analysis

## *Assessment of Business Risks*

An investment in EastCoast is subject to various risks including those risks inherent to the oil and natural gas industry. EastCoast will be exposed to operational risks inherent in exploring for, developing, producing and marketing natural gas. The Company is at a relatively early stage of development and accordingly there are numerous uncertainties in estimating gas reserves and in projecting future production, costs and expenses and the results, timing and costs of exploration and development projects, as well as the timing and costs associated with the realisation of markets for natural gas production. Total amounts or timing of production may vary significantly from reserves and production estimates.

### **The Company**

There are numerous factors which may affect the success of EastCoast's business which are beyond EastCoast's control including local, national and international economic and political conditions. EastCoast's business will involve a high degree of risk which a combination of experience, knowledge and careful evaluation may not overcome. The operations of EastCoast in East Africa, will expose EastCoast to risks which may not exist for domestic operations such as political and currency risks.

### **Operating Hazards and Uninsured Risks**

The business of EastCoast is subject to all of the operating risks normally associated with the exploration for, and the production, storage, transportation and marketing of gas. These risks include blowouts, explosions, fire, gaseous leaks and migration of harmful substances, any of which could cause personal injury, result in damage to, or destruction of, gas wells or formations or production facilities and other property, equipment and the environment, as well as interrupt operations. In addition, all of EastCoast's operations will be subject to the risks normally incident to drilling of natural gas wells and the operation and development of gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blowouts, equipment failures and other accidents, sour gas releases, uncontrollable flows of oil, natural gas or well fluids, adverse weather conditions, pollution and other environmental risks. Drilling conducted by EastCoast overseas will involve increased drilling risks of high pressures and mechanical difficulties, including stuck pipe, collapsed casing and separated cable. The impact that any of these risks may have upon EastCoast is increased due to the fact that EastCoast currently only has one producing property. EastCoast will maintain insurance against some, but not all, potential risks; however, there can be no assurance that such insurance will be adequate to cover any losses or exposure for liability. The occurrence of a significant unfavourable event not fully covered by insurance could have a material adverse effect on EastCoast's financial condition, results of operations and cash flows. Furthermore, EastCoast cannot predict whether insurance will continue to be available at a reasonable cost or at all.

## **Foreign Operations**

All of EastCoast's operations and related assets will be located in countries outside North America, some of which may be considered to be politically and economically unstable. Exploration or development activities in such countries may require protracted negotiations with host governments, national oil companies and third parties and are frequently subject to economic and political considerations, such as, the risks of war, actions by terrorist or insurgent groups, expropriation, nationalization, renegotiation or nullification of existing contracts, taxation policies, foreign exchange restrictions, changing political conditions, international monetary fluctuations, currency controls and foreign governmental regulations that favour or require the awarding of drilling contracts to local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. In addition, if a dispute arises with foreign operations, EastCoast may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons, especially foreign oil ministries and national oil companies, to the jurisdiction of England or Canada.

In the foreign countries in which EastCoast will conduct business, currently limited to Tanzania, the state generally retains ownership of the minerals and consequently retains control of (and in many cases, participates in) the exploration and production of hydrocarbon reserves. Accordingly, these operations may be materially affected by host governments through royalty payments, export taxes and regulations, surcharges, value added taxes, production bonuses and other charges.

All of EastCoast's development properties and all of its proved natural gas reserves will be located offshore Songo Songo Island in the Republic of Tanzania, and, consequently, EastCoast's assets will be subject to regulation and control by the government of Tanzania and certain of its national and parastatal organizations. Although there have been instances of unrest and uncertainty in Tanzania, to date, and to the best of EastCoast's knowledge, the Ministry of Energy and Minerals has been largely unaffected by political changes. EastCoast and its predecessors have operated in Tanzania for a number of years and believe that it has good relations with the current Tanzanian government. However, there can be no assurance that present or future administrations or governmental regulations in Tanzania will not materially adversely affect the operations or future cash flows of EastCoast.

## **Controlling Shareholder**

W. David Lyons, the Chairman of EastCoast, who will be the sole controlling shareholder of EastCoast holds approximately 22.7% of the equity and controls 69.5% of the total votes of EastCoast prior to the exercise of options. As a result, W. David Lyons will control the business and affairs of EastCoast.

# Management's Discussion & Analysis

## **Additional Financing**

Depending on future exploration, development, and marketing plans, EastCoast will require additional financing. The ability of EastCoast to arrange such financing in the future will depend in part upon the prevailing capital market conditions as well as the business performance of EastCoast. There can be no assurance that EastCoast will be successful in its efforts to arrange additional financing on terms satisfactory to EastCoast. If additional financing is raised by the issuance of shares from treasury of EastCoast, control of EastCoast may change and shareholders may suffer additional dilution.

From time to time EastCoast 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 EastCoast's debt levels above industry standards.

## **Industry Conditions**

The oil and gas industry is intensely competitive and EastCoast will compete with other companies which possess greater technical and financial resources. Many of these competitors not only explore for and produce oil and natural gas, but also carry on refining operations and market petroleum, natural gas products and other products on an international basis. Oil and gas production operations are also subject to all the risks typically associated with such operations, including premature decline of reservoirs and invasion of water into producing formations. Pursuant to the Operating Agreement, EastCoast's Songo Songo natural gas property will be operated by EastCoast. There is a risk that in the future either the operatorship could change and the property operated by third parties or operations may be subject to control by national oil companies, Songas, or other parastatal organisations and, as a result, EastCoast may have limited control over the nature and timing of exploration and development of such properties or the manner in which operations are conducted on such properties.

The marketability and price of natural gas which may be acquired, discovered or marketed by EastCoast will be affected by numerous factors beyond its control. There is currently no developed natural gas market in Tanzania and no infrastructure with which to serve potential new markets beyond that being constructed by EastCoast and Songas. The ability of EastCoast to market any natural gas from current or future reserves may depend upon its ability to develop natural gas markets in Tanzania and the surrounding region, obtain access to the necessary infrastructure to deliver sales gas volumes, including acquiring capacity on pipelines which deliver natural gas to commercial markets. EastCoast will also be subject to market fluctuations in the prices of oil and natural gas, uncertainties related to the delivery and proximity of its reserves to pipelines and processing facilities and extensive government regulation relating to prices, taxes, royalties, land tenure, allowable production, the export of gas and many other aspects of the gas business. EastCoast will also be subject to a variety of waste disposal, pollution control and similar environmental laws.

The oil and natural gas industry is subject to varying environmental regulations in each of the jurisdictions in which EastCoast may operate. Environmental regulations place restrictions and prohibitions on emissions of various substances produced concurrently and can impact on the selection of drilling sites and facility locations, potentially resulting in increased capital expenditures. EastCoast may be responsible for abandonment and site restoration costs.

### **Additional Gas**

EastCoast will have the right, under the terms of the Production Sharing Agreement, to market volumes of Additional Gas, subject to satisfying the requirements to deliver Protected Gas to Songas. There is a risk that Songas could interfere in EastCoast's ability to produce, transport and sell volumes of Additional Gas if EastCoast's obligations to Songas under the Gas Agreement are not met. In particular, Songas has the right to request reasonable security on all Additional Gas sales.

### **Replacement of Reserves**

EastCoast's natural gas reserves and production and, therefore, its cash flows and earnings will be highly dependent upon EastCoast developing and increasing its current reserve base and discovering or acquiring additional reserves. Without the addition of reserves through exploration, acquisition or development activities, EastCoast's reserves and production will decline over time as reserves are depleted. To the extent that cash flow from operations is insufficient and external sources of capital become limited or unavailable, EastCoast's ability to make the necessary capital investments to maintain and expand its oil and natural gas reserves will be impaired. There can be no assurance that EastCoast will be able to find and develop or acquire additional reserves to replace production at commercially feasible costs.

### **Asset Concentration**

EastCoast's natural gas reserves will be initially limited to one property, the Songo Songo field, and the production potential from this field is limited to five potential wells. There is no assurance that EastCoast will have sufficient deliverability through the existing wells to provide Additional Gas sales volumes, and that there may be significant capital expenditures associated with any remedial work or new drilling required to achieve deliverability. In addition, any difficulties relating to the operation or performance of the field would have a material adverse effect on EastCoast.

### **Environmental and Other Regulations**

Extensive national, state, and local environmental laws and regulations in foreign jurisdictions will affect nearly all of EastCoast's operations. These laws and regulations set various standards regulating certain aspects of health and environmental quality, provide for penalties and other liabilities for the violation of such standards and establish in certain circumstances obligations to remediate current and former facilities and locations where operations are or were conducted. In addition, special provisions may be appropriate or required in environmentally sensitive areas of operation. There can be no assurance that EastCoast will not incur substantial financial obligations in connection with environmental compliance. Significant liability could be imposed on EastCoast for damages, cleanup costs or penalties in the event of certain discharges into the environment, environmental damage caused by previous owners of property purchased by EastCoast or non-compliance with environmental laws or regulations. Such liability could have a material adverse effect on EastCoast. Moreover, EastCoast cannot predict what environmental legislation or regulations will be enacted in the future or how existing or future laws or regulations will be administered or enforced. Compliance with more stringent laws or regulations, or more vigorous enforcement policies of any regulatory authority, could in the future require material expenditures by EastCoast for the installation and operation of systems and equipment for remedial measures, any or all of which may have a material adverse effect on EastCoast. As it will, after giving effect to the Arrangement, be a party to various licenses, EastCoast has an obligation to restore producing fields to a condition acceptable to the authorities at the end of their commercial lives.

# Management's Discussion & Analysis

While management believes that the Company is currently in compliance with environmental laws and regulations applicable to the Company's operations in Tanzania, no assurances can be given that EastCoast will be able to continue to comply with such environmental laws and regulations without incurring substantial costs.

## **Volatility of Oil and Gas Prices and Markets**

EastCoast's financial condition, operating results and future growth will be dependent on the prevailing prices for its natural gas production. Historically, the markets for oil and natural gas have been volatile and such markets are likely to continue to be volatile in the future. Prices for oil and natural gas are subject to large fluctuations in response to relatively minor changes to the demand for oil and natural gas, whether the result of uncertainty or a variety of additional factors beyond the control of EastCoast. Any substantial decline in the prices of oil and natural gas could have a material adverse effect on EastCoast and the level of its natural gas reserves. Additionally, the economics of producing from some wells may change as a result of lower prices, which could result in a suspension of production by EastCoast.

No assurance can be given that oil and natural gas prices will be sustained at levels which will enable EastCoast to operate profitably. From time to time EastCoast may avail itself of forward sales or other forms of hedging activities with a view to mitigating its exposure to the risk of price volatility.

In addition, various factors, including the availability and capacity of gas gathering systems and pipelines, the effect of foreign regulation of production and transportation, general economic conditions, changes in supply due to drilling by other producers and changes in demand may adversely affect EastCoast's ability to market its gas production. Any significant decline in the price of oil or gas would adversely affect EastCoast's revenues, operating income, cash flows and borrowing capacity and may require a reduction in the carrying value of EastCoast's gas properties and its planned level of capital expenditures.

## **Uncertainties in Estimating Reserves and Future Net Cash Flows**

There are numerous uncertainties inherent in estimating quantities of proved and probable reserves and cash flows to be derived therefrom, including many factors beyond the control of EastCoast. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from EastCoast's properties have been independently evaluated by McDaniels. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, crude oil price differentials to benchmarks, future prices of oil and natural gas, operating costs, transportation costs, cost recovery provisions and royalties and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date of the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of EastCoast. Actual production and cash flows derived therefrom will vary from these evaluations, and such variations could be material.



The present value of estimated future net cash flows referred to herein should not be construed as the current market value of estimated proved natural gas reserves attributable to EastCoast's properties. The estimated discounted future cash flow from proved reserves are based upon price and cost estimates which may vary from actual prices and costs and such variance could be material. Actual future net cash flows will also be affected by factors such as the amount and timing of actual production, supply and demand for oil and natural gas, curtailments or increases in consumption by purchasers and changes in governmental regulations or taxation.

### **Title to Properties**

Although title reviews have been done and will continue to be done according to industry standards prior to the purchase of most oil and natural gas producing properties or the commencement of drilling wells, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise to defeat the claim of EastCoast which could result in a reduction of the revenue received by EastCoast.

### **Acquisition Risks**

EastCoast intends to acquire natural gas infrastructure and possibly additional oil and gas properties. Although EastCoast performs a review of the acquired properties that it believes is consistent with industry practices, such reviews are inherently incomplete. It generally is not feasible to review in depth every individual property involved in each acquisition. Ordinarily, EastCoast will focus its due diligence efforts on the higher valued properties and will sample the remainder. However, even an in depth review of all properties and records may not necessarily reveal existing or potential problems, nor will it permit a buyer to become sufficiently familiar with the properties to assess fully their deficiencies and capabilities. Inspections may not be performed on every well, and structural or environmental problems, such as ground water contamination, are not necessarily observable even when an inspection is undertaken. EastCoast may be required to assume pre-closing liabilities, including environmental liabilities, and may acquire interests in properties on an "as is" basis. There can be no assurance that EastCoast's acquisitions will be successful.

### **Reliance on Key Personnel**

EastCoast will be highly dependent upon its executive officers and key personnel. The unexpected loss of the services of any of these individuals could have a detrimental effect on EastCoast. EastCoast does not maintain key man life insurance on any of its employees.

## Consolidated Income Statement (unaudited)

(thousands of US dollars)	Note	Period ended 30 September 2004
<b>Revenue</b>		
Operating	2	50
<b>Cost of sales</b>		
Production and distribution expenses		(6)
Depletion		(1)
<b>Gross profit</b>		
		43
Administrative expenses		(126)
Other operating expenses	3	(1)
<b>Loss before taxation</b>		
		(84)
Taxation	5	-
<b>Loss for the period</b>		
		(84)
<b>Loss per share</b>		
	14	
Basic (US\$)		0.0040
Diluted (US\$)		0.0036

See accompanying notes to the consolidated financial statements.

## Consolidated Balance Sheet (unaudited)

(thousands of US dollars)	Note	As at 30 September 2004
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	7	2,219
Trade and other receivables	8	1,472
		<b>3,691</b>
Natural gas properties	9	9,568
		<b>13,259</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Trade and other payables	10	1,402
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock	13	11,862
Capital reserves		79
Accumulated losses		(84)
		<b>11,857</b>
		<b>13,259</b>

See accompanying notes to the consolidated financial statements.

## Consolidated Statement of Cash Flows (unaudited)

(thousands of US dollars)	Period ended 30 September 2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
<b>Net loss before taxation</b>	<b>(84)</b>
Adjustments for:	
Depletion	1
Stock-based compensation	79
<hr/>	
Operating profit before working capital changes	(4)
Decrease in trade and other receivables	931
Decrease in trade and other payables	(547)
<hr/>	
<b>Net cash flow from operating activities</b>	<b>380</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Acquisition of natural gas properties	(158)
<hr/>	
<b>Net decrease in cash and cash equivalents</b>	<b>222</b>
<b>Cash and cash equivalents at 31 August 2004</b>	<b>1,997</b>
<hr/>	
<b>Cash and cash equivalents at 30 September 2004</b>	<b>2,219</b>

See accompanying notes to the consolidated financial statements

## Statement of Changes in Equity (unaudited)

(thousands of US dollars)	Capital stock	Capital reserve	Accumulated loss	Total
Balance as at 31 August 2004	11,862	–	–	11,862
Loss for the period	–	–	(84)	(84)
Stock-based compensation	–	79	–	79
<b>Balance as at 30 September 2004</b>	<b>11,862</b>	<b>79</b>	<b>(84)</b>	<b>11,857</b>

# Notes to the Consolidated Financial Statements

## *General Information*

EastCoast Energy Corporation (“EastCoast” or the “Company”) was incorporated on 28 April 2004 under the laws of the British Virgin Islands. Between 28 April 2004 and 30 August 2004, EastCoast was a 100% subsidiary of PanOcean Energy Corporation Limited (“PanOcean”). On 31 August, as part of a Scheme of Arrangement, the Class A and Class B Subordinated Voting Shares in the Company were distributed to the PanOcean shareholders and the Company was listed on the TSX Venture Exchange under the symbols ECE.A and ECE.B. These financial statements are the first Consolidated Financial Statements to be prepared by the Company since it was incorporated and covers the period 31 August 2004 to 30 September 2004.

The Company is party to a gas-to-electricity project in Tanzania. The Company’s operations at the Songo Songo gas field in Tanzania provide for EastCoast to operate five producing wells and two 35 mmcf/d dehydration and refrigeration gas processing units on Songo Songo Island on behalf of Songas Limited (“Songas”) at cost. Gas processed by EastCoast is transported to Dar es Salaam.

Gas produced and sold from the Songo Songo field is either Protected Gas or Additional Gas. Protected Gas is 100% owned by Tanzania Petroleum Development Corporation (“TPDC”) and is sold to Songas under a twenty year Gas Agreement primarily for use at the Ubungu Power Plant and the Wazo Hill cement plant. The Protected Gas can only be used as feedstock for specified turbines and kilns and it is estimated that the maximum consumption is 44.8 mmcf/d based on a 100% load factor. However, over a twenty year period, it is forecast that a 75% utilization rate would be more likely.

Gas sales in excess of that required for the Protected Gas users is categorized as Additional Gas. The Company has the exclusive right to explore, develop, produce and market all Additional Gas. Revenues from the sale of Additional Gas, net of transportation tariff, are shared with TPDC in accordance with the terms of the Production Sharing Agreement (“PSA”) until October 2026.

## **Basis of preparation**

These Consolidated Financial Statements are measured and presented in US dollars as the main operating cash flows are linked to this currency through the commodity price. Management is required to make estimates and assumptions 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 from these estimates.

## **1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **a) Statement of compliance**

The Consolidated Financial Statements have been prepared in accordance with the International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and interpretations issued by the Standing Interpretations Committee of the IASB.

**b) Basis of consolidation**

*i) Subsidiaries*

The Consolidated Financial Statements include the accounts of the Company and all its subsidiaries (collectively, the “Company”). Subsidiaries are those enterprises controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial or operating policies of those enterprises. The financial statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

The following companies have been consolidated within the financial statements:

<b>Subsidiary</b>	<b>Registered</b>	<b>Holding</b>
PAE PanAfrican Energy Corporation	Mauritius	100 percent
PanAfrican Energy Tanzania Limited	Jersey	100 percent

*ii) Transactions eliminated upon consolidation*

Intra-company balances and transactions, and any unrealised gains arising from intra-company transactions, are eliminated in preparing the Consolidated Financial Statements.

**c) Foreign currency**

Foreign currency transactions are recorded at the rate of exchange prevailing at the date of transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Non-monetary items are translated at historic rates, unless such items are carried at market value, in which case they are translated using the exchange rates that existed when the values were determined. Any resulting exchange rate differences are taken to the income statement.

**d) Derivative financial instruments**

The Company may use derivative financial instruments to hedge its exposure to foreign exchange, interest rate and commodity price risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are initially recorded at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. Recognition of any resultant gain or loss depends on the hedge accounting model applied.

**e) Carried Interest**

The Company conducts certain international operations jointly with foreign governments or parastatal entities in accordance with production sharing agreements. Under these agreements, the Company pays both its share and the parastatal's share of operating, administrative and capital costs. The Company recovers all the operating, administrative and capital costs including the parastatal's share of these costs from future revenues over several years. The parastatal's share of operating and administrative costs are recorded in operating and general and administrative costs when incurred and capital costs are recorded in 'Natural Gas Properties'. All recoveries are recorded as revenue in the year of recovery in accordance with accounting policy 1 (n).

# Notes to the Consolidated Financial Statements

## f) Natural gas properties

The Company follows the full cost method of accounting for natural gas operations. Capitalised costs include land acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells, pipeline and related gas distribution equipment, market development and overhead charges directly related to exploration and development activities.

Costs are depleted on the unit-of-production method based on the estimated proved reserves as estimated by independent reservoir engineers. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties, or impairment occurs.

Costs incurred are not depleted until commercial production commences. These capitalised costs are periodically assessed to determine whether it is likely that such costs will be recovered in the future. To the extent that there are costs that are unlikely to be recovered in the future, they are written off and charged to earnings.

Capitalised costs, less accumulated depletion are limited to an amount equal to the estimated discounted future net revenue from proven reserves plus the cost (net of impairments) of unproven properties.

## g) Depreciation

Depreciation in respect of non natural gas assets is charged to the income statement on a straight line basis over the estimated useful lives of each class of asset. The estimated useful lives are as follows:

Leasehold improvements	Over remaining life of the lease
Computer equipment	3 years
Vehicles	3 years
Fixtures and fittings	4 years
Technical equipment	3 years

## h) Operatorship

The Company operates the gas field, flow lines and gas processing plant on behalf of Songas at cost.

The cost of operating and maintaining the wells and flow lines is paid for by EastCoast and Songas in proportion to the respective volumes of Protected Gas and Additional Gas sales. The costs of operating and maintaining the wells and flow lines are reflected in the accounts to the extent that the costs relate to Additional Gas sales.

The cost of operating the gas processing plant is paid by Songas. Where there are Additional Gas sales, a transportation tariff is paid to Songas as compensation for using the gas processing plant. This transportation tariff is netted off revenue in accordance with accounting policy 1 (n).

## i) Trade and other receivables

Trade and other receivables are stated at cost less impairment losses.

## j) Cash and cash equivalents

Cash and cash equivalents include cash on deposit and highly liquid investments with original maturities of three months or less.



**k) Impairment**

Consideration is given on each balance sheet date to determine whether there is any indication of impairment of the carrying value of the Company's assets. If any indication exists, an asset's recoverable amount is estimated. An impairment loss is immediately recognised in the income statement whenever the carrying value of an asset exceeds its estimated recoverable amount. The recoverable amount is the greater of the selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a risk adjusted discount factor.

**l) Employment benefits**

*i) Pension*

The Company does not operate a pension plan, but it does make defined contributions to the statutory pension fund for employees in Tanzania. Obligations for contributions to the statutory pension fund are recognised as an expense in the income statement as incurred.

*ii) Equity and equity-related compensation benefits*

The share option plan programme allows Company officers, directors and key personnel to acquire shares at an exercise price determined by the Company. When the options are exercised, equity is increased by the amount of the proceeds received.

The Company estimates the fair value of the stock options on the grant date using the Black-Scholes option pricing model with the assumptions described in note 13. The fair value of the options is expensed over the vesting period.

*iii) Bonuses*

Bonuses received by Company senior management are discretionary. Period-end bonuses are recognised in the income statement for the period to which they relate.

**m) Provisions**

A provision is recognised in the balance sheet when the Company has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required in the future to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

No provision has been made for future site restoration costs since the Company has no obligation under the PSA to restore the fields at the end of their commercial lives.

**n) Revenue recognition**

Revenue represents the Company's share of gas sales during the period, net of the transportation tariff as described in note 1 (h). The revenue includes those costs that may be recovered under the terms of production sharing agreements including those paid on behalf of parastatal organisations.

**o) Operating lease payments**

Payments made under operating leases are recognised in the income statement on a straight line basis over the term of the lease.

# Notes to the Consolidated Financial Statements

## p) **Taxation**

Income tax on the profit for the period comprises current and deferred tax.

The Company is liable to Tanzanian income tax, but this is paid through the profit sharing arrangements with TPDC. Where income tax is payable, the Company's net revenue is grossed up for the tax and the income tax shown as current 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, an additional profits tax is payable to the Government of Tanzania.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of carrying amount of assets and liabilities using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefits will be realised.

## q) **Segmental reporting**

No segment information has been presented, since all the revenue generating operations and assets are located in Tanzania.

## r) **Discontinued operations**

A discontinued operation is a clearly distinguishable component of the Company's business that is abandoned or terminated pursuant to a single plan and, accordingly, the Company only reflects its proportionate interest in such activities.

## 2 **Revenue**

Period ended  
30 September  
2004

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Operating revenue	<b>50</b>
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The Company started commercial gas sales on 18 September 2004. The revenue reported is the Company's proportionate share of revenue as calculated in accordance with the accounting policy 1(n).

## 3 **Other Operating Expenses**

Period ended  
30 September 2004

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Foreign exchange loss	<b>1</b>
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#### 4 *Personnel Expenses*

The average number of employees during the period was ten. The costs, net of Songas recharges for the operatorship of the gas processing plant, are as follows:

	<b>Period ended 30 September 2004</b>
Wages and salaries	<b>38</b>
Social security costs	<b>12</b>
Other statutory staff costs	<b>5</b>
	<b>55</b>
Capitalised pre-operating costs	<b>(33)</b>
	<b>22</b>

#### 5 *Taxation*

The Company was not liable to any Tanzanian income tax in the period under review.

#### 6 *Opening Balance Sheet*

As at 31 August 2004, PanOcean spun out its interests in Tanzania to its shareholders on completion of a Scheme of Arrangement. Accordingly, certain assets and liabilities of PanOcean relating to the Tanzanian business segment were transferred to the Company. The following table analyses the net assets distributed and the opening balance sheet for the Company as at 31 August 2004.

	<b>31 August 2004</b>
Cash and cash equivalents	1,997
Trade and other receivables	2,403
Natural gas properties	9,411
Trade and other payables	(1,949)
<b>Total net assets</b>	<b>11,862</b>

#### 7 *Cash and Cash Equivalents*

	<b>30 September 2004</b>
Cash and short term deposits	<b>2,219</b>

Included in the cash and cash equivalent is \$213,000 advanced from Songas under the terms of the Operatorship Agreement to pay for the costs of operating the wells and gas processing plant.

#### 8 *Trade and Other Receivables*

	<b>30 September 2004</b>
Trade receivables	<b>88</b>
Prepayments	<b>21</b>
Other receivables	<b>1,363</b>
	<b>1,472</b>

# Notes to the Consolidated Financial Statements

## 9 Natural Gas Properties

	Natural Gas Properties
<b>Costs</b>	
As at 31 August 2004	9,411
Additions	158
As at 30 September 2004	9,569
<b>Depletion</b>	
As at 31 August 2004	-
Charge for the period	1
As at 30 September 2004	1
<b>Net Book Value</b>	
<b>As at 30 September 2004</b>	<b>9,568</b>
As at 31 August 2004	9,411

The majority of the Company's costs were capitalised until commercial sale of the Additional Gas commenced on 18 September 2004.

Included in Natural Gas Properties at 30 September 2004 are \$5.6 million of capitalised costs that are recoverable out of 75% of the proceeds of the sale of Additional Gas net of transportation tariffs. The recovery of these costs is dependent on the future sales of commercial gas. The costs are included in Revenue in the period of recovery as set out in note 1 (n) and depleted in accordance with accounting policy 1 (f).

The Natural Gas Properties may be further analysed as follows:

	Recoverable costs	Non-recoverable costs	Total
As at 31 August 2004	5,407	4,004	9,411
Additions during the period	158	-	158
Depletion	-	(1)	(1)
<b>As at 30 September 2004</b>	<b>5,565</b>	<b>4,003</b>	<b>9,568</b>

The non-recoverable costs are primarily costs incurred on the Songo Songo project prior to the signing of the PSA. Accordingly, they are not recoverable under the PSA and are depleted in accordance with accounting policy 1(f).

The Company does not have any unproven property costs that are being excluded from the depletion calculation.

## 10 Trade and Other Payables

	30 September 2004
Trade payables	394
Other payables	1,008
	1,402

## **11** *Financial Instruments*

The company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. The Company monitors these risks. The Company may enter into financial instruments to manage its exposure to these risks.

### *Credit risk*

Substantially all the accounts receivable are due from PanOcean and Songas. As there are a limited number of gas customers, the Company is currently exposed to the potential default by any one of these counterparties. The level of receivables will be closely monitored.

### *Foreign currency risk*

The Company's exposure to foreign currency risk is limited to exchange rate fluctuations on foreign currency cash balances and the expenditure in currencies outside of the US dollar.

### *Commodity prices*

The Company did not enter into any financial contracts during the period as there was limited exposure to commodity prices.

## **12** *Deferred Tax Assets and Liabilities*

As at 30 September 2004, the Company has a deferred tax provision of nil.

## **13** *Capital Stock*

Authorised

50,000,000 Class A Common Shares	No par value
50,000,000 Class B Subordinate Voting Shares	No par value

The class A and class B shares rank pari passu in respect of dividends and repayment of capital in the event of winding-up. Class A shares carry twenty votes per share and class B shares carry one vote per share. The class A shares are convertible at the option of the holder at any time into class B shares on a one-for-one basis. The class B shares are convertible into class A shares on a one-for-one basis in the event that a take over bid is made to purchase class A shares which must, by reason of a stock exchange or legal requirements, be made to all or substantially all of the holders of class A shares and which is not concurrently made to holders of class B shares.

<i>Number of shares (thousands)</i>	<b>Authorised</b>	<b>Issued</b>	<b>Valuation at par value</b>
<b>Class A</b>			
As at 31 August and 30 September	<b>50,000</b>	1,751	983
<b>Class B</b>			
As at 31 August and 30 September	<b>50,000</b>	19,386	10,879
<b>Total as at 30 September</b>	<b>100,000</b>	21,137	11,862

All of the issued capital stock was considered fully paid at the time of spin off from PanOcean.

# Notes to the Consolidated Financial Statements

## **Stock-based Compensation Plan**

On 1 September, 2,000,000 options ('Options') were issued to certain Directors, Officers and Consultants. These Options have a term of 10 years and vest as to a third on 1 September 2004 and a third on each of the anniversaries in the following two years. At 30 September 2004, 666,666 options were exercisable. The exercise price for the Options is C\$1 representing the closing price of the Class B subordinated Voting Shares on 31 August 2004.

The Company has elected to adopt the fair method value of option valuation IFRS 2. The fair value of each option was estimated as at the date of the grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 2.6%, dividend yield of 0%, expected life of 10 years and volatility of 60%.

On this basis, the fair value of the Options is \$0.9 million, with a compensation expense of \$79,000 for the period ended 30 September 2004 and a corresponding amount booked to a capital reserve.

No Options were exercised during the period ended 30 September 2004.

## **14 Loss Per Share**

The calculation of basic loss per share is based on the net loss attributable to ordinary shareholders of \$84,000 and a weighted average number of ordinary shares outstanding during the period of 21,137,439.

## **15 Reconciliation of IFRS to Accounting Principles Generally Accepted in Canada**

The Consolidated Financial Statements have been prepared in accordance with the IFRS basis of accounting, which differ in some respects from those in Canada. There were no material differences in accounting principles as they pertain to the accompanying Consolidated Financial Statements.

## **16 Operating Leases**

Non-cancellable operating lease rentals are payable as follows:

	<b>30 September 2004</b>
Less than one year	<b>92</b>
Between one and five years	<b>199</b>
	<b>291</b>

The Company has rented office property under the five year operating lease expiring 30 November 2007.

## **17 Post Balance Sheet Events**

There are no undisclosed post balance sheet events.

## **18** *Commitments and Contingencies*

There are no undisclosed commitments.

Under the terms of the PSA, in the event that there is a shortfall in Protected Gas as a consequence of the sale of Additional Gas, then the Company is liable to pay the difference between the price of Protected Gas (\$0.55 per mmbtu) 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. Songas has the right to request reasonable security on all Additional Gas sales. No security has been requested for the initial industrial gas sales, but Songas still retains this right and may require security for larger volumes.

## **19** *Directors and Officers Emoluments*

	<b>BASE SALARY</b>	<b>BONUS</b>	<b>OTHER COMPENSATION</b>	<b>TOTAL</b>	<b>SHARE OPTIONS</b>
<b>Directors</b>					
W. David Lyons (i) President and CEO	–	–	–	–	1,000,000
Peter R. Clutterbuck (ii) Acting President	20	–	–	20	400,000
Nigel A. Friend (ii) Vice President and CFO	17	–	–	17	200,000
John Patterson (ii) Non Executive Director	2	–	–	2	50,000
Robert Spence (ii) Non Executive Director	2	–	–	2	50,000
<b>Officers</b>					
Pierre Raillard (iii) Vice President Operations	16	–	4	20	200,000

(i) A contract will be signed with W.D. Lyons in November 2004.

(ii) The 'Base Salary' for P.R. Clutterbuck, N. Friend, J. Patterson and R. Spence are in respect of consultancy fees.

(iii) The Company also paid for house rent, residence security costs and school fees on behalf of P. Raillard.

(iv) 100,000 Options were awarded to a consultant, R Wynne, for corporate advice.

#### **Board of Directors**

W. David Lyons, Chairman  
St. Helier, Jersey

Peter R. Clutterbuck, President & Chief Executive Officer  
Haslemere, United Kingdom

Nigel A. Friend, Chief Financial Officer  
London, United Kingdom

John Patterson, Non Executive Director  
Walton-on-Thames, United Kingdom

Robert K. Spence, Non-Executive Director  
Dar es Salaam, Tanzania

#### **Officers**

Pierre Raillard, Vice President Operations

David W. Ross, Company Secretary

#### **Head Office**

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Tel: + 255 22 2138737 Fax: + 255 22 2138938

#### **Registered Office**

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#### **International Subsidiaries**

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Tel: + 255 22 2138737 Fax: + 255 22 2138938

PAE PanAfrican Energy Corporation  
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Tel: + 230 207 8888 Fax: + 230 207 8833

#### **Engineering Consultants**

McDaniel & Associates Consultants Ltd, Calgary, Canada

#### **Auditors**

KPMG LLP, Calgary, Canada

#### **Lawyers**

Burnet, Duckworth & Palmer LLP, Calgary, Canada

#### **Transfer Agent**

CIBC Mellon Trust Company, Toronto, Montreal and Calgary, Canada

#### **Investor Relations**

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