ORCA EXPLORATION GROUP INC.

Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2014 and 2013

CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME/LOSS (UNAUDITED)

		Three months ended		*Nine months ended*	
US$'000 except per share amounts	**Note**	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Revenue	3, 4	**14,852**	14,659	**47,624**	39,853
Expenses					
Production and distribution expenses		**(1,179)**	(1,150)	**(3,825)**	(2,564)
Depletion expense		**(3,653)**	(2,971)	**(10,430)**	(8,306)
		10,020	10,538	**33,369**	28,983
General and administrative expenses		**(7,475)**	(3,327)	**(14,626)**	(10,287)
Finance income	*5*	**465**	289	**1,747**	2,155
Finance costs	*5*	**(295)**	(3,624)	**(4,142)**	(20,824)
Profit before tax		**2,715**	3,876	**16,348**	27
Income taxes	*6*	**(2,352)**	(1,976)	**(7,872)**	(1,919)
Net profit/(loss) after tax		**363**	1,900	**8,476**	(1,892)
Foreign currency translation gain/(loss) from foreign operations		**(112)**	**28**	**52**	(47)
Total comprehensive income/(loss) for the period		**251**	**1,928**	**8,528**	(1,939)
Earnings per share					
Basic (US$)	*13*	**0.01**	0.05	**0.24**	(0.05)
Diluted (US$)	*13*	**0.01**	0.05	**0.24**	(0.05)

See accompanying notes to the condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (UNAUDITED)

US$'000	Note	30 Sept 2014	31 Dec 2013
		As at	
ASSETS			
Current Assets			
Cash		**63,116**	32,588
Trade and other receivables	*8*	**44,232**	37,215
Tax receivable	*6*	**15,975**	14,585
Prepayments		**512**	281
		123,835	84,669
Non-Current Assets			
Long-term trade receivable	*8*	**27,920**	29,911
Exploration and evaluation assets		**5,564**	5,564
Property, plant and equipment	*9*	**80,519**	90,832
		114,003	126,307
Total Assets		**237,838**	210,976
EQUITY AND LIABILITIES			
Current Liabilities			
Trade and other payables	*10*	**69,123**	53,296
Bank loan	*11*	**–**	1,659
Tax payable		**–**	1,958
Additional Profits Tax	*7*	**5,094**	–
		74,217	56,913
Non-Current Liabilities			
Deferred income taxes	*6*	**12,313**	12,132
Deferred additional profits tax	*7*	**22,436**	21,679
		34,749	33,811
Total Liabilities		**108,966**	90,724
Equity			
Capital stock	*12*	**85,663**	85,428
Contributed surplus		**6,339**	6,482
Accumulated other comprehensive loss		**(251)**	(303)
Accumulated income		**37,121**	28,645
		128,872	120,252
Total Equity and Liabilities		**237,838**	210,976

See accompanying notes to the consolidated interim financial statements.
Going concern (Note 1)
Contractual obligations and committed capital investment (Note 15)
Contingencies (Note 16)

The condensed consolidated interim financial statements were approved by the Board of Directors on 20 November 2014.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS (UNAUDITED)

		Three months ended		Nine months ended	
US$'000	Note	30 Sept 2014	30 Sept 2013	30 Sept 2014	30 Sept 2013
OPERATING ACTIVITIES					
Profit/(loss) after tax		**363**	1,900	**8,476**	(1,892)
Adjustment for:					
Depletion and depreciation	9	**3,812**	3,071	**10,900**	8,573
Disposal of fixtures and fittings	9	**–**	–	**7**	–
Provision for doubtful debt	5	**459**	1,200	**3,665**	8,300
Discount on long-term receivable		**–**	2,900	**–**	10,800
Stock-based compensation		**4,221**	24	**4,583**	(289)
Deferred income taxes	6	**21**	(800)	**181**	(5,767)
Deferred additional profits tax	4,7	**(120)**	3,979	**757**	10,405
Interest expense	5	**–**	158	**24**	586
Unrealised loss on foreign exchange		**(468)**	(423)	**65**	889
Funds flow from operating activities		**8,288**	12,009	**28,658**	31,605
(Increase)/decrease in trade and other receivables		**(3,172)**	5,120	**(10,032)**	13,789
(Increase)/decrease in tax receivable		**(1,020)**	(1,451)	**(1,390)**	(1,044)
Decrease/(increase) in prepayments		**64**	(207)	**(231)**	(390)
Increase/(decrease) in trade and other payables		**8,812**	(3,056)	**9,861**	1,198
(Decrease)/increase in tax payable		**(185)**	774	**(1,958)**	(2,118)
Decrease/(increase) in long-term receivable		**8,660**	1,450	**1,991**	(25,529)
Increase in Additional Profits Tax payable		**2,630**	–	**5,094**	–
Cash flows from operating activities		**24,077**	14,639	**31,993**	17,511
INVESTING ACTIVITIES					
Exploration and evaluation expenditures		**–**	–	**–**	(2)
Property, plant and equipment expenditures	9	**(324)**	(744)	**(594)**	(1,150)
Cash from/(used in) investing activities		**(324)**	(744)	**(594)**	(1,152)
FINANCING ACTIVITIES					
Bank loan proceeds	11	**–**	–	**–**	4,000
Bank loan repayments	11	**–**	(2,465)	**(1,659)**	(5,704)
Interest paid		**–**	(158)	**(24)**	(586)
Proceeds from exercise of options		**92**	174	**92**	174
Cash flow from/(used in) financing activities		**92**	(2,449)	**(1,591)**	(2,116)
Increase in cash		**23,845**	11,446	**29,808**	14,243
Cash at the beginning of the period		**38,694**	18,766	**32,588**	16,136
Effect of change in foreign exchange on cash in hand		**577**	78	**720**	(89)
Cash at the end of the period		**63,116**	30,290	**63,116**	30,290

See accompanying notes to the condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

US$'000	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated income	Total
Note	*12*				
Balance as at 1 January 2014	85,428	6,482	(303)	28,645	**120,252**
Options exercised	235	(143)	–	–	**92**
Foreign currency translation adjustment on foreign operations	–	–	52	–	**52**
Net profit after tax for the period	–	–	–	8,476	**8,476**
Balance as at 30 September 2014	85,663	6,339	(251)	37,121	**128,872**

US$'000	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated income	Total
Balance as at 1 January 2013	84,983	6,753	89	34,110	**125,935**
Options exercised	445	(271)	–	–	**174**
Foreign currency translation adjustment on foreign operations	–	–	(47)	–	**(47)**
Net loss after tax for the period	–	–	–	(1,892)	**(1,892)**
Balance as at 30 September 2013	85,428	6,482	42	32,218	**124,170**

See accompanying notes to the condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

For the three and nine months ended 30 September 2014

General information

Orca Exploration Group Inc. was incorporated on 28 April 2004 under the laws of the British Virgin Islands. The Company produces and sells natural gas to the power and industrial sectors in Tanzania and has gas and oil exploration interests in Italy.

The condensed consolidated interim financial statements of the Company as at and for the three months and nine months ended 30 September 2014 comprise accounts of the Company and all its wholly owned subsidiaries (collectively, the "Company" or "Orca Exploration") and were authorised for issue in accordance with a resolution of the directors on 20 November 2014.

1 GOING CONCERN

These financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying amounts of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications.

The ability of the Company to continue as a going concern is dependent on the Company's ability to collect its receivables from Government entities to fund on-going operations and the exploration and development program. The continuing weakness in the financial position of the state utility, TANESCO, has created uncertainty as to whether the Company will be able to collect the amounts owing and to continue operations and meet its commitments. Beginning in May 2014, TANESCO commenced a series of payments for current and past gas deliveries of US$1.8 million received approximately weekly. Management estimates these continued payments would result in approximately US$1.5 million per month credited against arrears. As of the date of this report, however, there is no set schedule or repayment plan for TANESCO arrears agreed with the Company and payments since mid-2011 have been irregular and unpredictable. Subsequent to the quarter end TANESCO has only made one payment of US$1.8 million. As a result, there continues to be significant doubt about TANESCO's ability to settle current and arrears and the Company's ability to continue as a going concern.

In the event that the Company does not collect from TANESCO the balance of the outstanding receivables at 30 September 2014, and TANESCO continues to be unable to pay the Company for subsequent gas deliveries, management estimates that the Company will likely not require additional funding for its ongoing operations before the end of Q3 2015, however the Company would not be able to undertake any significant capital expenditure. There are no guarantees that additional funding will be available if needed, or will be available on suitable terms. Pursuant to its rights under the PGSA, the Company, on 2 April 2014, served a Notice of Dispute to TANESCO demanding payment in full to collect the arrears, as well as examining the Company's legal and contractual options to mitigate a further increase in arrears including but not limited to suspending gas deliveries to TANESCO. The Notice of Dispute has remained in effect whilst the Company sought a mutually acceptable payment plan to clear the arrears within an acceptable time frame. Management is in the process of reviewing all available options to secure regular payments from TANESCO in the light of recent delays in weekly payments subsequent to the quarter end.

The material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern are set forth below. The Company generates on average in excess of 60% of its operating revenue from sales to the Power sector companies, Songas and TANESCO. The financial security of Songas is heavily reliant on the payment of capacity and energy charges by TANESCO, which in turn is dependent on the Government of Tanzania to subsidise a significant portion of TANESCO's operating budget.

At 30 September 2014, TANESCO owed the Company US$54.6 million prior to discount (which includes arrears of US$50.6 million), compared to US$56.6 million (including arrears of US$51.5 million) as at 31 December 2013. During the quarter the Company received a total of US$24.0 million (Q3 2013: US$16.4 million) from TANESCO and, subsequent to the quarter end, TANESCO paid the Company a further US$1.8 million. Receipts for the nine months to 30 September totaled US$45.0 million (2013: US$36.2 million). As of the date of this report, the outstanding balance is US$56.4 million of which US$52.8 million is in arrears.

At the end of Q1 2013, the World Bank approved a Tanzania First Power and Gas Development Policy Operation ("DPO") of US$100 million, the first in a programme of three contemplated operations. The objective of the program is to: (i) strengthen Tanzania's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources. TANESCO made tangible progress in late 2013 towards sustainability in securing a 39% power tariff increase from the energy regulator, the Energy Water Utilities Regulatory Authority ("EWURA"). This was an important outcome of the World Bank condition to limit Government subsidies of TANESCO and resulted in the advancement of the Second US$100 million Power and Gas DPO, approved by the World Bank on 26 March 2014 and disbursed at the end of Q2 2014. The Company received approximately US$18.7 million in 2013 from TANESCO around the time of the disbursement of the First DPO. In early July 2014, the Company has received from TANESCO a payment of US$5.96 million against arrears as an allocation of the World Bank Second US$100 million DPO. This was substantially less than that which was represented to the Company prior to disbursement and without an additional significant payment the full Songo Songo drilling programme will not be able to commence.

The DPO programme contemplates a third tranche which the Company understands is conditional, among other things, upon the Tanzania Gas Act being enacted by Parliament.

Management continues to believe that TANESCO will ultimately settle its debts with the Company and has repeatedly requested meetings with TANESCO senior management to agree a payment schedule. However, based on the repayment history as at 30 September 2014, US$9.6 million (Q4 2013: US$9.6 million) of the TANESCO receivable was classified as current and US$45.0 million (Q4 2013: US$47.0 million) before discount was classified as long-term. A discount of US$17.1 million (Q4 2013: US$17.1 million) has been taken against the TANESCO receivable to reflect the estimated cost of delays in collections. The trade receivable was discounted using a risk adjusted discount rate of 15% to reflect the cost of delayed timing of collections from TANESCO. The discount rate and the expected timing of the collections are reviewed at each period end with any adjustments recorded in the period that the estimates change.

As at 30 September 2014, Songas owed the Company US$39.4 million (Q4 2013: US$24.8 million), whilst the Company owed Songas US$27.4 million (Q4 2013: US$16.9 million). There is no contractual right to offset these amounts. Amounts due to Songas primarily relate to pipeline tariff charges of US$25.8 million (Q4 2013: US$15.4 million), whereas the amounts due to the Company are mainly for sales of gas of US$20.6 million (Q4 2013: US$11.6 million) and for the operation of the gas plant for US$18.8 million (Q4 2013: US$13.3 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis without profit margin.

Following an extended period during which no cash was received and no balances set-off, the Company was unable to recognise the Songas receivable. Accordingly, as at 31 March 2014 the Company had fully provided for the net amount due from Songas. However, during the quarter Songas made two payments totalling US$0.8 million in response to cash calls for July and August 2014, and subsequent to the quarter end has made a further three payments totalling US$1.2 million in respect of September, October and November. Management is continuing to work with Songas towards an agreement to set-off outstanding sales, purchases and gas plant operating charges . As a result no additional provision has been made against the net Songas receivable. The existing provision will be released as and when the Company is able to collect the outstanding debt. Any amounts which are not agreed will be pursued by the Company through the dispute mechanisms provided in its agreements with Songas.

2 BASIS OF PREPARATION

A) Statement of compliance

These condensed consolidated interim financial statements have been prepared on a historical cost basis using the accrual basis of accounting, and are presented in US dollars. They have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all of the information required for the full annual financial statements prepared in accordance with International Financial Reporting Standards as issued by the IASB. Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the Company during the period and should be read in conjunction with the consolidated financial statements and notes thereto in the Company's 2013 Annual Report approved on 24 April 2014.

B) Judgements and estimates

The preparation of these condensed consolidated interim financial statements requires management 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.

In preparing these 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 31 December 2013.

C) Significant accounting policies

The same accounting policies have been applied in the preparation of these condensed consolidated interim financial statements as those applied by the Company in its consolidated financial statements as at and for the year ended 31 December 2013, except as highlighted below.

On January 1, 2014 the Company adopted new standards with respect to Employee Contributions (Amendments to IAS 19), Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32) and Liability for Levies (IFRIC 21). The adoption of these amendments and standards had no impact on the amounts recorded in the consolidated financial statements as at January 1, 2014 or on the comparative periods.

IFRS 9 Financial Instruments (2014) is effective January 1, 2018 with early adoption permitted. IFRS 9 provides guidelines for recognizing and measuring financial assets and liabilities and other contracts to buy or sell non-financial items. The objective is to provide readers with information for the assessment of amounts, timing and probability of the entity's future cash flows. This Standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The Company is currently evaluating the impact that the standard will have on its results of operations and financial position and is assessing when adoption will occur.

IFRS 15 Revenue from Contracts with Customers is effective for fiscal periods ending on or after December 31, 2017 with early adoption permitted. IFRS 15 provides guidelines for reporting information to readers about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The Company intends to adopt IFRS 15 for the annual period beginning on January 1, 2017. The Company is currently evaluating the impact that the standard will have on its results of operations and financial position.

D) 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.

The Company's long-term trade receivable is considered a Level 3 measurement.

3 SEGMENT INFORMATION

The Company has one reportable industry segment which is international exploration, development and production of petroleum and natural gas. The Company currently has producing assets in Tanzania and exploration interests in Italy.

	2014			2013		
	Italy	**Tanzania**	**Total**	**Italy**	**Tanzania**	**Total**
US$'000	**Three months ended 30 September**					
External Revenue	**–**	**14,852**	**14,852**	–	14,659	14,659
Segment Income	**–**	**363**	**363**	–	1,900	1,900
Non-cash charge[1]	**–**	**(459)**	**(459)**	–	(4,100)	(4,100)
Depletion & Depreciation	**–**	**3,812**	**3,812**	–	3,071	3,071
US$'000	**Nine months ended 30 September**					
External Revenue	**–**	**47,624**	**47,624**	–	39,853	39,853
Segment Income/(Loss)	**–**	**8,476**	**8,476**	–	(1,892)	(1,892)
Non-cash charge[1]	**–**	**(3,665)**	**(3,665)**	–	(19,100)	(19,100)
Depletion & Depreciation	**–**	**10,900**	**10,900**	–	8,573	8,573

	As at					
	30 September 2014			31 December 2013		
US$'000	**Italy**	**Tanzania**	**Total**	**Italy**	**Tanzania**	**Total**
Total Assets	**33**	**237,805**	**237,838**	257	210,719	210,976
Total Liabilities	**221**	**108,745**	**108,966**	221	90,503	90,724
Capital Additions	**–**	**594**	**594**	–	1,288	1,288

(1) The non-cash charge represent amounts provided for doubtful debts and discount on long-term receivables. The charge for the current quarter was US$0.5 million (Q3 2013: US$4.1 million), and for the nine months US$3.7 million (2013: US$19.1 million).

4 REVENUE

	Three months ended		Nine months ended	
US$'000	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Operating revenue	**14,007**	14,797	**42,486**	39,282
Current income tax adjustment	**3,355**	3,841	**10,989**	10,975
Additional Profits Tax	**(2,510)**	(3,979)	**(5,851)**	(10,404)
Revenue	**14,852**	14,659	**47,624**	39,853

The Company's total revenues for the quarter, and the nine months ended 30 September, amounted to US$14,852 and US$47,624 respectively, after adjusting the Company's operating revenue of US$14,007 and US$42,486 by:

i) adding US$3,355 for income tax for the current period, and US$10,989 for the nine months. The Company is liable for income tax in Tanzania, but the income tax is recoverable out of TPDC's Profit Gas when the tax is payable. To account for this, revenue is adjusted to include the current income tax charge grossed up at 30% (see Note 6); and,

ii) subtracting US$2,510 and US$5,851 for deferred Additional Profits Tax ("APT") charged in the quarter and for nine months– this tax is considered a royalty and is presented as a reduction in revenue. The nine month APT charge includes a reduction in APT of US$936 resulting from the recovery of downstream costs previously and temporarily excluded from the cost recoverable pool as discussed below.

Cost Pool Adjustments

In 2010, following an agreement with TPDC the Company agreed to temporarily defer the cost recovery of expenditure associated with development of the downstream network until such time as a mutually acceptable methodology could be agreed between the Company and TPDC/MEM to unbundle the downstream assets and related business and to recover the associated cost of the operation outside of the PSA. In 2013 the Company re-tabled a number of proposals that were economically neutral to the parties; however these received no feedback and were subsequently withdrawn. The Company has now formally advised TPDC that the downstream business will remain under the PSA and that related costs would be recovered in accordance with the terms of the PSA and would no longer be held separately. As a result of recovering this expenditure the nine month results reflect a reallocation of Cost Gas and Profit Gas between TPDC and the Company.

During the ongoing discussions concerning the disputed US$34 million TPDC Cost Pool audit claim, items totalling US$1.0 million were agreed by the Company to have been non-recoverable and consequently were removed from the Cost Pool in the second quarter of 2014.

The following table shows the impact on the Company's operating revenue for the nine months ended 30 September 2014 of adjusting the cost pool. The net amount has been recovered from TPDC's share of revenue as follows:

	Nine months ended
US$'000	**30 Sept 2014**
Non-recoverable costs	(1,024)
Recoverable costs 2011-2013	7,360
Cost Gas recorded in the period	6,336
Reduction in Profit Gas in the period	(3,342)
Net impact on Company share of operating revenue	2,994

5 FINANCE INCOME AND FINANCE COSTS

	Three months ended		*Nine months ended*	
US$'000	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Interest charged on overdue trade receivables	**465**	289	**1,747**	2,155
Finance income	**465**	289	**1,747**	2,155
Interest expense	**–**	(157)	**(24)**	(586)
Net foreign exchange loss	**164**	633	**(453)**	(1,138)
Discount on long-term receivable	**–**	(2,900)	**–**	(10,800)
Provision for doubtful accounts	**(459)**	(1,200)	**(3,665)**	(8,300)
Finance costs	**(295)**	(3,624)	**(4,142)**	(20,824)
Net finance income/expense	**170**	(3,335)	**(2,395)**	(18,669)

Interest of US$0.5 million for the quarter (Q3 2013: US$0.3 million) and US$1.7 million (2013: US$2.2 million) for the nine months ended 30 September was charged to TANESCO under the terms of the PGSA for late payment of gas supplied and has been fully provided against to reflect the uncertainty over timing of collection.

6 INCOME TAXES

The tax charge is as follows:

	Three months ended		Nine months ended	
US$'000	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Current tax	**2,330**	2,778	**7,691**	7,685
Deferred tax/(recovery)	**22**	(802)	**181**	(5,766)
	2,352	1,976	**7,872**	1,919

Tax of US$ nil (Q3 2013: US$ nil) was paid during the quarter, and for the nine months ended 30 September 2014 US$1.5 million (2013: US$5.8 million) was paid in relation to the settlement of the 2013 tax liability. In addition, provisional tax payments of US$0.8 million (Q3 2013: US$2.0 million) for the quarter and US$8.8 million (2013: US$4.0 million) for the nine months were made. These are presented as a reduction in Tax Payable on the balance sheet.

Tax Rate Reconciliation

	Three months ended		Nine months ended	
US$'000	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Profit before taxation	**2,715**	3,876	**16,348**	27
Provision for income tax calculated at the statutory rate of 30%	**815**	1,163	**4,904**	8
Add the tax effect of non-deductible income tax items:				
Administrative and operating expenses	**247**	724	**1,388**	1,820
Financing charge	**4**	5	**74**	8
Stock-based compensation	**1,266**	7	**1,375**	(87)
Other permanent differences	**20**	77	**131**	170
	2,352	1,976	**7,872**	1,919

As at 30 September 2014, there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Accordingly a deferred tax liability has been recognized for the quarter ended 30 September 2014.

A deferred tax asset of US$2.2 million (Q3 2013: US$2.2 million) in respect of Longastrino Italy E&E costs has not been recognised because it is not probable that there will be future profits against which this can be utilised.

The deferred income tax liability includes the following temporary differences:

	As at	
US$'000	**30 Sept 2014**	**31 Dec 2013**
Differences between tax base and carrying value of property, plant and equipment	**16,958**	17,081
Income tax recoverable	**13,005**	10,182
Discount on receivable and provision for doubtful debt	**(9,380)**	(8,281)
Deferred Additional Profits Tax	**(8,260)**	(6,509)
Unrealised exchange losses/other provisions	**(10)**	(341)
	12,313	12,132

Tax Receivable

The Company has a "Tax Receivable" balance of US$15.3 million (Q4 2013: US$14.6 million). This arises from the revenue sharing mechanism within the PSA, which entitles the Company to a share of revenue equivalent to its tax charge, grossed up at the prevailing rate. This amount is collected by way of an offset against TPDC's share of revenue, as and when the Company pays its tax. For the current quarter the Company has an additional tax receivable balance of US$0.7 million relating to 2014 quarterly advance income tax payments.

	As at	
US$'000	**30 Sept 2014**	**31 December 2013**
Tax receivable from TPDC	**15,254**	14,585
Income tax prepayment	**721**	–
	15,975	**14,585**

7 ADDITIONAL PROFITS TAX

The effective APT rate of 22.3% (Q3 2013: 33.3%) has been applied to Profit Gas of US$11.3 million (Q3 2013: US$12.0 million) for the quarter and US$30.5 million (2013: US$31.2 million) for the nine months ended 30 September 2014. Accordingly, US$2.5 million (Q3 2013: US$4.0 million) and US$5.9 million (2013: US$10.4 million) has been netted off revenue for the quarter and for the nine months ended 30 September 2014. The year-to-date APT charge include a reduction of US$0.9 million, reflecting the impact of recovering downstream costs on cumulative Profit Gas, as a result of the US$3.3 million Profit Gas adjustment identified in the Cost Pool adjustment see Note 4.

	Three months ended		*Nine months ended*	
US$'000	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Current APT payable	**2,630**	–	**5,094**	–
Deferred APT	**(120)**	3,979	**757**	10,404
	2,510	3,979	**5,851**	10,404

The deferred APT credit represents the release of an accumulated provision bringing the APT rate down from 25% to currently projected rate for the life of the PSA.

8 TRADE AND OTHER RECEIVABLES

Current Receivables

US$'000	30 Sept 2014	31 Dec 2013
	As at	
TANESCO	**9,591**	9,624
Songas	**20,556**	11,560
Other debtors	**8,001**	10,874
Trade receivables	**38,148**	32,058
Songas gas plant operations	**18,783**	13,280
Other receivables	**1,496**	2,408
Less provision for doubtful accounts	**(14,195)**	(10,531)
	44,232	37,215

In addition to the trade receivable from Songas of US$20.6 million, an additional US$18.8 million (Q4 2013: US$13.3 million) is due from Songas with respect to gas plant operations. All receivable amounts from Songas have been included in the net Songas balance (see Note 10) of US$12.0 million (Q4 2013: US$7.9 million) against which, as at 30 September 2014, a provision for doubtful debts had been recognised of US$9.8 million.

Trade Receivables Age Analysis

As at 30 Sept 2014 (US$'000)	Current	>30 <60	>60 <90	>90	Total
TANESCO	3,964	5,627	–	–	**9,591**
Songas	1,146	892	960	17,558	**20,556**
Other debtors	4,280	2,768	1,075	(122)	**8,001**
Trade receivables	9,390	9,287	2,035	17,436	**38,148**

As at 31 December 2013 (US$'000)	Current	>30 <60	>60 <90	>90	Total
TANESCO	5,071	4,553	–	–	**9,624**
Songas	1,076	1,016	927	8,541	**11,560**
Other debtors	3,663	2,822	1,661	2,728	**10,874**
Trade receivables	9,810	8,391	2,588	11,269	**32,058**

Subsequent to 30 September 2014, US$1.8 million has been received from TANESCO, and US$6.1 million from other debtors. As a result of irregular and unpredictable payments by TANESCO, management reclassifies any TANESCO balance more than 60 days as a long-term receivable and has discounted the value of the long-term TANESCO receivable (see Note 1). The Songas trade receivable is less than the equivalent trade payable; however, no contractual right of set off exists.

Long-Term Receivables

US$'000	30 Sept 2014	31 Dec 2013
	As at	
TANESCO receivable > 60 days	**44,993**	46,984
Discount on long-term receivable	**(17,073)**	(17,073)
Net long-term receivable	**27,920**	29,911

9 PROPERTY, PLANT AND EQUIPMENT

US$'000	**Oil & natural gas interests**	**Leasehold improvements**	**Computer equipment**	**Vehicles**	**Fixtures & Fittings**	**Total**
Costs						
As at 1 January 2014	139,072	885	1,158	137	1,082	142,334
Additions	375	70	70	32	47	594
Disposals	–	(258)		–	(7)	(265)
As at 30 Sept 2014	**139,447**	**697**	**1,228**	**169**	**1,122**	**142,663**
Depletion and depreciation						
As at 1 January 2014	49,967	245	761	137	392	51,502
Depletion and depreciation	10,430	124	136	–	210	10,900
Depreciation on disposals	–	(258)	–	–	–	(258)
As at 30 Sept 2014	**60,397**	**111**	**897**	**137**	**602**	**62,144**
Net Book Values						
As at 30 Sept 2014	**79,050**	**586**	**331**	**32**	**520**	**80,519**
As at 31 December 2013	89,105	640	397	–	690	90,832

In determining the depletion charge, it is estimated that future development costs of US$239 million (31 December 2013: US$239 million) will be required to bring the total proved reserves to production. During the quarter the Company recorded depreciation of US$0.2 million (Q3 2013: US$0.1 million), and for the nine months ended 30 September US$0.5 million (2013: US$0.3 million), in General and Administrative expenses.

10 TRADE AND OTHER PAYABLES

	As at	
US$'000	**30 Sept 2014**	**31 Dec 2013**
Songas	**25,784**	15,355
Other trade payables	**1,289**	3,857
Trade payables	**27,073**	19,212
TPDC	**28,026**	20,644
Deferred income	**3,674**	6,271
Accrued liabilities	**10,350**	7,169
	69,123	53,296

The January 1, 2014 balances payable to Songas are net of amounts receivable from Songas that have been agreed as fully settled.

US$'000	**1 Jan 2014**	**Year to date transactions**	**Gross balance 30 Sept 2014**
Pipeline tariff - payable	(15,355)	(10,429)	**(25,784)**
Gas sales - receivable	11,560	8,995	**20,555**
Gas plant operation - receivable	13,280	5,503	**18,783**
Miscellaneous payable	(1,544)	(29)	**(1,575)**
Net balances	7,941	4,040	**11,981**

11 BANK LOAN

The loan was fully paid by February 2014. Total payments during the nine months ended 30 September 2014 were US$1.7 million.

12 CAPITAL STOCK

Authorised and Issued Share Capital

Number of shares (000s)	**Authorised**	**Issued**	**Amount (US$'000)**
Class A			
As at 1 January 2014 and 30 September 2014	50,000	1,751	983
Class B			
As at 1 January 2014	100,000	33,072	84,445
Options exercised	–	92	235
As at 30 September 2014	100,000	33,164	84,680
First preference			
As at 1 January 2014 and 30 September 2014	100,000	–	–
Total Class A, Class B and First Preference shares	250,000	34,915	85,663

All of the issued capital stock is fully paid.

Stock options

Thousands of options or CDN$	**Options**	**Exercise Price**
Outstanding as at 1 January 2014	**1,742**	1.00 to 3.60
Forfeited	**(250)**	3.60
Exercised	**(92)**	1.00
Expired unexercised	**(1,000)**	1.00
Outstanding as at 30 September 2014	**400**	3.18

During the quarter 1.0 million options with an exercise price of CDN$ 1.00 expired unexercised, 92,400 options with an exercise price of CDN$1.00 were exercised and a further 250,000 with an exercise price of CDN$3.60 were forfeit.

The weighted average remaining life and weighted average exercise prices of options at 30 September 2014 were as follows:

Exercise Price (CDN$)	Number Outstanding as at 30 Sept 2014	Weighted Average Remaining Contractual Life (years)	Number Exercisable as at 30 Sept 2014	Weighted Average Exercise Price (CDN$)
3.18	**400**	3.25	400	3.18

Stock Appreciation Rights

Thousands of stock appreciation rights or CDN$	SARs	Exercise Price
Outstanding as at 1 January 2014	1,030	2.12 to 4.20
Granted	1,780	2.30
Outstanding as at 30 September 2014	**2,810**	**2.12 to 4.20**

A total of 1,780,000 SARs were granted in January with an exercise price of CDN$2.30, a five-year term and which vest in five equal instalments, the first fifth on the anniversary of the grant date.

Restricted Stock Units

Thousands of restricted stock units or CDN$	RSUs	Grant/ Exercise Price
Outstanding as at 1 January 2014	–	–
Granted	792	3.70
Exercised	(147)	3.79
Outstanding as at 30 September 2014	**645**	**3.79**

In September the Company issued 792,391 Restricted Stock Units (RSUs) with an award price of CDN$0.01.

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 recognised 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 1.75% stock volatility of 51.9% to 59.6%; 0% dividend yield; 0% forfeiture; a closing stock price of CDN$3.79 per share.

US$'000	30 Sept 2014	30 Sept 2013	30 Sept 2014	30 Sept 2013
SARs	**1,544**	24	**1,906**	(289)
RSUs	**2,677**	–	**2,677**	–
	4,221	24	**4,583**	(289)

As at 30 September 2014, a total accrued liability of US$5.0 million (Q3 2013: US$0.3 million) has been recognised in relation to the SARs and RSUs. The Company recognised an expense of US$4.2 million (Q3 2013: nil) for the quarter and for the nine months ended 30 September 2014 an expense of US$4.6 million (2013: credit US$0.3 million). The increase in the cost of SARs year over year is due to the granting of an additional 1.8 million SARs in January 2014 and an increase in the market value of the Company's shares.

13 EARNINGS PER SHARE

	Three months ended		*Nine months ended*	
Number of shares ('000s)	**30 Sept 2014**	**30 Sept 2013**	**30 Sept 2014**	**30 Sept 2013**
Weighted average number of shares outstanding				
Class A and Class B shares	**34,887**	34,763	**34,845**	34,683
Convertible securities				
Stock options	**16**	580	**–**	617
Weighted average diluted Class A and Class B shares	**34,903**	35,343	**34,845**	35,300

The calculation of basic earnings per share is based on the profit for the quarter of US$0.3 million (Q3 2013: US$1.9 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,887,036 (Q3 2013: 34,762,558). For the nine months, earnings per share is based on a profit of US$8.5 million (2013: loss US$1.9 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,844,719 (2013: 34,683,139).

In computing the diluted earnings per share, the effect of the stock options is added to the weighted average number of Class A and Class B shares outstanding during the quarter. For Q3 2014 the number was 15,710 (Q3 2013: 579,536) shares, resulting in a diluted weighted average number of Class A and Class B shares of 34,902,746 (Q3 2013: 35,342,094). For the nine months the dilution effect of stock options was nil (2013: 617,444) resulting in a diluted weighted average number of Class A and Class B shares of 34,844,719 (2013: 35,300,583).

No adjustments were required to the reported earnings from operations in computing diluted per share amounts.

14 RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm. During the quarter, the Company incurred US$0.1 million (Q3 2013: US$0.1 million) and for the nine months ended 30 September US$0.2 million (2013: US$0.2 million) to this firm for services provided. The transactions with this related party were made at the exchange amount. The Chief Financial Officer provided services to the Company through a consulting agreement with a personal services company, during the quarter the Company incurred US$0.1 million (Q3 2013 US$0.1 million) and for the nine months ended 30 September US$0.3 million (2013: US$0.3. million) to this firm for services provided. As at 30 September 2014 the Company has a total of US$0.1 million (Q3 2013: US$0.1) recorded in trade and other payables in relation to the related parties.

15 CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENTS

CONTRACTUAL OBLIGATIONS

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, then 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 (119 Bcf as at 30 September 2014). 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.

The Gas Agreement may be superseded by an initialed Amended and Restated Gas Agreement ("ARGA"). The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and the consequences of any insufficiency to a new Insufficiency Agreement ("IA"). The IA specifies terms under which Songas may demand cash security in order to keep it whole in the event of a Protected Gas insufficiency. Should the IA be signed, it will govern the basis for determining security. Under the provisional terms of the IA, when it is calculated that funding is required, the Company is required to fund an escrow account at a rate of US$2.00/MMbtu on all Industrial Additional Gas sales out of its and TPDC's share of revenue, and TANESCO shall contribute the same amount on Additional Gas sales to the Power sector. The funds provide security for Songas 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.

Re-rating Agreement

In 2011, the Company signed a re-rating agreement with TANESCO and Songas (the "Re-Rating Agreement") to increase the gas processing capacity 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 effectively pays an additional tariff of US$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US$0.40/mcf for volumes above 90 MMcfd in addition to the tariff of US$0.59/mcf payable to Songas as set by the energy regulator, EWURA.

Under the terms of this agreement, the Company agreed to indemnify Songas for damage to its facilities caused by the re-rating, up to a maximum of US$15 million, but only to the extent that this was not already covered by indemnities from TANESCO or Songas' insurance policies. The Re-rating Agreement expired on 31st December 2012 and in September 2013 was extended by Songas to 31 December 2013. At this time, the Company knows of no reason to de-rate the Songas plant. Since 31 December 2013 production has continued within the higher rated limit and, given the Government's interest in pursuing further development and increasing gas production, the Company expects this to continue. However there are no assurances that this will occur.

Portfolio Gas Supply Agreement

On 17 June 2011, a long term (to June 2023) PGSA was signed between the Company, TPDC and TANESCO. Under the PGSA, the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 37 MMcfd for use in any of TANESCO's current power plants except those operated by Songas at Ubungo. Under the agreement, the basic wellhead price of approximately US$2.88/mcf increased to US$2.93/mcf on 1 July 2014. Any volumes of gas delivered under the PGSA in excess of 36 MMcfd are subject to a 150% increase in the basic wellhead gas price.

Operating leases

The Company has two office rental agreements, one in Dar es Salaam, Tanzania and one in Winchester, United Kingdom. The agreement in Dar es Salaam was entered into on 1 November 2013 and expires on 31 October 2015 at an annual rent of US$401 thousand. The agreement in Winchester expires on 25 September 2022 and is at an annual rental of GBP35 thousand (US$58 thousand) per annum during 2012 and 2013 and GBP71 thousand (US$115 thousand) per annum thereafter. The costs of these leases are recognised in the General and Administrative expenses.

CAPITAL COMMITMENTS

There are no capital commitments at this time.

16 CONTINGENCIES

Downstream unbundling

The separation or unbundling of the downstream assets currently in the PSA has been an objective of TPDC and MEM for some time. Unbundling was an issue raised by TPDC in the 2012 GNT negotiations and by MEM in the National Natural Gas Policy issued in 2013, which contemplates TPDC as a monopoly aggregator and distributor of gas. In the context of the gas policy, TPDC and MEM have indicated that they wish the Company to unbundle the downstream distribution business in Tanzania. The methodology for this has been discussed with TPDC in the course of GNT negotiations. During 2013, the Company tabled a proposal with alternative mechanisms to unbundle the downstream from the PSA which were economically neutral to the parties. TPDC did not respond to the proposal and it was later withdrawn by the Company in connection with the termination of negotiations arising from the GNT, and TPDC was advised that the downstream would remain in the PSA until mutually agreed otherwise. The disposition of the downstream business will be addressed at such a time as there is a conflict between new legislation and the Company's rights under the PSA. The results for the nine months reflect the impact of fully recovering downstream costs previously and temporarily excluded from the cost recoverable pool pending resolution of the unbundling of the downstream business and related assets – see note on Cost Pool Adjustments.

TPDC Back-in

TPDC has previously indicated a wish to exercise its right under the PSA to 'back in' to the Songo Songo field development, and a further wish to convert this into a carried interest in the PSA. The current terms of the PSA require TPDC to provide formal notice in a defined period and contribute a proportion of the costs of any development, sharing in the risks in return for an additional share of the gas. To date, TPDC has not contributed any costs. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however there were no changes to the PSA agreed between the parties. As such the Company continues to stand behind the original terms of the PSA. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively.

For the purpose of the reserves certification as at 31 December 2013, it was assumed that TPDC will elect to 'back-in' for 20% for all future new drilling activities within the prescribed period as determined by the current development plan, and this is reflected in the Company's net reserve position.

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. The Company has contended that the disputed costs were appropriately incurred on the Songo Songo project in accordance with the terms of the PSA. Undertakings to resolve this matter were an outcome of GNT negotiations and the matter was referred to the Controller and Auditor General ("CAG"), head of the National Audit Office of Tanzania. With no progress on resolving the matter, the Company served a Notice of Dispute on TPDC to put the matter to a definitive timeline for resolution, following which the CAG appointed an international independent audit firm to review the disputed costs. The work of the CAG has been completed and TPDC has reviewed its findings. TPDC and Company senior management have held discussions, and are currently in the process of appointing an independent specialist to assist the parties in reaching agreement on costs that are still subject to dispute. The Company has agreed a number of small adjustments, totaling approximately US$1.0 million, and these were removed from the Cost Pool in the previous quarter. If the matter is not resolved to the Company's satisfaction, it intends to proceed to arbitration via the International Centre for Settlement of Investment Disputes ("ICSID") pursuant to the terms of the PSA.

TPDC marketing costs

Under the Songo Songo PSA, all reasonable marketing costs including those incurred by TPDC, with the prior approval by the Company are recoverable. TPDC has to date attempted to claim US$3.6 million in marketing costs from the Company. Management reviewed the claims and can demonstrate that there was no prior approval for such costs, no supporting documentation provided evidencing the expenditure, and further believes the nature of the costs to be unreasonable and not related to marketing the downstream business. Accordingly the Company has rejected the claim by TPDC.

Taxation

During 2013 the Company received a number of assessments for additional tax from the Tanzania Revenue Authority ("TRA"), which together with interest penalties total US$18.4 million. Management, together with tax advisors, have reviewed each of the assessments and believe them to be without merit. The Company has appealed against assessments for additional withholding tax and employment related taxes, and has filed formal objections against TRA's claims for additional corporation tax and VAT.

The Tax Revenue Appeals Board (TRAB) considered the Company's appeal against a withholding tax assessment of US$2.4 million in March 2013 and upheld the assessment. The Company then appealed to Tax Revenue Appeals Tribunal whose decision is awaited. Although a similar appeal to the Tribunal has been decided in favour of TRA, management continues to believe this assessment is flawed and, if necessary, will pursue the case in the Court of Appeal where a similar case is currently being heard.

The Company, based on legal counsel's advice, believes it has strong support, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US$7.8 million, including penalties. During the quarter TRA notified the Company that it would not accept the objection relating to 2009 and issued a notice confirming the assessment for US$2.5 million. The Company has lodged an appeal against this assessment with the TRAB . In the event that the Company's 2008 and 2010 objections are rejected and subsequent appeals are overturned, any additional tax payable will be recoverable from TPDC under the terms the PSA.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US$7.5 million. Again, the Company, based on legal counsel's advice, believes that it has strong grounds for objecting to this assessment and accordingly has made no provision.

The Company has received an assessment of US$0.7 million in respect of employment related taxes which TRA believe to have been underpaid. The Company does not accept TRA's finding and has appealed.

Management continues to review the progress of the above appeals and objections and, as of the date of this report, does not believe any provision is required.

Subsequent to the quarter end TRA conducted an audit of the Company's tax returns for 2011 and issued their audit findings which indicated that additional taxes amounting to US$3.3 million should be paid in respect of employment costs, income and withholding taxes. Management and reviewed the findings which it considers to be without merit and is preparing to respond to TRA. No additional provision is considered necessary at this time.

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