



ORCA EXPLORATION GROUP INC.

2014  
ANNUAL  
REPORT

**Orca Exploration Group Inc.** is an international public company engaged in hydrocarbon exploration, development and supply of gas in Tanzania and oil appraisal and gas exploration in Italy. Orca Exploration trades on the TSXV under the trading symbols ORC.B and ORC.A.

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## GLOSSARY

mcf	Thousands of standard cubic feet	<i>1P</i>	Proven reserves
MMcf	Millions of standard cubic feet	<i>2P</i>	Proven and probable reserves
Bcf	Billions of standard cubic feet	<i>3P</i>	Proven, probable and possible reserves
Tcf	Trillions of standard cubic feet	<i>Kwh</i>	Kilowatt hour
MMcfd	Millions of standard cubic feet per day	<i>MW</i>	Megawatt
MMbtu	Millions of British thermal units	<i>US\$</i>	US dollars
HHV	High heat value	<i>CDN\$</i>	Canadian dollars
LHV	Low heat value	<i>bar</i>	Fifteen pounds pressure per square inch

# Financial and Operating Highlights

	YEAR ENDED/AS AT 31 DECEMBER		
	2014	2013 – restated	% Change
<i>US\$'000 except where otherwise stated</i>			
<b>Financial</b>			
Revenue	56,607	53,482	6
Loss before tax	(26,863)	(5,384)	(399)
Operating netback (US\$/mcf)	2.22	2.20	1
Cash	57,659	32,588	77
Working capital <sup>(1)</sup>	34,148	20,857	64
TANESCO receivable (before impairment) <sup>(1)</sup>	64,630	56,608	14
Shareholders' equity	76,635	114,780	(33)
Net loss	(38,301)	(7,640)	(401)
per share - basic and diluted (US\$)	(1.10)	(0.22)	(400)
Funds flow from operating activities <sup>(2)</sup>	32,436	32,394	–
per share - basic and diluted (US\$)	0.93	0.93	–
Cash flows from operating activities	29,757	22,491	32
per share - basic and diluted (US\$)	0.85	0.65	31
<b>Outstanding Shares ('000)</b>			
Class A shares	1,751	1,751	–
Class B shares	33,164	33,072	–
Options	400	1,742	(77)
<b>Operating</b>			
Additional Gas sold – Industrial (MMcf)	4,598	4,478	3
– Power (MMcf)	14,823	17,957	(17)
Average daily volume – Industrial (MMcfd)	12.6	12.3	2
– Power (MMcfd)	40.6	49.2	(17)
– Total (MMcfd)	53.2	61.5	(13)
Average price per mcf – Industrial (US\$/mcf)	8.61	8.27	4
– Power (US\$/mcf)	3.56	3.76	(5)
– Total (US\$/mcf)	4.76	4.66	2
<b>Additional Gas Gross Recoverable Reserves to end of licence (BCF) <sup>(3)</sup></b>			
Proved	450	476	(5)
Probable	54	52	4
Proved plus probable	504	527	(4)
<b>Net Present Value, discounted at 10% (US\$ millions) <sup>(3)</sup></b>			
Proved	379	365	4
Proved plus probable	417	403	3

(1) Working capital as at 31 December 2014 includes a TANESCO receivable (excluding interest) of US\$7.7 million (31 December 2013: US\$9.6 million). Management has placed a doubtful debt provision against the long-term receivables in excess of 60 days totaling US\$52.2 million (31 December 2013: US\$43.3 million). The total of long- and short-term TANESCO receivables, including interest, as at 31 December 2014 was US\$64.6 million. The financial statements do not recognise the interest receivable from TANESCO as it does not meet IAS 18 income recognition criteria. The Company is however actively pursuing the collection of all the receivables and the interest that has been charged to TANESCO.

(2) See MD&A – Non-GAAP Measures.

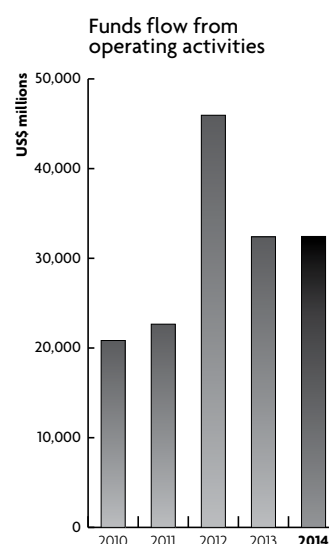
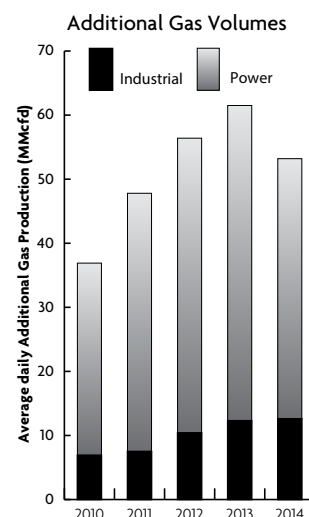
(3) Based on a report prepared by independent petroleum engineers McDaniel & Associates Consultants Ltd., dated 31 December 2014, which was prepared on 28 April 2015 in accordance with National Instrument 51-101 and definitions, standards and procedures contained in the Canadian Oil and Gas Evaluation Handbook. The 2013 information is based on a report prepared by the Company's independent reserves evaluator as at 31 December 2013. In accordance with the National Instrument 51-101 and the Canadian Oil and Gas Evaluation Handbook.

## 2014 Operating Highlights

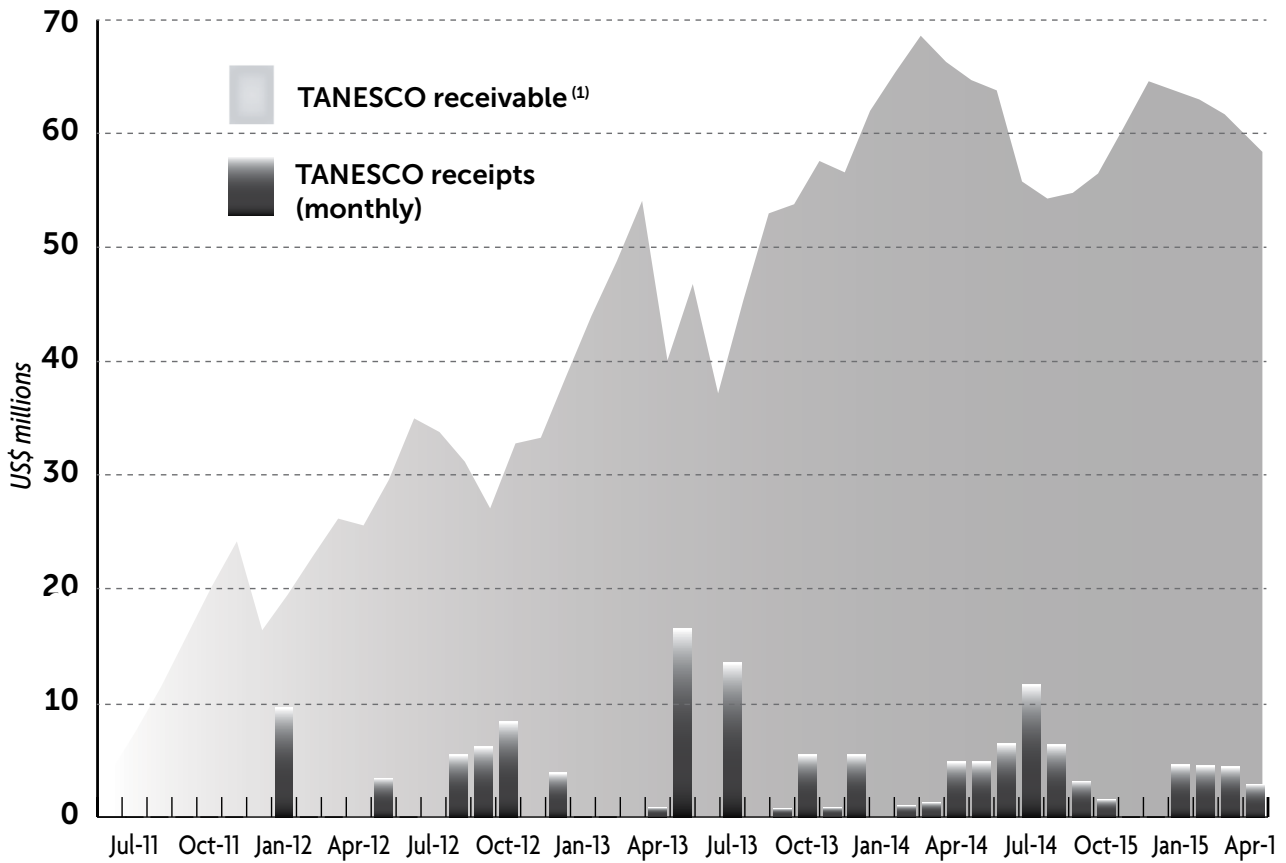
- Total Songo Songo field production of Protected Gas plus Additional Gas averaged 89.8 million standard cubic feet per day ("MMcfd") down 7% from 2013. Additional Gas sales volumes averaged 53.2 MMcfd, a decrease of 13% over the prior year (61.5 MMcfd), due largely to declining field productivity and reduced takes by TANESCO.
- Production declines, combined with continued support of hydro power generation in Tanzania and Q4 TANESCO maintenance, reduced Power sector nominations during 2014 by 17% to 40.6 MMcfd, compared to 49.2 MMcfd in 2013. Industrial sales increased 3% to 12.6 MMcfd from 12.3 MMcfd in 2013.
- Total proved reserves of Additional Gas decreased 5% to 450 Bcf (2013: 476 Bcf) and total proved plus probable (2P) reserves decreased 4% to 504 Bcf (2013: 527 Bcf), both primarily as a result of production of 19.4 Bcf of gas during the year. The net present value of the estimated future cash flows of the 2P reserves at a 10% discount rate ("NPV10") increased 10% to US\$417 million (2013: NPV10 US\$403 million), as a result of an optimization to the capital programme in 2014 which has resulted in a change in the timing of the compression requirements, together with the removal of the abandonment costs from the reserve reports (as there is no obligation to undertake abandonment under the PSA).
- Regular weekly payments from TANESCO commenced in Q2 2014, but were discontinued during Q4 2014. Weekly payments have resumed in 2015 to date with TANESCO having made a renewed commitment to remain current for ongoing gas deliveries and work towards a solution for arrears. At year-end, TANESCO owed the Company (including interest) US\$64.6 million (2013: US\$56.6 million), of which US\$52.2 million (2013: US\$51.5 million) were in arrears.
- TANESCO currently owes the Company US\$52.9 million (excluding interest).
- At 31 December 2014, the Company re-assessed the TANESCO arrears in light of (i) the discontinuance of weekly payments during Q4 2014; (ii) the fact that TANESCO did not pay down substantially all of the arrears by year-end pursuant to a formal commitment made earlier during the year which was tied to World Bank funding; (iii) the lack of a definitive plan to repay arrears in light of (ii) above; and (iv) the absence of any evidence of the availability of external funding for TANESCO, including World Bank funding. As a result of increased uncertainty with respect to the timing and amount of ultimate collection of amounts in arrears, and the Company recorded a provision for doubtful accounts against the balance of the long-term receivable of US\$35.1 million as at 31 December 2014.
- Amounts collected with respect to the long-term receivable in the future will be reflected in earnings when payment is received. Notwithstanding this provision, the Company and TANESCO continue to operate in accordance with the terms of the Portfolio Gas Supply Agreement whereby natural gas continues to be delivered by the Company and TANESCO payments remain current on current deliveries as agreed during Q2 2013, this understanding was reconfirmed in Q1 2015. This provision against the TANESCO long-term receivable will not prejudice the Company's rights to payment in full or its ability to pursue collection in accordance with the terms of the agreement with TANESCO.
- Working capital as at 31 December 2014 increased by 64% to US\$34.1 million (2013: US\$20.9 million) but decreased 19% from 30 September 2014 (US\$42.0 million) primarily as a result of TANESCO suspending payments for gas during Q4, an increase in tax payable in respect of prior years and a reduction in the amount of prior year tax recoverable.
- As at 31 December 2014, the Company had US\$57.7 million in cash, US\$34.1 million in working capital (2013: US\$32.6 million cash, US\$20.9 million working capital) and no debt.
- During the year capital expenditure was US\$1.3 million in relation to engineering and planning relating to well workovers and subsequent drilling activities.

- Net loss for the year was US\$38.3 million or US\$1.10 per share diluted, as opposed to a loss of US\$7.6 million or US\$0.22 per share in 2013. The increase in net loss over 2013 was primarily the result of a US\$35.1 million provision against the remaining TANESCO net long-term receivable.
- Average gas prices were up 2% in 2014 to US\$4.76/mcf over 2013 (US\$4.66/mcf). Industrial gas prices were up 4% in 2014 to US\$8.61/mcf (2013: US\$8.27/mcf). Increases in annual indexation and a significant contract renewal offset decreases driven by lower heavy fuel oil ("HFO") prices during the year. Average Power sector gas prices decreased 5% over the year to US\$3.56/mcf (2013: US\$3.76/mcf), largely as a result of reduced sales volumes to the Power sector which in turn reduced the amount sales subject to premium pricing in accordance with the Portfolio Gas Supply Agreement with TANESCO more than offsetting the impact of annual price indexation.
- Revenue was US\$56.6 million, an increase of 6% from 2013 (\$53.5 million). Funds flow from operating activities in 2014 was US\$32.4 million or US\$0.93 per share diluted, no change from 2013 (US\$32.4 million or US\$0.93 per share).
- The US\$1.2 billion government sponsored Tanzania National Natural Gas Infrastructure Project ("NNGIP") is substantially complete, with first gas expected by the end of 2015. During the year, the Mnazi Bay partners and Kiliwani North partners separately announced that they had signed gas purchase agreements with the Tanzania Petroleum Development Corporation ("TPDC") for an initial 80 MMcfd and 20 MMcfd respectively. Discussions between TPDC, the Ministry of Energy and Minerals and the Company on commercial terms for future incremental gas sales showed no progress during the year. Commercial terms remain a key condition to the Company's commitment to expanded Songo Songo development for the NNGIP.

- Despite the stalled efforts to reach agreement on commercial terms for production expansion to the NNGIP, the Company advanced work on Songo Songo development. Provided that TANESCO maintain its weekly payments and subject to financing, the Company intends to proceed the first phase of a workover and drilling programme commencing mid-2015. The initial US\$120 million of the first US\$150 million first phase expenditure is intended to maintain deliverability and provide sufficient capacity to fill the existing Songas infrastructure until the Company can secure commercial terms for additional gas sales to the NNGIP.
- International Finance Corporation ("IFC") of the World Bank Group is in the process of receiving its internal approvals to provide approximately half the capital cost of the initial phase, or US\$60 million, in quasi-equity financing to the Company's operating subsidiary, PanAfrican Energy Tanzania Limited. Definitive terms have yet to be agreed and any financing will require board approval of both IFC and the Company and be subject to a number of terms and conditions, including with respect to the assurance of ongoing TANESCO payments. There is no assurance such financing will be concluded on mutually agreeable terms.
- In response to speculation regarding a potential sale of the Company or a significant transaction, in mid-July Orca issued a press release advising that the Company was in discussions with a number of third parties which have made unsolicited approaches to the Company relating to the sale of the Company, a significant asset disposal, strategic investment or other transaction involving the Company. As at the date hereof, the Company has nothing to report.



### TANESCO receivables since emergency power plan mid-2011



(1) Total TANESCO receivable at month-end and prior to provisions.

## Gas Reserves

In accordance with National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities and the Canadian Oil and Gas Evaluation Handbook, the independent petroleum engineers, McDaniel & Associates Ltd. prepared a report dated 28 April 2015 that assessed natural gas reserves of Orca Exploration Group Inc. based on information on the Songo Songo Field and Songo Songo North as at 31 December 2014 (the "McDaniel Report"). A summary of the remaining Additional Gas reserves on a life of license and life of field basis are presented below. The Total Proved (1P) and Proved plus Probable (2P) reserves are based on production to the end of the license period (October 2026).

During the course of 2014 no significant geological or geophysical data has been acquired on or close to the Songo Songo field that might allow a re-assessment of the volumetric gas initially in place ("GIIP") and reserves. On a Gross Company basis there has been a 5% decrease in Songo Songos' Total Proved Additional Gas reserves to the end of the license period, with 2% increase on a life of field basis, with a total Additional Gas production of 19.4 Bcf during the year. There has been a 4% decrease in the Proved plus Probable Additional Gas reserves on a Gross Company life of license basis from 527.3 Bcf to 504.4 Bcf. The decrease is due to the 2014 production of Additional Gas.

The gross and net Company Additional Gas reserves to end of license are as follows:

Songo Songo Additional Gas reserves to October 2026 (Bcf)	2014		2013	
	Gross <sup>(1)</sup>	Net <sup>(2)</sup>	Gross	Net
<b>Independent reserves evaluation</b>				
Proved producing	283.6	194.0	304.9	212.2
Proved undeveloped	166.8	88.9	170.8	100.4
Total proved (1P)	450.4	282.9	475.7	312.6
Probable	54.0	37.3	51.6	36.9
Total proved and probable (2P)	504.4	320.2	527.3	349.5

(1) Gross equals the gross reserves that are available for the Company after estimating the effect of the TPDC back in (see below).

(2) Net equals the economic allocation of the Gross reserves to the Company as determined in accordance with the Production Sharing Agreement.

(3) The 2013 information is based on a report prepared by the Company's independent reserves evaluator as at 31 December 2013, in accordance with the National Instrument 51-101 and the Canadian Oil and Gas Evaluation Handbook

Songo Songo Additional Gas reserves to end of field life (Bcf)	2014		2013	
	Gross <sup>(1)</sup>	Net <sup>(2)</sup>	Gross	Net
<b>Independent reserves evaluation</b>				
Proved producing	554.2	359.7	573.5	381.6
Proved undeveloped	95.1	50.9	62.3	39.6
Total proved (1P)	649.3	410.6	635.8	421.2
Probable	118.4	76.5	113.5	75.9
Total proved and probable (2P)	767.7	487.1	749.3	497.1

(1) Gross equals the gross reserves that are available for the Company after estimating the effect of TPDC back in (see below).

(2) Net equals the economic allocation of the Gross reserves to the Company as determined in accordance with the Production Sharing Agreement.

(3) The 2013 information is based on a report prepared by the Company's independent reserves evaluator as at 31 December 2013, in accordance with the National Instrument 51-101 and the Canadian Oil and Gas Evaluation Handbook

For the purpose of the reserves certification as at 31 December 2014, the McDaniel Report has assumed that the Tanzania Petroleum Development Corporation ("TPDC") will only be able to exercise its right to 'back in' to the new field development plan for Songo Songo and consequently will receive a 20% increase in the profit share for the production emanating from future production from the new wells SS-12 and SSN-1 wells. McDaniel treats this 'back in' right as a TPDC working interest and therefore the Gross reserves have been adjusted for the volumes of Additional Gas that are allocated to TPDC for its working interest share. There may be the need for additional reserve and accounting modifications once the matter is concluded.

For the purpose of calculating the Gross Additional Gas reserves, McDaniel has assumed in its 2P case that 130 Bcf (2013: 144 Bcf) or an average of 13.5 Bcf per annum will be required to meet the demands of the Protected Gas users from 1 January 2015 to 31 July 2024. During 2014, the Protected Gas users consumed 13.4 Bcf.

McDaniel forecast gas sales prices and volumes	Additional Gas price	Gross Additional Gas volumes	Additional Gas price	Gross Additional Gas volumes
	1P	1P	2P	2P
Year	US\$/mcf	MMcfd	US\$/mcf	MMcfd
2015	3.92	52.39	3.93	52.39
2016	4.27	97.78	4.32	115.04
2017	4.45	131.09	4.47	131.09
2018	4.57	131.09	4.60	131.09
2019	4.68	131.09	4.73	131.09
2020	4.79	131.09	4.86	131.09
2021	4.89	131.09	4.97	131.09
2022	4.97	112.91	5.08	131.09
2023	5.05	93.34	5.19	131.09
2024	5.21	90.90	5.34	124.94
2025	5.40	98.13	5.51	129.48
2026	5.51	85.33	5.63	111.69

### Present value of reserves

The estimated value of the Company's net share of Songo Songo reserves on a life of license basis based on the assumptions on production and pricing are as follows:

US\$ millions	2014			2013		
	5%	10%	15%	5%	10%	15%
Proved producing	274.3	195.9	144.3	265.2	186.4	136.0
Proved undeveloped	233.5	182.9	145.1	237.3	178.8	136.9
Total proved (1P)	507.8	378.8	289.4	502.5	365.2	272.9
Probable	60.3	38.4	25.4	57.1	37.9	26.8
Total proved and probable (2P)	568.1	417.2	314.8	559.6	403.1	299.7

There has been a 3% increase on the 2P present value at a 10% discount basis from US\$403 million to US\$417 million on a life of licence basis. There has been an optimization to the capital programme in 2014 which has resulted in a change in the timing of the compression requirements, which together with the removal of the abandonment costs from the reserve reports (as there is no obligation to undertake abandonment under the Production Sharing Agreement) has resulted in an increase in the 2P present value. The valuation contemplates the roll out of the current Portfolio Gas Sales Agreement ("PGSA") with TANESCO and is consistent with 2013. It has been assumed that from the commencement of the National Natural Gas Infrastructure Project ("NNGIP") which is contemplated to be on stream by July 2016 future sales to TANESCO will be at the PGSA well head price. As a consequence no estimate has been made for the transportation tariff under the NNGIP.

It should not be assumed that the estimates of future net revenues presented in the table above represent the fair market value of the reserves.



ORCA EXPLORATION GROUP INC.

MANAGEMENT'S  
DISCUSSION  
& ANALYSIS

## Management's Discussion & Analysis

THIS MD&A OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE IN CONJUNCTION WITH THE AUDITED CONSOLIDATED FINANCIAL AND NOTES FOR THE YEAR ENDED 31 DECEMBER 2014. THIS MD&A IS BASED ON THE INFORMATION AVAILABLE ON 6 May 2015.

### FORWARD LOOKING STATEMENTS

*This management's discussion and analysis ("MD&A") contains forward-looking statements or information (collectively, "forward-looking statements") within the meaning of applicable securities legislation. More particularly, this MD&A contains, without limitation, forward-looking statements pertaining to the following: under "Principle Terms of the Tanzanian PSA and Related Agreements", the potential that TPDC will seek to amend the PSA and convert its back-in rights into a carried working interest, the Company's belief that the parties to the unsigned AGRA will continue to conduct themselves as through the AGRA is in full force and effect, and the Company's expectation that, despite the Re-Rating Agreement being expired, Songas Limited will not de-rate the Songas gas processing plant; under "Songo Songo Deliverability", with respect to the NNGIP, the Company's intention to proceed with the first phase workover and drilling programme commencing mid 2015 subject to financing; under "Net Finance Costs", the Company's belief that the provision against the TANESCO long-term receivable will not prejudice the Company's right to payment in full or its ability to pursue collection in accordance with the terms of the agreement with TANESCO; and management's expectation to receive the balance of 'Other trade debtors' during the course of Q2 2015; under "Contractual Obligations and Committed Capital Investment", the Company's expectation that it will not have a shortfall during the term of the Protected Gas delivery obligation to July 2024; the Company's commitment to fund all future costs relating to the Elsa-2 appraisal well and farm in permit in Italy in proportion to the Company's participating interest, and the Company's expectation that the Elsa-2 appraisal well will be drilled in 2016; the Company intention, subject to financing, to proceed with a workover and drilling programme offshore Songo Songo in order to maintain deliverability and fill the existing Songas infrastructure to capacity for the life of the Songo Songo licence, being 2026, and the Company's estimated spending for the programme between 2015 and 2017; under "Contingencies", with respect to the TPDC's audit of the historic Cost Pool, the Company's intention to proceed with arbitration with the International Centre for Settlement of Investment Dispute pursuant to the terms of the PSA, if the matter is not resolved to the Company's satisfaction; and with respect to the Company's tax disputes with the TRA, the Company's belief that it has a strong case and that, in the event 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 of the PSA; the Company's belief that there can be no assurance that the rights of the Company under the PSA will be grandfathered with respect to any future natural gas legislation arising from the National Natural Gas Policy; the Company's expectation that the cost of complying with environmental legislation and regulations will increase in the future and management's belief that the Company's operations and facilities are currently in material compliance with such laws and regulations; and the Company's commitment to maintain insurance against some but not all potential risks associated with the exploration for, and the production, storage, transportation and marketing of, oil and gas. In addition, statements relating to "reserves" are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. The recovery and reserve estimates of Orca's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Although management believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, operational, competitive, political and social uncertainties and contingencies.*

These forward-looking statements involve substantial known and unknown risks and uncertainties, certain of which are beyond Orca's control, and many factors could cause Orca's actual results to differ materially from those expressed or implied in any forward-looking statements made by Orca, including, but not limited to: failure to receive payments from TANESCO; failure to reach a sales agreement with TPDC for incremental gas volumes; potential negative effect on the Company's rights under the PSA as a result of the National Natural Gas Policy; risk that the contingencies related to the development work for the full field development plan for Songo Songo are not satisfied; risk that the onstream date for the National Natural Gas Infrastructure Project is delayed; failure to obtain funding for full field development plan for Songo Songo; risk that, without extending or replacing the Re-Rating Agreement, Songas Limited may de-rate plant capacity back to the capacity originally agreed to resulting in a material reduction in the Company's sales volumes of Additional Gas; risk that the Company will be required to pay additional taxes and penalties; the impact of general economic conditions in the areas in which Orca 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; competition for, among other things, capital, drilling equipment and skilled personnel; failure to obtain required equipment for drilling; delays in drilling plans; failure to obtain expected results from drilling of wells; effect of changes to the PSA on the Company; changes in laws; imprecision in reserve estimates; the production and growth potential of the Company's assets; obtaining required approvals of regulatory authorities; risks associated with negotiating with foreign governments; inability to access sufficient capital; failure to successfully negotiate agreements; and risk that the Company will not be able to fulfil its obligations. In addition there are risks and uncertainties associated with oil and gas operations, therefore Orca's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurances can be given that any of the events anticipated by these forward-looking statements will transpire or occur, or if any of them do so, what benefits Orca will derive therefrom. Readers are cautioned that the foregoing list of factors is not exhaustive.

Such forward-looking statements are based on certain assumptions made by Orca in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors Orca believes are appropriate in the circumstances, including, but not limited to that TPDC will exercise its right under the PSA to 'back in' for 20% of all new drilling activities in the future as determined by the Company's current development plan for the Songo Songo field; that there will continue to be no restrictions on the movement of cash from Mauritius or Tanzania; that the Company will have sufficient cash flow, debt or equity sources or other financial resources required to fund its capital and operating expenditures and requirements as needed; that the Company will have adequate funding to continue operations; that the Company will successfully negotiate agreements; receipt of required regulatory approvals; the ability of Orca to increase production at a consistent rate; infrastructure capacity; commodity prices will not deteriorate significantly; the ability of Orca to obtain equipment and services in a timely manner to carry out exploration, development and exploitation activities; future capital expenditures; availability of skilled labour; timing and amount of capital expenditures; uninterrupted access to infrastructure; the impact of increasing competition; conditions in general economic and financial markets; effects of regulation by governmental agencies; that the Company will obtain funding for full field development plan for Songo Songo; that the Company's appeal of the tax assessment by the TRA will be successful; that the enactment of a Gas Act in Tanzania will not impair the Company's rights under the PSA to develop and market natural gas in Tanzania; current or, where applicable, proposed industry conditions, laws and regulations will continue in effect or as anticipated as described herein; and other matters.

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

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## NON-GAAP MEASURES

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

- FUNDS FLOW FROM OPERATING ACTIVITIES IS A TERM THAT REPRESENTS CASH FLOW FROM OPERATIONS BEFORE WORKING CAPITAL CHANGES. IT IS A KEY MEASURE AS IT DEMONSTRATES THE COMPANY'S ABILITY TO GENERATE CASH NECESSARY TO ACHIEVE GROWTH THROUGH CAPITAL INVESTMENTS.
- OPERATING NETBACKS REPRESENT THE PROFIT MARGIN ASSOCIATED WITH THE PRODUCTION AND SALE OF ADDITIONAL GAS AND IS CALCULATED AS REVENUES LESS PROCESSING AND TRANSPORTATION TARIFFS, GOVERNMENT PARASTATAL'S REVENUE SHARE, OPERATING AND DISTRIBUTION COSTS FOR ONE THOUSAND STANDARD CUBIC FEET OF ADDITIONAL GAS. THIS IS A KEY MEASURE AS IT DEMONSTRATES THE PROFIT GENERATED FROM EACH UNIT OF PRODUCTION, AND IS WIDELY USED BY THE INVESTMENT COMMUNITY.
- FUNDS FLOW FROM OPERATING ACTIVITIES PER SHARE IS CALCULATED ON THE BASIS OF THE FUNDS FLOW FROM OPERATIONS DIVIDED BY THE WEIGHTED AVERAGE NUMBER OF SHARES.
- CASH FLOW FROM OPERATING ACTIVITIES PER SHARE IS CALCULATED AS CASH FLOW FROM OPERATIONS DIVIDED BY THE WEIGHTED AVERAGE NUMBER OF SHARES.

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

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## NATURE OF OPERATIONS

The Company's principal operating asset is its interest in a Production Sharing Agreement ("PSA") with the Tanzania Petroleum Development Corporation ("TPDC") and the Government of Tanzania in the United Republic of Tanzania. This PSA covers the production and marketing of certain gas from the Songo Songo Block offshore Tanzania.

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

Songas utilizes the Protected Gas as feedstock for its gas turbine electricity generators at Ubungo, for onward sale to the Wazo Hill Cement Plant and for electrification of some villages along the pipeline route. The Company receives no revenue for the Protected Gas delivered to Songas and operates the field and gas processing plant on a 'no gain no loss' basis.

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

The Tanzania Electric Supply Company Limited ("TANESCO") is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the Ministry of Energy and Minerals ("MEM"). TANESCO is responsible for the generation, transmission and distribution of electricity throughout Tanzania. Natural gas has become an integral component of TANESCO's power generation fuel mix as a more reliable source of supply over seasonal hydro power and a more cost effective alternative to liquid fuels. The Company currently supplies gas directly to TANESCO by way of a Portfolio Gas Supply Agreement ("PGSA") and indirectly through the supply of Protected Gas and Additional Gas to Songas which in turn generates and sells power to TANESCO. The state utility is the Company's largest customer and the gas supplied by the Company to TANESCO today fires approximately 60% of the electrical power generated in Tanzania.

In addition to gas supplied to Songas and TANESCO for the generation of power, the Company has developed and supplies an industrial gas market in the Dar es Salaam area consisting of some 39 industrial customers.

## PRINCIPAL TERMS OF THE TANZANIAN PSA AND RELATED AGREEMENTS

The principal terms of the Songo Songo PSA and related agreements are as follows:

### Obligations and restrictions

- (a) The Company has the right to conduct petroleum operations, market and sell all Additional Gas produced and share the net revenue with TPDC for a term of 25 years, expiring in October 2026.
- (b) The PSA covers the two licenses in which the Songo Songo field is located ("Discovery Blocks"). The Proven Section is essentially the area covered by the Songo Songo field within the Discovery Blocks.
- (c) No sale of Additional Gas may be made from the Discovery Blocks, if in the Company's reasonable judgment such sales would jeopardise the supply of Protected Gas. Any Additional Gas contracts entered into are subject to interruption. Songas has the right to request that the Company and TPDC obtain security reasonably acceptable to Songas prior to making any sales of Additional Gas from the Discovery Block to secure the Company's and TPDC's obligations in respect of Insufficiency (see (d) below).
- (d) "Insufficiency" occurs if there is insufficient gas from the Discovery Blocks to supply the Protected Gas requirements or if the gas is so expensive to develop that its cost exceeds the market price of alternative fuels at Ubungo.

Where there have been third party sales of Additional Gas by the Company and TPDC from the Discovery Blocks prior to the occurrence of the Insufficiency, the Company and TPDC shall be jointly liable for the Insufficiency and shall satisfy its related liability by either replacing the Indemnified Volume (as defined in (e) below) at the Protected Gas price with natural gas from other sources; or by paying money damages equal to the difference between: (a) the market price for a quantity of alternative fuel that is appropriate for the five gas turbine electricity generators at Ubungo without significant modification together with the costs of any modification; and (b) the sum of the price for such volume of Protected Gas (at US\$0.55/MMbtu escalated) and the amount of transportation revenues previously credited by Songas to the state electricity utility, the Tanzania Electric Supply Company ("TANESCO"), for the gas volumes.

- (e) The "Indemnified Volume" means the lesser of the total volume of Additional Gas sales supplied from the Discovery Blocks prior to an Insufficiency and the Insufficiency Volume. "Insufficiency Volume" means the volume of natural gas determined by multiplying the average of the annual Protected Gas volumes for the three years prior to the Insufficiency by 110% and multiplied by the number of remaining years (initial term of 20 years) of the power purchase agreement entered into between Songas and TANESCO in relation to the five gas turbine electricity generators at Ubungo from the date of the Insufficiency.

### Access and development of infrastructure

- (f) The Company is able to utilise the Songas infrastructure including the gas processing plant and main pipeline to Dar es Salaam. Access to the pipeline and gas processing plant is open and can be utilised by any third party who wishes to process or transport gas. Ndovu Resources Limited, a subsidiary of Aminex PLC ("Aminex"), with support from TPDC and MEM, had previously indicated that it wished to tie into the gas processing plant on Songo Songo Island and sell up to 10 MMcfd from its Kiliwani North field. Aminex announced in 2014 that it had agreed commercial terms for a gas sales agreement with TPDC which would provide for gas from Kilwa North to be tied in to the new National Natural Gas Infrastructure Project ("NNGIP") facilities on Songo Songo Island and not be connected into the Songas facilities.

Songas is not required to incur capital costs with respect to additional processing and transportation facilities unless the construction and operation of the facilities are, in the reasonable opinion of Songas, financially viable. If Songas is unable to finance such facilities, Songas shall permit the seller of the gas to construct the facilities at its expense, provided that, the facilities are designed, engineered and constructed in accordance with good pipeline and oilfield practices.

## Revenue sharing terms and taxation

- (g) 75% of the gross revenues, less processing and pipeline tariffs and direct sales taxes in any year ("Net Revenues"), can be used to recover past costs incurred. Costs recovered out of Net Revenues are termed "Cost Gas".

The Company pays and recovers costs of exploring, developing and operating the Additional Gas with two exceptions: (i) TPDC may recover reasonable market and market research costs as defined under the PSA; and (ii) TPDC has the right to elect to participate in the drilling of at least one well for Additional Gas in the Discovery Blocks for which there is a development program as detailed in an Additional Gas plan ("Additional Gas Plan") as submitted to MEM, subject to TPDC being able to elect to participate in a development program only once and TPDC having to pay a proportion of the costs of such development program by committing to pay between 5% and 20% of the total costs ("Specified Proportion"). If TPDC does not notify the Company within 90 days of notice from the Company that the MEM has approved the Additional Gas Plan, then TPDC is deemed not to have elected. If TPDC elects to participate, then it will be entitled to a rateable proportion of the Cost Gas and their profit share percentage increases by the Specified Proportion for that development program.

To date, TPDC has neither elected to back in within the prescribed notice period nor contributed any costs associated with backing in and accordingly the Company has determined that to date there has been no working interest earned by TPDC. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the Government Negotiating Team ("GNT") along with other issues; however nothing was agreed between the parties. Until such time as an agreement is reached, the Company will apply the terms of the original 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 2014, it was assumed that TPDC will 'back-in' for 20% for all future new drilling activities as determined by the current development plan and this is reflected in the Company's net reserve position.

- (h) In 2009, the energy regulator, Energy and Water Utility Regulatory Authority ("EWURA"), issued an order that saw the introduction of a flat rate tariff of US\$0.59/mcf from 1 January 2010. The Company's long-term gas price to the Power sector as set out in the unsigned ARGA and the Portfolio Gas Supply Agreement ("PGSA") is based on the price of gas at the wellhead. As a consequence, the Company is not impacted by the changes to the tariff paid to Songas or other operators in respect of sales to the Power sector. As at the date of this report, the ARGA remains an initialled agreement only, however the parties thereto, in certain respects are conducting themselves as though the ARGA is in full force and effect.

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's 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 whereupon it expired without renewal. At this time the Company knows of no reason to de-rate the Songas gas processing plant. Since then production has continued at 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.

- (i) The cost of maintaining the wells and flowlines is split between the Protected Gas and Additional Gas users in proportion to the volume of their respective sales. The cost of operating the gas processing plant and the pipeline to Dar es Salaam is covered through the payment of the pipeline tariff.

- (j) Profits on sales from the Proven Section ("Profit Gas") are shared between TPDC and the Company, the proportion of which is dependent on the average daily volumes of Additional Gas sold or cumulative production.

The Company receives a higher share of the net revenues after cost recovery, based on the higher the cumulative production or the average daily sales. The Profit Gas share is a minimum of 25% and a maximum of 55%.

<b>Average daily sales of Additional Gas</b>	<b>Cumulative sales of Additional Gas</b>	<b>TPDC's share of Profit Gas</b>	<b>Company's share of Profit Gas</b>
<i>MMcfd</i>	<i>Bcf</i>	<i>%</i>	<i>%</i>
0 - 20	0 – 125	75	25
> 20 <= 30	> 125 <= 250	70	30
> 30 <= 40	> 250 <= 375	65	35
> 40 <= 50	> 375 <= 500	60	40
> 50	> 500	45	55

For Additional Gas produced outside of the Proven Section, the Company's Profit Gas share is 55%.

Where TPDC elects to participate in a development program, its profit share percentage increases by the Specified Proportion (for that development program) with a corresponding decrease in the Company's percentage share of Profit Gas.

The Company is liable for income tax in Tanzania. Where income tax is payable, the Company pays the tax and there is a corresponding deduction in the amount of the Profit Gas payable to TPDC.

- (k) "Additional Profits Tax" (or "APT") is payable when the Company recovers its costs out of Additional Gas revenues plus an annual operating return under the PSA of 25%, plus the percentage change in the United States Industrial Goods Producer Price Index ("PPI"); and (ii) the maximum APT rate is 55% of the Company's Profit Gas when costs have been recovered with an annual return of 35% plus PPI return. The PSA is, therefore, structured to encourage the Company to develop the market and the gas fields in the knowledge that the Profit Gas share can increase with larger daily gas sales and that the costs will be recovered with a 25% plus PPI annual return before APT becomes payable. APT can have a significant negative impact on the project economics if only limited capital expenditure is incurred.



## Operatorship

- (l) The Company is appointed to develop, produce and process Protected Gas and operate and maintain the Songas gas production facilities and processing plant, including the staffing, procurement, capital improvements, contract maintenance, maintain books and records, prepare reports, maintain permits, handle waste, liaise with the Government of Tanzania and take all necessary safety, health and environmental precautions, all in accordance with good oilfield practices. In return, the Company is paid or reimbursed by Songas so that the Company neither benefits nor suffers a loss as a result of its performance.
- (m) In the event of loss arising from Songas' failure to perform and the loss is not fully compensated by Songas, the Company, or insurance coverage, then the Company is liable to a performance and operation guarantee of US\$2.5 million when (i) the loss is caused by the gross negligence or wilful misconduct of the Company, its subsidiaries or employees, and (ii) Songas has insufficient funds to cure the loss and operate the project.

## Consolidation

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

Company	Incorporated
Orca Exploration Group Inc.	British Virgin Islands
Orca Exploration Italy Inc.	British Virgin Islands
Orca Exploration Italy Onshore Inc.	British Virgin Islands
PAE PanAfrican Energy Corporation	Mauritius
PanAfrican Energy Tanzania Limited	Jersey
Orca Exploration UK Services Limited	United Kingdom

# Results for the year ended 31 December 2014

## SUMMARY

The year ended 31 December 2014 saw a decrease in reserves commensurate with production, with the net present value of reserves increasing as a result of the Company optimising its planned Songo Songo development programme. Reduced Power sector consumption and field declines contributed to Additional Gas production volumes being down for the year. A small increase in revenues left funds flow from operations essentially flat year-over-year. A full provision against all of the TANESCO long-term receivable resulted in a significant loss for the year. The Company finished 2014 in a strong financial position with US\$34 million in working capital and no debt.

## RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED STATEMENTS

Orca has restated its consolidated statements of financial position as at 31 December 2013 and 1 January 2013; and its consolidated statement of comprehensive loss, consolidated statement of cash flows and consolidated statement of changes in shareholders' equity for the year ended 31 December 2013.

In the course of preparing the Company's consolidated financial statements for the year ended 31 December 2014, errors were discovered involving the computation of Tanzania income tax from 2005 through and to 30 September 2014. In addition, the Company is correcting reported finance income and finance costs previously recognized on overdue trade receivables for 2013 and 2014. The restatement adjustments are described in the paragraphs following the tables below.

The following tables present the impact of the restatement adjustments on the Company's previously reported consolidated financial statements as at and for the year ended 31 December 2013, as well as the impacts on the consolidated statement of financial position as at 1 January 2013. The "Restated" columns for 2013 reflect final adjusted balances after the restatement.

### EFFECT ON CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS

	YEAR ENDED 31 DECEMBER 2013		
<i>(US\$000s except per share amounts)</i>	<b>As reported</b>	<b>Adjustment</b>	<b>Restated</b>
<b>REVENUE</b>	54,718	(1,236)	53,482
<b>Expenses</b>			
Production and distribution expenses	(4,426)	–	(4,426)
Depletion expense	(12,166)	–	(12,166)
	38,126	(1,236)	36,890
General and administrative expenses	(15,428)	(735)	(16,163)
Exploration asset impairment	(158)	–	(158)
Net finance costs	(26,262)	309	(25,953)
<b>Loss before tax</b>	(3,722)	(1,662)	(5,384)
Income tax expense	(1,743)	(513)	(2,256)
<b>Net loss</b>	(5,465)	(2,175)	(7,640)
Foreign currency translation loss from foreign operations	(392)	–	(392)
<b>Comprehensive loss</b>	(5,857)	(2,175)	(8,032)
<b>Loss profit after tax per share</b>			
Basic and diluted	(0.16)	(0.06)	(0.22)
<b>Weighted average shares outstanding (millions)</b>			
Basic and diluted	34.7	–	34.7

## EFFECT ON CONSOLIDATED STATEMENT OF FINANCIAL POSITION

US\$'000	AS AT 31 DECEMBER 2013			AS AT 1 JANUARY 2013		
	As reported	Adjustment	Restated	As reported	Adjustment	Restated
<b>ASSETS</b>						
<b>Current Assets</b>						
Cash	32,588	–	32,588	16,047	–	16,047
Trade and other receivables	37,215	2,636	39,851	73,495	–	73,495
Tax recoverable	14,585	(3,719)	10,866	14,692	(2,483)	12,209
Prepayments	281	–	281	246	–	246
	84,669	(1,083)	83,586	104,480	(2,483)	101,997
<b>Non-Current Assets</b>						
Long-term trade receivable	29,911	(2,636)	27,275	–	–	–
Exploration and evaluation assets	5,564	–	5,564	5,720	–	5,720
Property, plant and equipment	90,832	–	90,832	102,044	–	102,044
	126,307	(2,636)	123,671	107,764	–	107,764
<b>Total Assets</b>	<b>210,976</b>	<b>(3,719)</b>	<b>207,257</b>	<b>212,244</b>	<b>(2,483)</b>	<b>209,761</b>
<b>EQUITY AND LIABILITIES</b>						
<b>Current Liabilities</b>						
Trade and other payables	53,296	857	54,153	45,496	1,166	46,662
Bank loan	1,659	–	1,659	5,842	–	5,842
Tax payable	1,958	4,959	6,917	6,322	1,385	7,707
	56,913	5,816	62,729	57,660	2,551	60,211
<b>Non-Current Liabilities</b>						
Deferred income taxes	12,132	(4,063)	8,069	20,399	(1,737)	18,662
Deferred Additional Profits Tax	21,679	–	21,679	8,250	–	8,250
	33,811	(4,063)	29,748	28,649	(1,737)	26,912
<b>Total Liabilities</b>	<b>90,724</b>	<b>1,753</b>	<b>92,477</b>	<b>86,309</b>	<b>814</b>	<b>87,123</b>
<b>Equity</b>						
Capital stock	85,428	–	85,428	84,983	–	84,983
Contributed surplus	6,482	–	6,482	6,753	–	6,753
Accumulated other comprehensive income/(loss)	(303)	–	(303)	89	–	89
Accumulated income	28,645	(5,472)	23,173	34,110	(3,297)	30,813
	120,252	(5,472)	114,780	125,935	(3,297)	122,638
<b>Total Equity and Liabilities</b>	<b>210,976</b>	<b>(3,719)</b>	<b>207,257</b>	<b>212,244</b>	<b>(2,483)</b>	<b>209,761</b>

## EFFECT ON CONSOLIDATED STATEMENT OF CASH FLOWS

US\$'000	YEAR ENDED 31 DECEMBER 2013		
	As reported	Adjustment	Restated
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
<b>Net loss</b>	(5,465)	(2,175)	(7,640)
Adjustment for:			
Depletion and depreciation	12,498	–	12,498
Exploration asset impairment	158	–	158
Provision for doubtful debt / Discount on long-term receivable	27,604	(2,636)	24,968
Stock-based compensation	(209)	–	(209)
Deferred income taxes	(8,267)	(2,326)	(10,593)
Deferred Additional Profits Tax	13,429	–	13,429
Interest expense	678	–	678
Unrealised loss/(gain) on foreign exchange	(586)	(309)	(895)
<b>Funds flow from operating activities</b>	<b>39,840</b>	<b>(7,446)</b>	<b>32,394</b>
Decrease in trade and other receivables	25,845	–	25,845
Decrease in tax receivable	107	1,236	1,343
Increase in prepayments	(35)	–	(35)
Increase in trade and other payables	8,082	–	8,082
(Decrease)/increase in taxation payable	(4,364)	3,574	(790)
(Decrease)/increase in long term receivable	(46,984)	2,636	(44,348)
<b>Net cash flows from operating activities</b>	<b>22,491</b>	<b>–</b>	<b>22,491</b>
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>			
Exploration and evaluation expenditures	(2)	–	(2)
Property, plant and equipment expenditures	(1,286)	–	(1,286)
<b>Net cash used in investing activities</b>	<b>(1,288)</b>	<b>–</b>	<b>(1,288)</b>
<b>CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES</b>			
Bank loan proceeds	4,000	–	4,000
Bank loan repayments	(8,183)	–	(8,183)
Interest paid	(678)	–	(678)
Proceeds from exercise of options	174	–	174
<b>Net cash flow used in financing activities</b>	<b>(4,687)</b>	<b>–</b>	<b>(4,687)</b>
Increase in cash	16,516	–	16,516
Cash at the beginning of the year	16,047	–	16,047
Effect of change in foreign exchange on cash on hand	25	–	25
<b>Cash at the end of the year</b>	<b>32,588</b>	<b>–</b>	<b>32,588</b>

## EFFECT ON ACCUMULATED INCOME

US\$'000	YEAR ENDED 31 DECEMBER 2013		
	As reported	Adjustment	Restated
<b>ACCUMULATED INCOME</b>			
Balance, beginning of year	34,110	(3,297)	30,813
Net loss	(5,465)	(2,175)	(7,640)
Balance, end of year	28,645	(5,472)	23,173

**Net changes to prior periods**

The following is a description of the matters corrected in the restatement adjustments.

**Incorrect computation of Tanzania income tax**

The Songo Songo PSA, which governs substantially all of the Company's business in Tanzania, provides a mechanism to keep the Company whole for income taxes paid in Tanzania. Pursuant to the PSA, the Company is reimbursed for all income tax payable on income derived from Petroleum Operations (as defined) by way of an "adjustment factor", under which the Company is allocated additional Profit Gas of a value equal to the taxes paid/payable, thus reducing the allocation to the Company's partner in the field, the TPDC. The adjustment factor is determined by grossing up tax payable on the current year's profit, to the level necessary for the Company to remain neutral in the payment of income tax.

Computation of the adjustment factor, over a number of years, incorrectly included tax paid in respect of prior years taxes in the gross up calculation. The net effect of which was to overstate reported revenue, deferred tax expense, net loss and funds flow from operating activities, as well as tax recoverable and deferred income taxes payable.

In Tanzania, taxpayers are required to pay at least 80% of the estimated year's taxes in four quarterly instalments during the year, with a final tax payment for the balance owing to be made in the following year after completion of the financial statements. The PSA requires that taxable income for any year include the tax paid in respect of the previous year. The calculation of taxable income for any given year incorrectly included only the final payment for the previous year, rather than the sum of all of the five payments. This resulted in the understatement of taxable income.

The combined effect of these errors was an understatement of taxable income and a cumulative underpayment of tax from 2005 to 31 December 2013 of US\$3.5 million, which the Company has reported and paid. The Tanzania Revenue Authority has the right to assess penalties and interest on overdue taxes, which if assessed could be up to US\$1.6 million and would not be recoverable under the PSA. An estimate of these penalties and interest has been included in the restatement reflected in the periods for which they relate.

The cumulative impact of the income tax errors, including applicable penalties and interest, as at 1 January 2013 results in a decrease in accumulated income of US\$2.5 million, a decrease in Tax recoverable from TPDC of US\$2.5 million, an increase in tax payable of US\$1.4 million, a decrease in deferred income taxes payable of US\$1.4 million.

**Elimination of Finance Income and Finance Costs relating to TANESCO receivables**

In addition, the Company is correcting reported finance income and finance costs previously recognized on overdue trade receivables for 2013 and 2014. Finance income and finance costs in the amount of \$2.6 million for the year ended 31 December 2013 are eliminated in the restatement. As the finance income was fully provided for as finance cost, there is no impact on the net loss after tax, accounts receivable or cash flows from operating activities for 2013. The Company determined that the recognition of finance income, reflecting interest on amounts overdue from TANESCO, coupled with a full provision of the same amount was in error, as collection was not probable.

**Foreign exchange**

In addition, the Company is correcting reported trade and other payables in relation to the calculation of foreign exchange on amounts due to TPDC whereby payments made to TPDC are required to be made in the currency collected for gas sales. The cumulative impact of the foreign exchange as at 1 January 2012 results in an increase in trade and other payables of US\$1.2 million, a decrease in accumulated income of US\$0.8 million and a decrease in deferred income taxes of US\$0.4 million. The cumulative impact on the 2013 consolidated financial statements results in an increase in trade and other payables of US\$0.9 million, a decrease in net finance costs of US\$0.3 million and a decrease in accumulated income of US\$1.2 million.

**Cumulative impact of combined income tax, finance income and foreign exchange errors**

The cumulative impact of the combined income tax, finance income and foreign exchange errors, including applicable penalties and interest, on the 2013 consolidated financial statements results in a decrease of revenue from US\$54.7 million to US\$53.5 million, an increase in general and administrative expenses from US\$15.4 million to US\$16.2 million, a decrease in net finance costs from US\$ 26.3 million to US\$ 26.0 million, an increase in income tax expense from US\$1.7 million to US\$2.3 million, an increase in net loss after tax from US\$5.5 million to US\$7.6 million, a decrease in tax recoverable from TPDC from US\$14.6 million to US\$10.9 million, an increase in trade and other payables from US\$ 53.3 million to US\$ 54.2 million, an increase in the tax payable from US\$2.0 million to US\$6.9 million, a decrease in deferred income taxes payable from US\$12.1 million to US\$8.1 million, and a decrease in accumulated income from US\$28.6 million to US\$23.2 million.

## OPERATING VOLUMES

The total production volume of Protected Gas and Additional Gas for the year ended 31 December 2014 was 32,770 MMcf (2013: 35,153 MMcf) or 89.8 MMcfd (2013: 96.3 MMcfd), net of approximately 0.8 MMcfd (2013: 0.4 MMcfd) consumed locally for fuel gas. The Additional Gas sales volumes for the year were 19,421 MMcf (2013: 22,435 MMcf) or average daily volumes of 53.2 MMcfd (2013: 61.5 MMcfd). This represents a decrease in average daily volumes of 13% year on year. Additional Gas sales volumes for Q4 2014 were 4,461 MMcf (Q4 2013: 5,528 MMcf) or average daily volumes of 48.5 MMcfd (Q4 2013: 60.1 MMcfd), a decrease of 19% over the prior year quarter. The reduction in Additional Gas volumes year/year and quarter/quarter are primarily the result of declining field productivity and reductions in nominations to TANESCO, marginally offset by increases in Industrial gas volumes.

The Company's sales volumes were split between the Industrial and Power sectors as follows:

	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013	2014	2013
<b>Gross sales volume (MMcf)</b>				
Industrial sector	<b>1,084</b>	1,143	<b>4,598</b>	4,478
Power sector	<b>3,377</b>	4,385	<b>14,823</b>	17,957
<i>Total volumes</i>	<b>4,461</b>	5,528	<b>19,421</b>	22,435
<b>Gross daily sales volume (MMcfd)</b>				
Industrial sector	<b>11.8</b>	12.4	<b>12.6</b>	12.3
Power sector	<b>36.7</b>	47.7	<b>40.6</b>	49.2
<i>Total daily sales volume</i>	<b>48.5</b>	60.1	<b>53.2</b>	61.5

### Industrial sector

Industrial sales volume increased by 3% to 4,598 MMcf (12.6 MMcfd) from 4,478 MMcf (12.3 MMcfd) in 2013. Consumption by a major cement producer and a glass company, two major customers accounting for about 63% of Industrial volumes, remained at the same level as that of 2013. The increase is primarily due to increased sales to non-textile Industrial customers. A 5% increase in Protected Gas consumption also reduced the Additional Gas volumes available to the cement producer partly as a result of changes in the gas supply terms in the renewed sales agreement with the customer made during the year. As part of the new sales terms, the maximum volume to be supplied at base rate was reduced thus resulted in the customer opting for maximisation of its Protected Gas allocations.

Fourth quarter Industrial sales volume decreased by 5% to 1,084 MMcf (11.8MMcfd) from 1,143 MMcf (12.4 MMcfd) in the prior year quarter. The decrease is primarily due to a decrease in gas nominations by the cement producer as a result of changes in gas supply terms in the renewed gas supply agreement that came into effect in Q3 2014 which offsetted increase in gas consumption by the glass company.

Industrial gas volumes decreased by 17% over Q3 2014 (1,304 MMcf or 14.2 MMcfd) primarily due to a decrease in gas nominations by the cement producer.

### Power sector

Power sector sales volumes decreased by 17% to 14,823 MMcf or 40.6 MMcfd, compared to 17,957 MMcf or 49.2 MMcfd in 2013 as a result of a decline in gas production of approximately 8% compared with 2013; increased availability of hydroelectricity which led to reduction in demand for natural gas-fired power, especially in the first three quarters of the year, and maintenance work at TANESCO gas fired turbines in the fourth quarter. In accordance with the PGSA, TANESCO ranks last in the priority list for supply of gas to customers. Declining gas production therefore impacts most on gas volumes supplied to TANESCO.

Power sector sales volumes decreased by 23% to 3,377 MMcf or 36.7 MMcfd, compared to 4,385 MMcf or 47.7 MMcfd in Q4 2014 as a result of a decline in gas fired power generation of 7% compared with the same period in 2013. This was the result of TANESCO shutting down a number of gas-fired turbines for maintenance during Q4 2014 and an increase in Protected Gas nominations by the cement producer following changes in the terms for supply of gas which came into effect in August 2014. Power sales volumes were down 14% over Q3 2014 (3,935 MMcf or 42.8 MMcfd) principally as a result of declining gas production, but exacerbated by maintenance work at TANESCO's gas-fired turbines and increased Protected Gas nominations by a cement producer, which reduced Additional Gas volumes available for supply.

## SONGO SONGO DELIVERABILITY

As at 31 December 2014, the Company had a field productive capacity of approximately 89 MMcfd, with the expansion of production volumes limited to 102 MMcfd by the available Songas infrastructure. Production wells SS-3, SS-5 and SS-9 remain suspended pending workovers. SS-4 continues to be monitored and may have to be suspended in the future.

There remains no redundant productive capacity until additional wells can be drilled in the field, or existing wells can be worked over or until refrigeration and compression facilities are installed. A loss or material reduction in the production of any given well will have a material adverse effect on the total production and funds flow from operations of the Company.

Significant additional capital expenditure will be required to enable the Songo Songo field to produce 190 MMcfd in line with the anticipated infrastructure expansion plans of the local government authorities. There are no contractual commitments either in the PSA or otherwise agreed for capital expenditure at Songo Songo. Any significant additional capital expenditure by the Company in Tanzania is discretionary and dependent on, among other things; (i) agreeing commercial terms with TPDC or other buyers regarding the sale of incremental gas volumes from Songo Songo; (ii) TANESCO receivables being brought up to date, guaranteed or other arrangements for payment satisfactory to the Company, (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any contracts with Government entities; and (iv) the arrangement of finance with the International Finance Corporation ("IFC") or other lenders.



Despite stalled efforts to reach agreement on commercial terms for production expansion to the NNGIP, the Company advanced work on Songo Songo development. Provided TANESCO maintains its weekly payments for current deliveries of gas, with any additional amounts to pay down arrears, and subject to financing, the Company intends to proceed with the first phase workover and drilling programme commencing mid-2015. The first US\$120 million of total Phase I spending of US\$150 million is intended to maintain deliverability and provide sufficient capacity to fill the existing 102 MMcfd Songas infrastructure until the Company can secure commercial terms for additional gas sales to the NNGIP. See "Contractual Obligations and Committed Capital Investment".

## COMMODITY PRICES

The commodity prices achieved in the different sectors during the year are shown in the table below:

US\$/mcf	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013	2014	2013
<b>Average sales price</b>				
Industrial sector	<b>8.24</b>	8.38	<b>8.61</b>	8.27
Power sector	<b>3.49</b>	3.68	<b>3.56</b>	3.76
Weighted average price	<b>4.64</b>	4.66	<b>4.76</b>	4.66

(1) In Q4 the Company recognized income of US\$0.9 million (2014 US\$4.2 million) deferred under a take-or-pay provision in an Industrial contract. Under the contract the customer has three years in which to utilise the deferred income, after which it is released to revenue. These amounts have been deducted from revenue in calculating the average sales prices achieved.

### Industrial sector

The average gas price achieved during the year was US\$8.61/mcf up 4% from (2013: US\$8.27/mcf). This is a consequence of (i) an annual price indexation for Industrial customers other than the cement producer, (ii) a change in the terms under which gas is supplied to the cement producer in Q3 2014, under which the gas price for the base volume increased by 28%, and (iii) a change in sales mix.

The average Industrial gas price for the fourth quarter was US\$8.24/mcf down 2% from Q4 2013 (US\$8.38/mcf) and down 7% from Q3 2014 (US\$8.85/mcf). The decrease over the same period for the prior year is the result of a 17% decrease in heavy fuel oil ("HFO") prices which offset annual price indexation applied in January each year and change in gas supply terms to the cement producer in which decrease in nominations in Q4 2014 resulted in reduced gas volume sold at premium prices. The decrease in Industrial prices from Q3 2014 to Q4 2014 is a result of a change in sales mix and a 16% decrease in HFO prices. Gas price floors and ceilings incorporated into Industrial gas sales agreements mitigated the effect of decreases in HFO prices both for the year and for the quarter.

### Power sector

The average sales price to the Power sector was US\$3.56/mcf for the year (2013: US\$ 3.76 /mcf). The 5% decrease is due to annual indexation of the base price in July, offset by the impact of a decrease in gas sales volumes sold at higher marginal prices under the ARGA, which is not in full force and effect, and the Portfolio Gas Supply Agreement ("PGSA"). As at the date of this report, the ARGA remains an initialled agreement only; however, the parties thereto, in certain respects, are conducting themselves as though the ARGA is in full force and effect.

The average sales price to the Power sector in the fourth quarter was US\$3.49/mcf, down 5% compared with US\$3.68/mcf in Q4 2013, and down 3% compared to the Q3 2014 price of US\$3.60/mcf. The decreases are the result of reduced sales volumes, which in turn reduced the volumes subject to premium pricing in accordance with the PGSA and which offset the impact of the annual price indexation which was applied in July. Higher volumes in both prior comparative periods, Q4 2013 and Q3 2014, resulted in a larger proportion being sold at a higher price, in accordance with the PGSA.

## OPERATING REVENUE

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

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

The Additional Gas sales volumes for 2013 and the first nine months of 2014 were in excess of 50 MMcfd entitling the Company to a 55% share of Profit Gas revenue (net of Cost Gas recoveries from revenue). In Q4 2014, Additional Gas sales volumes fell to 48.5 MMcfd and as a result, the Company's share of Profit Gas revenue fell to 40%. See "Principal Terms of the Tanzanian PSA and Related Agreements."

The Company's share of revenue for the year includes an adjustment to the Cost Pool (as defined herein) in respect of downstream costs incurred in prior years and a further adjustment relating to non-recoverable items agreed by the Company in the course of settling the TPDC Cost Pool audit of 2002 to 2009. See "Cost Pool Adjustments".

The Company was allocated a total of 63% of Net Revenue in 2014 (2013: 61%), before taking into account the Cost Pool adjustment as follows:

US\$'000	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013 – restated	2014	2013 – restated
Gross sales revenue	21,601	25,754	96,566	104,474
Gross tariff for processing plant and pipeline infrastructure	(3,153)	(3,854)	(13,674)	(16,138)
Gross revenue after tariff ("Net Revenues")	18,448	21,900	82,892	88,336
<i>Analysed as to:</i>				
Company Cost Gas	3,231	2,040	12,223	10,231
Company Profit Gas	6,902	12,533	37,402	43,624
Cost Pool adjustment	–	–	2,994	–
Company operating revenue	10,133	14,573	52,619	53,855
TPDC share of revenue	8,315	7,327	30,273	34,481
	<b>18,448</b>	21,900	<b>82,892</b>	88,336

The Company's total revenues for the quarter, and the year ended 31 December 2014, amounted to US\$9,645 and US\$56,607 respectively, after adjusting the Company's operating revenues of US\$10,133 and US\$52,619 by:

- i) subtracting US\$941 for income tax for the quarter, and adding US\$11,268 for the year. 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%; and,
- ii) subtracting US\$1,429 and US\$7,280 for deferred Additional Profits Tax charged in the quarter and for the year – this tax is considered a royalty and is presented as a reduction in revenue. The APT charge for the year includes a reduction in APT of US\$936 resulting from the recovery of downstream costs previously and temporarily excluded from the cost recoverable pool. See note on Cost Pool adjustments below.

Revenue presented on the *Consolidated Statement of Comprehensive Loss* may be reconciled to the operating revenue as follows:

US\$'000	QUARTER ENDED		YEAR ENDED	
	December 2014	December 2013 restated	December 2014	December 2013 restated
Industrial sector	9,825	9,578	43,763	37,040
Power sector	11,776	16,176	52,803	67,434
<b>Gross sales revenue</b>	<b>21,601</b>	25,754	<b>96,566</b>	104,474
Processing and transportation tariff	(3,153)	(3,854)	(13,674)	(16,138)
TPDC share of revenue	(8,315)	(7,327)	(30,273)	(34,481)
<b>Company operating revenue</b>	<b>10,133</b>	14,573	<b>52,619</b>	53,855
Additional Profits Tax charge	(1,429)	(3,025)	(7,280)	(13,429)
Current income tax adjustment	941	3,281	11,268	13,056
<b>Revenue</b>	<b>9,645</b>	14,829	<b>56,607</b>	53,482

Company operating revenue decreased 30% in the fourth quarter of 2014 compared with Q4 2013. The decrease is the result of several factors. A 19% decrease in sales volumes resulted in average daily volumes for Q4 dropping below 50MMcfd which, in line with the PSA, led to a reduction in the Company's share of Profit Gas from 55% to 40%. The reduction in volumes was partially offset by US\$0.7 million of deferred income giving a net 17% drop in gross sales revenue. The increase in TPDC's share of revenue was almost entirely offset by a fall in the tariff.

The APT charge for Q4 2014 decreased by 53% compared to Q4 2013; the result of a 45% drop in the Company's share of Profit Gas and a decrease in the effective rate of APT to 20.7% (Q3 2013: 24.4%) following updated reserves data.

The current income tax adjustment includes a prior year reduction and a reduction in the credit for the first nine months of 2014 resulting from identification of an error in the mechanism for recovery of tax. This has been adjusted to reflect the prior period impacts.

Company operating revenue for the year ended 31 December 2014 is down 2%, the result of a number factors, namely a reduction of 13% in sales volumes offset by a 2% increase in the weighted average sales price, a US\$4.0 million credit from deferred income, a US\$2.5 million reduction in tariffs due to reduced production and a credit of the US\$3.0 million resulting from the Cost Pool adjustment in Q2 2014.

A reduction of US\$6.1 million or 46% in the APT charge for the year is the result of a reduction in the effective rate from 31.1% to 21.9% and a US\$0.9 million credit attributable to the Cost Pool adjustment.

## 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 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 there has been 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 as 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 year to 31 December 2014, of adjusting the Cost Pool. The net amount was recovered from TPDC's share of revenue in the second quarter as follows:

<i>US\$'000</i>	<b>YEAR ENDED 31 DECEMBER 2014</b>
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	<u>2,994</u>

## PROCESSING AND TRANSPORTATION TARIFF

The Company effectively pays a 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 regulated tariff of US\$0.59/mcf payable to Songas. The charge for the quarter and for the year were US\$3.2 million (Q4 2013: US\$3.9 million) and US\$13.7 million (2013: US\$16.1 million) respectively. Reductions in the tariff for the year and the quarter are a result of lower volumes over the periods.

## PRODUCTION AND DISTRIBUTION EXPENSES

Well maintenance costs are allocated between Protected Gas and Additional Gas in proportion to their respective sales during the period. The total cost of maintenance for the quarter was US\$500 (Q4 2013: US\$439) and for the year, US\$1,193 (2013: US\$863). For the quarter and for the year the amounts allocated for Additional Gas were US\$277 (Q4 2013: US\$272) and US\$796 (2013: US\$546) respectively. The increase in the year is the result of focusing on engineering and planning in respect of well workovers.

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

Distribution costs represent the direct cost of maintaining the ring main distribution pipeline and pressure reduction station (security, insurance and personnel). Ring main distribution costs were US\$603 (Q4 2013: US\$315) in the quarter and US\$2,323 (2013: US\$1,406) for the year. The increase in maintenance costs is due to pigging operations, for which the Company procured substantial additional spares, and had to carry out repairs on one of its pressure reduction stations. In addition, meter testing led to the replacement of four customer meters. These production and distribution costs are summarized in the table below:

	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013	2014	2013
Share of well maintenance	277	272	796	546
Other field and operating costs	788	1,275	2,374	2,474
	<b>1,065</b>	1,547	<b>3,170</b>	3,020
Ringmain distribution costs	603	315	2,323	1,406
<b>Production and distribution expenses</b>	<b>1,668</b>	1,862	<b>5,493</b>	4,426

## OPERATING NETBACKS

The netback per mcf before general and administrative costs, overhead, tax and APT may be analysed as follows:

<i>US\$/mcf</i>	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013 restated	2014	2013 restated
Gas price – Industrial	8.24	8.38	8.61	8.27
Gas price – Power	3.49	3.69	3.56	3.76
<b>Weighted average price for gas</b>	<b>4.64</b>	4.66	<b>4.76</b>	4.66
Tariff	(0.71)	(0.70)	(0.70)	(0.72)
TPDC share of revenue	(1.86)	(1.33)	(1.56)	(1.54)
<b>Net selling price</b>	<b>2.07</b>	2.63	<b>2.50</b>	2.40
Well maintenance and other operating costs	(0.24)	(0.28)	(0.16)	(0.14)
Distribution costs	(0.14)	(0.06)	(0.12)	(0.06)
<b>Operating netback</b>	<b>1.69</b>	2.29	<b>2.22</b>	2.20

The operating netback for the quarter decreased by 26% from US\$2.29/mcf in Q4 2013 to US\$1.69/mcf in Q4 2014; this was the result of several factors. Lower Power sales volumes led to a reduction in sales at premium prices and a 12% drop in the average price, largely offsetting the effect of indexation in July and the effect of a 5% increase in the weighted average Industrial gas price. The 3% increase in the TPDC share of revenue on a unit basis is a direct result of the lower sales volume.

The operating netback for the year increased 1% to US\$2.22/mcf from US\$2.20/mcf in 2013. Overall sales volumes dropped 13%, however the weighted average price for the year rose 2%. On a per Mcf basis TPDC's share of revenue rose 1%; this is the net of a reduction to recover downstream costs in Q2 which accounted for US\$0.20/mcf offset by a higher TPDC share resulting from reduced production. The increased netback resulting from the change in price and sales mix was offset by increases in field operating and distribution costs.

## GENERAL AND ADMINISTRATIVE EXPENSES

Administrative expenses ("G&A") may be analysed as follows:

US\$'000	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013 restated	2014	2013 restated
Employee & related costs	2,618	2,281	7,115	7,399
Stock based compensation	(1,101)	82	3,482	(209)
Office costs	1,060	1,812	3,660	4,635
Marketing & business development costs	(25)	38	41	773
Reporting, regulatory & corporate	466	930	3,346	2,830
Tax penalties	195	182	270	735
<b>General and administrative expenses</b>	<b>3,213</b>	<b>5,325</b>	<b>17,914</b>	<b>16,163</b>

G&A includes the costs of running the natural gas distribution business in Tanzania which is recoverable as Cost Gas and which is relatively fixed in nature. The increase in reporting, regulatory and corporate expenses is primarily the result of additional legal costs associated with the various contractual and dispute resolution matters which are ongoing. The prior period error in computing taxes resulted in the Company underpaying income tax of US\$3.5 million. The Company is liable for penalties and interest for late payment and whilst the Company has requested the tax authority to exercise its statutory authority to waive same, management has recognised a provision of US\$1.5 million in the G&A expenses across the years affected by the restatement. Excluding stock based compensation and the tax penalty, G&A averaged US\$1.1 million (Q4 2013: US\$1.8 million) per month during the quarter and US\$1.5 million (2013: US\$1.3 million) per month over the year.

## STOCK BASED COMPENSATION

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

US\$'000	QUARTER ENDED		YEAR ENDED	
	December 2014	December 2013	December 2014	December 2013
Stock appreciation rights	(537)	82	1,369	(209)
Restricted stock units	(564)	–	2,113	–
<b>Stock-based compensation</b>	<b>(1,101)</b>	<b>82</b>	<b>3,482</b>	<b>(209)</b>

400,000 stock options were outstanding as at 31 December 2014 compared to 1,742,400 at the end of 2013.

No options were granted during the quarter (Q4 2013: nil).

2,910,000 stock appreciation rights ("SARs") were outstanding as at 31 December 2014 compared to 1,030,000 as at 31 December 2013. 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.

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 52.4% to 60.7%; 0% dividend yield; 0% forfeiture; and a closing price of CDN\$2.90 per Class B share.

As at 31 December 2014, a total accrued liability of US\$3.4 million (2013: US\$0.4 million) has been recognised in relation to SARS and RSUs. The Company recognised a credit of US\$1.0 million (Q4 2013: expense US\$0.1 million) for the quarter and for the year ended 31 December 2014 an expense of US\$3.5 million (2013: credit US\$0.2 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.

## NET FINANCE COSTS

The movement in net financing costs is summarized in the table below:

US\$'000	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013 restated	2014	2013 restated
Interest charged on overdue trade receivables	12	(86)	98	–
Gain on disposal of motor vehicle	–	10	–	10
Finance income	12	(76)	98	10
Interest expense	–	(92)	(24)	(678)
Net foreign exchange gain/(loss)	(4,814)	596	(4,437)	(317)
Provision for doubtful debts / Discount on long-term receivable	(35,127)	(7,937)	(37,047)	(24,968)
Finance costs	(39,941)	(7,433)	(41,508)	(25,963)
Net finance income/(expense)	(39,929)	(7,509)	(41,410)	(25,953)

The decrease in interest expense is the result of repaying the bank loan in full by the end of February 2014.

The foreign exchange gain/loss reflects the impact of movements in the value of the Tanzanian Shilling against the US Dollar during the period on outstanding customer/supplier balances and bank accounts in Tanzanian Shillings.

### TANESCO

At 31 December 2014, TANESCO owed the Company US\$59.8 million excluding interest (of which arrears were US\$52.2 million) compared to US\$54.0 million (including arrears of US\$44.3 million) as at 31 December 2013. During the year, the Company received a total of US\$46.7 million (2013: US\$49.6 million) from TANESCO against sales totaling US\$54.7 million (2013: US\$72.9 million). Current TANESCO receivables as at 31 December 2014 amounted to US\$7.7 million (2013 US\$9.6 million). Since the year-end, TANESCO has paid the Company US\$18.7 million in 2015, and as at the date of this report the total TANESCO receivable is US\$52.9 million (of which US\$52.2 million has been provided for). The amounts owed do not include interest billed to TANESCO.

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 estimated that if these payments continued they would result in approximately US\$1.5 million per month credited against arrears. During Q4 2014 TANESCO made only one payment, although subsequent to the year-end TANESCO resumed weekly payments and as of the date of this report the Company has received US\$18.7 million in 2015. Whilst weekly payments against current deliveries have re-commenced, there is still no set schedule or repayment plan for TANESCO arrears and payments continue to be irregular and unpredictable. As a result, there is significant doubt about TANESCO's ability and/or willingness to settle arrears.

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 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. In April 2014 and again in May, TANESCO advised the Company of its intention to make weekly payments of TZS 3.0 billion (approximately US\$1.8 million) to the Company against ongoing deliveries of gas as well as continue to seek third-party financing to

repay the balance of arrears. TANESCO has confirmed the understanding reached between the parties in Q2 2013 that payments would be applied firstly to pay for the current gas deliveries, and that remaining amounts, if any, would be applied to the accumulated arrears.

At 31 December 2014, Company has re-assessed the TANESCO arrears in light of (i) the discontinuance of weekly payments during Q4 2014; (ii) the fact that TANESCO did not pay down substantially all of the arrears by year-end pursuant to a formal commitment made earlier during the year which was tied to Government receipt of World Bank funding; (iii) the lack of a definitive plan to repay arrears in light of (ii) above; and (iv) the absence of any evidence of the availability of external funding for TANESCO, including World Bank funding. As a result of increased uncertainty with respect to the timing and amount of ultimate collection of amounts in arrears, the Company recorded a provision for doubtful accounts against the entire long-term receivable of US\$52.2 million as at 31 December 2014. Amounts collected with respect to the long-term receivable in the future will be reflected in earnings when payment is received. Notwithstanding this provision, the Company and TANESCO continue to operate in accordance with the terms of the Portfolio Gas Supply Agreement and in accordance with the understanding between the Company and TANESCO from Q2 2013 whereby natural gas continues to be delivered by the Company and TANESCO would pay for current deliveries on a current basis with payments to be applied firstly to pay for the current deliveries and any excess amount applied to accumulated arrears. This provision against the TANESCO long-term receivable will not prejudice the Company's rights to payment in full or its ability to pursue collection in accordance with the terms of the agreement with TANESCO. Whilst the Company is unable to recognise interest revenue in accordance with International Accounting Standards 18 – Revenue, it will continue to charge TANESCO interest in accordance with the terms of the PGSA.

## TAXATION

### Income Tax

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

As at 31 December 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 under the Income Tax Act 2004. Applying the 30% Tanzanian tax rate, the Company has recognised a deferred tax liability of US\$7.6 million (31 December 2013: liability US\$8.1 million). During the quarter there was a deferred tax increase of US\$1.3 million compared with a reduction of US\$7.2 million in Q4 2013. The deferred tax has no impact on cash flow until it becomes a current income tax, at which point the tax is paid and recovered from TPDC's share of Profit Gas.



## Additional Profits Tax

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

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

The effective APT rate of 20.7% (Q4 2013: 24.4%) has been applied to Profit Gas of US\$6.9 million (Q4 2013: US\$12.5 million) for the quarter, and an average effective rate of 21.9% (2013: 30.8%) has been applied to Profit Gas of US\$37.4 million (2013: US\$43.6 million) for the year ended 31 December 2014. Accordingly, US\$1.4 million (Q4 2013: US\$3.0 million) and US\$7.3 million (2013: US\$13.4 million) has been netted off revenue for the quarter and for the year ended 31 December 2014 respectively. The year-to-date APT charge includes 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 detailed above.

<i>US\$'000</i>	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013	2014	2013
Deferred APT	<b>1,429</b>	3,025	<b>7,280</b>	13,429

## DEPLETION AND DEPRECIATION

Natural gas properties are depleted using the unit of production method based on the production for the period as a percentage of the total future production from the Songo Songo proven reserves. As at 31 December 2014 the proven reserves estimated to be produced over the term of the PSA licence, as evaluated by the independent reservoir engineers, McDaniel & Associates Consultants Ltd., were 450 Bcf (2013: 475.7 Bcf). A depletion expense of US\$3.1 million (Q4 2013: US\$3.7 million) for the quarter and US\$13.6 million for the year (2013: US\$12.2 million) has been recorded in the accounts; the increase for the year is the result of a 13% decrease in sales volumes and a 30% increase in the average depletion rate to US\$0.70/mcf (2013: US\$0.54/mcf).

Non-natural gas properties are depreciated as follows:

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

## CARRYING AMOUNT OF ASSETS

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 impaired and recorded in earnings.

## FUNDS FLOW FROM OPERATING ACTIVITIES

Funds flow from operating activities before working capital changes was US\$8.7 million for Q4 2014 (Q4 2013: US\$7.4 million) and US\$32.4 million (2013: US\$32.4 million) for the year.

US\$'000	QUARTER ENDED 31 DECEMBER		YEAR ENDED 31 DECEMBER	
	2014	2013 restated	2014	2013 restated
<b>Funds flow from operating activities</b>	<b>8,733</b>	7,412	<b>32,436</b>	32,394
Working capital adjustments <sup>(1)</sup>	<b>(10,969)</b>	(1,846)	<b>(2,679)</b>	(9,903)
<b>Cash flows from operating activities</b>	<b>(2,236)</b>	5,566	<b>29,757</b>	22,491
Cash used in investing activities	<b>(718)</b>	(136)	<b>(1,312)</b>	(1,288)
Cash from/(used in) financing activities	<b>(9)</b>	(3,157)	<b>(1,600)</b>	(4,687)
Increase in cash	<b>(2,963)</b>	2,273	<b>26,845</b>	16,516
Effect of change in foreign exchange on cash in hand	<b>(2,494)</b>	25	<b>(1,774)</b>	25
<b>Net (decrease)/increase in cash</b>	<b>(5,457)</b>	2,298	<b>25,071</b>	16,541

(1) See Consolidated Statement of Cash Flows

Operating revenues with respect to TANESCO and Songas are not fully reflected in the overall cash position as a consequence of the failure of both TANESCO and Songas to pay their invoices in full during the period.

## CAPITAL EXPENDITURE

The Company incurred US\$0.5 million in relation to engineering and planning relating to planned well workovers and subsequent drilling activities, plus a further US\$0.5 million of drilling materials for use on the planned 2015 drilling programme.

US\$'000	QUARTER ENDED		YEAR ENDED	
	December 2014	December 2013	December 2014	December 2013
Geological and geophysical and well drilling	522	(1,370)	<b>913</b>	(608)
Pipelines and infrastructure	193	548	<b>133</b>	724
Other equipment	3	958	<b>266</b>	1,172
	<b>718</b>	136	<b>1,312</b>	1,288

## WORKING CAPITAL

Working capital as at 31 December 2014 was US\$34.1 million (31 December 2013: US\$20.9 million) and may be analysed as follows:

US\$'000	YEAR ENDED 31 DECEMBER	
	2014	2013 restated
Cash	<b>57,659</b>	32,588
Trade and other receivables	<b>49,324</b>	39,851
TANESCO	7,671	9,624
Songas	23,864	11,560
Other trade debtors	7,532	10,874
Songas gas plant operations	19,300	13,280
Other receivables	773	2,408
Provision for doubtful accounts	(9,816)	(7,895)
Tax recoverable	<b>11,815</b>	10,866
Prepayments	<b>642</b>	281
	<b>119,440</b>	83,586
Trade and other payables	<b>76,747</b>	54,153
TPDC	33,409	21,501
Songas	28,871	15,355
Other trade payables	1,961	3,857
Deferred income	2,780	6,271
Accrued liabilities	9,726	7,169
Bank loan	–	1,659
Tax payable	<b>8,545</b>	6,917
<b>Working capital <sup>(1)</sup></b>	<b>34,148</b>	20,857

### Notes:

(1) Working capital as at 31 December 2014 includes a TANESCO receivable (excluding interest) of US\$7.7 million (31 December 2013: US\$9.6 million). Management has placed a doubtful debt provision against the long-term receivables in excess of 60 days totaling US\$52.2 million (31 December 2013: US\$43.3 million). The total of long- and short-term TANESCO receivables, including interest, as at 31 December 2014 was US\$64.6 million. The financial statements do not recognise the interest receivable from TANESCO as it does not meet IAS 18 income recognition criteria. The Company is however actively pursuing the collection of all the receivables and the interest that has been charged to TANESCO.

Working capital as at 31 December 2014 increased by 64% over 31 December 2013 and but fell 23% during the quarter, primarily as a result of TANESCO suspending weekly payments for gas, together with an increase in tax payable in respect of prior years. The Company did not incur any major capital expenditure during the quarter. Other significant points are:

- There are no restrictions on the movement of cash from Mauritius or Tanzania, and currently the majority of cash is outside of Tanzania. As at the date of this report, approximately 88% of the Company's cash was held outside of Tanzania.
- Since the quarter end the Company has received US\$18.7 million from TANESCO.
- Of the US\$7.5 million relating to other trade debtors US\$7.3 million had been received as at the date of this report.
- The balance of US\$33.4 million payable to TPDC represents the remaining balance of its share of revenue as at 31 December 2014.

## BANK LOAN

The loan was fully paid by February 2014. Total payments during the year ended 31 December 2014 were US\$1.7 million (2013: US\$8.2 million).

## SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

There were 34,914,932 million shares outstanding as at 31 December 2014 which may be analysed as follows:

<i>Number of shares ('000)</i>	<b>AS AT 31 DECEMBER</b>	
	<b>2014</b>	2013
<b>Shares outstanding</b>		
Class A shares	<b>1,751</b>	1,751
Class B shares	<b>33,164</b>	33,072
Class A and Class B shares outstanding	<b>34,915</b>	34,823
<b>Convertible securities</b>		
Options	<b>400</b>	1,742
Fully diluted Class A and Class B shares	<b>35,315</b>	36,565
<b>Weighted average</b>		
Class A and Class B shares	<b>34,863</b>	34,719
<b>Convertible securities</b>		
Options	–	–
<b>Weighted average diluted Class A and Class B shares</b>	<b>34,863</b>	34,719

As at 30 April 2015, there were a total of 1,750,517 Class A Common Voting Shares ("Class A shares") and 33,147,695 Class B Subordinated Voting Shares ("Class B shares") outstanding.

## RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm that provides legal advice to the Company and its subsidiaries. During the quarter, the Company incurred US\$0.1 million (Q4 2013: US\$nil) and for the year ended 31 December US\$0.2 million (2013: US\$0.1 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 (Q4 2013 US\$0.1 million) and for the year ended 31 December US\$0.6 million (2013: US\$0.6 million) to this firm for services provided. As at 31 December 2014 the Company has a total of US\$nil (2013: US\$nil) recorded in trade and other payables in relation to the related parties.

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## CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

### Protected Gas

Under the terms of the original gas agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, 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 (127.7 Bcf as at 31 December 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 ARGA. The unsigned ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and contract terms dealing with the consequences of any insufficiency are dealt with in 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. As at the date of this report, the ARGA remains an initialed agreement only, however the parties thereto, in certain respects, are conducting themselves as though the ARGA is in full force and effect.

### 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's 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 TANESCO (as the buyer) and the Company and TPDC (collectively as the seller). 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

### *Italy*

On 31 May 2010, the Company signed an agreement with Petroceltic International plc ("Petroceltic") to farm in on Petroceltic's Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US\$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay Petroceltic fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US\$0.5 million.

No activity has occurred on the Adriatic Sea block during 2014. In 2012, a new law modified restrictions on offshore oil and gas exploration and production originally introduced by DLGS 128/2010 in August 2010. The Elsa-2 appraisal well is now expected to be drilled in 2016 following finalisation of an environmental impact study. The Company will not be liable to any costs associated with the drilling of Elsa-2 until a rig contract is signed. As of the date of this report, there is no rig contract. There are no further capital commitments in Italy.

### *Songo Songo*

There are no contractual commitments for exploration or development drilling or other field development either in the PSA or otherwise agreed which would give rise to significant capital expenditure at Songo Songo. Any significant additional capital expenditure in Tanzania is discretionary and dependent on, among other things: (i) agreeing commercial terms with TPDC or other buyers regarding the sale of incremental gas volumes from Songo Songo; (ii) TANESCO receivables being brought up to date, guaranteed or other arrangements for payment satisfactory to the Company, (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any contracts with Government entities; and (iv) the arrangement of financing with the IFC or other lenders.

Significant additional capital expenditure will be required to both maintain production levels and fill the existing Songas infrastructure to 105 MMscfd capacity, as well as enable the Songo Songo field to produce 190 MMcfd in line with gas supply requirements of the NNGIP anticipated to be commissioned in 2015. In the absence of a commercial agreement with TPDC for volumes dedicated to the NNGIP, and with TANESCO maintaining its weekly payments for current gas deliveries and a small amount towards arrears, the Company intends, subject to finance, to proceed with the first phase of a discretionary workover and drilling programme to maintain deliverability and fill the existing Songas infrastructure to capacity for the life of the Songo Songo licence (2026). Phase I spending is estimated to be approximately US\$150 million, of which the first US\$120 million to be spent on offshore workovers and drilling (the "Offshore Programme") is expected to be spent over 2015 to 2017, which spending would be intended to restore field deliverability and provide sufficient natural gas production to fill the Songas plant and pipeline to capacity for the greater portion of the remaining life of the Songo Songo licence. When commercial terms are agreed with TPDC for the supply of gas to the NNGIP, and in so doing justify bringing field production to approximately 190 MMscfd, the Company would contemplate undertaking the balance of Phase I at an additional cost estimated to be approximately US\$30 million.

The Offshore Programme is estimated to be approximately US\$120 million of which the Company is seeking finance for half. There is no assurance that financing is available and on acceptable commercial terms.

## Summary of planned capital expenditure

(US\$ millions)	Tanzania – Songo Songo		Italy	Total
	Offshore Programme	Onshore Programme	Elsa <sup>(1)</sup>	
Well workovers	75.4	26.0	–	101.4
Development drilling	32.6	–	–	32.6
Exploration/appraisal drilling	–	–	12.3	12.3
Refrigeration and facilities	8.5	4.0	–	12.5
G&G/Other	3.8	–	–	3.8
Total capital spending	120.3	30.0	12.3	162.6

1) The expenditure in relation to Elsa is not discretionary after a rig contract is signed. At the date of this report no rig contract has been signed.

## 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 year 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 the related assets – see 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 working 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 along with other issues, however there were no amendments made to the PSA. 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 2014, it was assumed that TPDC will elect to 'back-in' for 20% for all future new drilling activities with-in 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 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 currently await the appointment of 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 during the year— see "Cost Pool Adjustments." 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 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\$16.9 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. If the Company is unsuccessful in its appeals against these assessments, the amounts of interest and penalties could be materially higher.

The Tax Revenue Appeals Board ("TRAB") considered the Company's appeal against a withholding tax assessment of US\$2.2 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 a strong case, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US\$7.1 million, including penalties. During the year, TRA notified the Company that TRA would not accept the objection relating to 2009 and issued a notice confirming the assessment for US\$2.3 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\$6.9 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.

During the year 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\$1.1 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.

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## NEW ACCOUNTING POLICIES

On 1 January, 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 or on the comparative periods.

IFRS 9 Financial Instruments (2014) is effective 1 January, 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 31 December 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 1 January, 2017. The Company is currently evaluating the impact that the standard will have on its results of operations and financial position.

### **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.

## SUMMARY QUARTERLY RESULTS OUTSTANDING

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

<i>(US\$'000 except where otherwise stated)</i>	2014				2013			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	restated	restated	restated	restated	restated	restated	restated	restated
<b>Financial</b>								
Revenue	9,645	14,631	18,854	13,477	14,829	14,260	11,596	12,797
Net (loss)/profit	(46,381)	4	6,137	1,939	(3,867)	1,383	(7,519)	2,363
Earnings/(loss) per share - diluted (US\$)	(1.32)	–	0.17	0.05	(0.11)	0.04	(0.20)	0.05
Funds flow from operating activities	8,733	6,641	11,651	5,411	7,412	10,131	7,449	7,402
Funds flow per share - diluted (US\$)	0.25	0.19	0.33	0.15	0.22	0.29	0.22	0.21
Operating netback (US\$/mcf)	1.69	2.12	2.92	2.03	2.29	2.26	2.10	2.15
Working capital	34,148	42,001	30,399	12,783	20,857	22,896	15,056	48,506
Shareholders' equity	76,635	123,004	123,019	116,752	114,780	118,992	117,407	125,177
<b>Capital expenditures</b>								
Geological and geophysical and well drilling	522	273	9	109	(1,370)	391	103	268
Pipeline and infrastructure	193	12	(270)	198	397	296	31	–
Other equipment	3	39	48	176	1,111	57	4	–
<b>Operating</b>								
Additional Gas sold – industrial (MMcf)	1,084	1,304	1,046	1,164	1,143	1,092	1,067	1,176
Additional Gas sold – power (MMcf)	3,377	3,935	3,503	4,008	4,385	4,959	4,250	4,363
Average price per mcf – industrial (US\$)	8.24	8.85	9.27	8.11	8.38	8.43	8.60	7.78
Average price per mcf – power (US\$)	3.49	3.60	3.65	3.52	3.68	4.10	3.63	3.55

### Prior Eight Quarters

Throughout the two-year period, TANESCO payments have been irregular and have affected cash and receivables. From no receipts in Q1 2013, through significant single payments related to World Bank and external funding in Q2 and Q4 2013, the commencement of weekly payments in Q2 and Q3 2014 and the cessation of these payments in Q4 2014, overall the TANESCO receivable built from US\$48.8 million at the end of Q1 2013 to US\$58.9 million (excluding interest) as at 31 December 2014. The financial statements do not recognise the interest receivable from TANESCO as it does not meet IAS 18 income recognition criteria. The Company is however actively pursuing the collection of interest that has been charged to TANESCO.

Working capital declined significantly in Q2 2013 over Q1 2013 commensurate with the reclassification of US\$34.9 million in TANESCO receivables as long-term and a provision of US\$7.9 million applied to reflect the timing and uncertainty of collection. The provision had a significant impact on earnings period over period, with an additional provision in Q3 2013, together with a final provision against the remainder of the TANESCO receivable during Q4 2014, all affecting earnings over the periods. With minimal capital spending over the two-year period, the Company's cash balances have overall increased. The US\$8.1 million decrease in working capital in Q1 2014 over Q4 2013 is due to a US\$12.0 million rise in the TANESCO long-term receivable with the resultant TPDC share of Profit Gas being recorded as a current liability.

Revenues over the two-year period fluctuated quarter over quarter due to overall sales volumes, changing demand for Power sector and Industrial sector volumes, which in turn reflected the average price received for natural gas in each period, and declining productive capacity at Songo Songo. Greater access to hydro power beginning in Q1 2014 served to reduce demand by TANESCO, and continued throughout much of the year. Overall Power sector sales were declining quarter over quarter during 2014, with the exception of a 13% increase in Q3, reflecting the seasonally higher demand. Maintenance at TANESCO facilities also reduced Power sector volumes during Q4 2014. Reduced sales volumes to TANESCO results in a reduction in the amount of gas which is sold at premium pricing under the PGSA. Despite the precipitous drop in global crude oil prices in mid-2014, Industrial sector gas prices, linked to landed HFO prices and subject to certain contractual floors and ceilings, have maintained.

In Q4 2014, with declining productivity of the Songo Songo field, the average Additional Gas volumes fell below 50 MMcfd to 48.5 MMcfd and accordingly the Profit Gas share fell from 55% to 40% for the first time since Q2 2011 when the additional volumes sold to TANESCO under the PGSA were brought onstream (see "Principal Terms of the Tanzanian PSA and Related Agreements"), reducing revenue, funds flow and earnings.

## SELECTED FINANCIAL INFORMATION

Selected annual financial information derived from the audited consolidated financial statements for the years ended 31 December 2012, 2013 and 2014 is set out below:

<i>Figures in US\$'000 except per share amount</i>	2014	2013 restated	2012 restated
Revenue	<b>56,607</b>	53,482	74,776
Funds flow from operating activities	<b>32,436</b>	32,394	42,081
Cash flows from operating activities	<b>29,757</b>	22,491	30,568
Net loss	<b>(38,301)</b>	(7,640)	15,032
Total assets	<b>198,492</b>	207,257	209,761
<b>(Loss)/earnings per share:</b>			
Basic and diluted	<b>(1.10)</b>	(0.22)	0.53

Revenue increased by 6% to US\$56.6 million in 2014 from US\$53.5 million in 2013. The sales volumes were 13% lower in 2014 than 2013, with the weighted average price increasing from US\$4.66/mcf to US\$4.76/mcf.

The tax payable in respect of 2014 is US\$11.9 million (2013: US\$12.8 million). Of this, US\$7.9 million (2013: US\$9.1 million) relating to the current year's profit is, in accordance with the terms of the PSA, recoverable from TPDC. Consequently revenue in 2014 has been uplifted by the gross amount of US\$11.3 million (2013: US\$13.1 million).

The level of Industrial volumes increased by 3% to 4,598 MMcf in 2014 from 4,478 MMcf in 2013, mainly as a consequence of reducing supplies of Protected Gas whilst Songas carried out maintenance on power generating turbines.

The level of Power volumes decreased by 17% to 14,823 MMcf (2013: 17,957 MMcf). The decrease in Power sales is attributable to increased demand for gas from TANESCO.

## BUSINESS RISKS

### Additional Financing

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

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

### Collectability of Receivables

The Company evaluates the collectability of its receivables on the basis of payment history, frequency and predictability, as well as Management's assessment of the customer's willingness and ability to pay. Both Songas and the Company have been impacted by TANESCO's inability to pay.

Amounts collected with respect to the long-term receivable in the future will be reflected in earnings when payment is received. Notwithstanding this provision, the Company and TANESCO continue to operate in accordance with the terms of the Portfolio Gas Supply Agreement whereby natural gas continues to be delivered by the Company and TANESCO payments remain current on current deliveries. This provision against the TANESCO net long-term receivable will not prejudice the Company's rights to payment in full or its ability to pursue collection in accordance with the terms of the agreement with TANESCO.

As at 31 December 2014, Songas owed the Company US\$43.2 million (Q4 2013: US\$24.8 million), whilst the Company owed Songas US\$30.4 million (Q4 2013: US\$16.9 million); there was no contractual right to offset these amounts. Since 31 December 2014 the Company has settled the outstanding pipeline tariff charges of US\$28.9 million and Songas has settled outstanding gas sales invoices of US\$23.9 million. US\$19.3 million (Q4 2013: US\$13.3 million) remains outstanding in respect of the gas plant operation, which should be conducted at cost and the charges are billed to Songas on a flow through basis without profit margin. Management has placed a provision of US\$9.8 million against this debt.

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

### Operating Hazards and Uninsured Risks

The business of the Company is subject to all of the operating risks normally associated with the exploration for, and the production, storage, transportation and marketing of oil and gas. These risks include blowouts, explosions, fire, gaseous leaks, downhole design and integrity, migration of harmful substances and oil spills, any of which could cause personal injury, result in damage to, or destruction of, oil and gas wells or formations or production facilities and other property, equipment and the environment, as well as interrupt operations. In addition, all of the Company'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 and tubing 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 the Company 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 the Company is increased due to the fact that the Company currently only has one producing property. The Company 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 the Company's financial condition, results of operations and cash flows.

Furthermore, the Company cannot predict whether insurance will continue to be available at a reasonable cost or at all.

## Foreign Operations

The Company's operations and related assets are located in Italy and Tanzania which may be considered to be politically and/or economically unstable. Exploration or development activities in Tanzania and Italy 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, creeping nationalization, renegotiation or nullification of existing contracts and production sharing agreements, 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 and construction 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, the Company may be subject to the exclusive jurisdiction of foreign courts.

In Tanzania the state retains ownership of the minerals and consequently retains control of, the exploration and production of hydrocarbon reserves. Accordingly, these operations may be materially affected by the Government through royalty payments, export taxes and regulations, surcharges, value added taxes, production bonuses and other charges. The Government of Tanzania issued a National Natural Gas Policy in 2013, which policy contemplates greater government control over the industry and in some areas conflicts with the Company's rights under the Songo Songo PSA. There can be no assurance that the rights of the Company under the PSA will be grandfathered with respect to any future natural gas legislation arising from this policy.

The Company's development properties and its current proved natural gas reserves located offshore on the Songo Songo Island in Tanzania, are subject to regulation and control by the government of Tanzania and certain of its national and parastatal organizations including the energy regulator, EWURA and TPDC. The Company and its predecessors have operated in Tanzania for a number of years and believe that it has had reasonably 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 the Company.

Corruption remains an issue in Tanzania, the country ranking 119 out of 175 on the Transparency International Corruption Index. At the end of 2014, there was a significant corruption scandal in Tanzania's energy sector involving a number of senior government officials, including senior officials from MEM. Having assessed the Company's exposure to corruption in Tanzania, it was concluded that the risk of the Company and/or its subsidiaries violating applicable laws prohibiting corrupt activities are mitigated or unlikely given the Company's controls relating to such risks and their effective operation. There can be no assurance, however that corruption may indirectly affect or otherwise impair the Company's ability to operate in Tanzania and effectively pursue its business plan in that country.

The Tanzania Revenue Authority ("TRA") is responsible for the collection of taxes in Tanzania. TRA is not party to the Songo Songo PSA and there is no assurance that the TRA will consider itself bound by its terms. Accordingly, there is a risk that the TRA will take interpretations of issues distinct from the PSA and result in assessments, penalties and fines which have not been contemplated by the Company and result in additional costs which are not recoverable under the PSA. The TRA has significant powers in Tanzania and is capable of causing the Company's operations in that country to cease.

The Company requires additional gas processing and transportation infrastructure to allow additional development and the ultimate monetisation of the Company's reserves through additional gas sales. In 2012, the Government of Tanzania announced a US\$1.2 billion natural gas infrastructure expansion project, the over two years of negotiations with TPDC, there has been no progress on commercial terms for the sale of incremental gas volumes and there is no assurance that the Company's gas could be processed and transported to markets on economic terms.

## PSA Negotiations

In November 2011 Parliament passed a resolution advising the Government to terminate the Company's Songo Songo PSA on the grounds of an allegation by TPDC that the Company had over recovered approximately US\$21 million in Cost Gas revenue. On the recommendation of MEM in February 2012, the Government announced that it was establishing a Government Negotiating Team ("GNT") to discuss a number of issues raised in Parliament in relation to the Company's Songo Songo PSA. In Tanzania, government negotiating teams are a common mechanism to negotiate with business. The scope of the GNT was to discuss a number of issues that were raised by the Parliamentary Committee for Energy into the workings of the PSA. This included, but is not limited to, TPDC back in rights, profit sharing arrangements, the unbundling of the downstream assets, cost recovery and the Company's management of the upstream operations. A conditional agreement in principle was reached in mid-2012 on a number of major points to resolve the issues. The GNT completed its mandate, and the responsibility for finalisation, documentation and implementation moved back to MEM. The conditional agreement in principle contemplated completion of this process by the end of 2012 as well as a number of deliverables from TPDC and the Government. As at the date of this report none of the TPDC or Government undertakings have been met and other than the alleged US\$21 million over recovery discussed below, none of the issues have been resolved.

In response to a Notice of Dispute delivered by the Company, in March 2014 TPDC retracted its claim that the Company had over-recovered approximately US\$21 million in Cost Gas, which management believes has substantially exonerated the Company of allegations made by Parliament. Accordingly, the Company continues to rely upon its rights under the existing PSA and has initiated notices of dispute to resolve any remaining issues.

## Access to Songas processing and transportation

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

As a result of the Ubungo power plant re-rating that occurred in 2011 pursuant to the Re-Rating Agreement, the capacity of the Songas gas processing plant was increased to a maximum of 110 MMcfd (restricted to 102 MMcfd because of pipeline and pressure requirements). The Re-Rating Agreement expired on 31 December 2012 and, although it was initially extended to 31 December 2013, no new agreement is currently in place. Without the Re-Rating Agreement, Songas may de-rate plant capacity to 70 MMcfd (the capacity originally agreed to), which would result in a material reduction in the Company's sales volumes of Additional Gas.

## Amended and Restated Gas Agreement

The Gas Agreement may be superseded by an initialed ARGA. The unsigned ARGAs provide clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and contract terms dealing with the consequences of any insufficiency are dealt with in 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. As at the date of this report, the ARGAs remain an initialed agreement only, however the parties thereto, in certain respects, are conducting themselves as though the ARGAs are in full force and effect. Management does not foresee at this time a material risk with the conduct of the Company's business with an unsigned ARGAs.

## Industry Conditions

The oil and gas industry is intensely competitive and the Company competes 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. Currently, the Company operates the Songo Songo natural gas property and has earned interests in two permits in Italy. 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 parastatal organisations and, as a result, the Company 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 the Company 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 the Company and Songas. The ability of the Company to market any natural gas from current or future reserves in Tanzania 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. The Company is also 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 oil and gas and many other aspects of the oil and gas business. The Company is also 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 the Company may operate. Environmental regulations place restrictions and prohibitions on emissions of various substances produced concurrently and oil and natural gas and can impact on the selection of drilling sites and facility locations, potentially resulting in increased capital expenditures.

## Additional Gas

The Company has the right under the terms of the PSA 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 the Company's ability to produce, transport and sell volumes of Additional Gas if the Company's obligations to Songas under the Gas Agreement are not met. In particular, Songas has the right in specific circumstances to request reasonable security on all Additional Gas sales.

The Government of Tanzania has issued a National Natural Gas Policy in October 2013, which policy contemplates TPDC becoming sole aggregator of natural gas in the country. This policy objective conflicts with the Company's prior right under the PSA to directly market Additional Gas, and there is a risk that this prior right will not be recognized and that the Company's ability to maximize revenue on Additional Gas sales may be impaired by a requirement at law to sell gas to TPDC as aggregator.

## Replacement of Reserves

The Company's natural gas reserves and production and, therefore, its cash flows and earnings are highly dependent upon the Company developing and increasing its current reserve base and discovering or acquiring additional reserves. Without the addition of reserves through exploration, acquisition or development activities, the Company'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, the Company'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 the Company will be able to find and develop or acquire additional reserves to replace production at commercially feasible costs.

## Asset Concentration

The Company's natural gas reserves are currently limited to one producing property, the Songo Songo field, and the productive potential from this field is limited to seven wells, of which three are currently suspended. There has been limited production from the Songo Songo field to date. There is no assurance that the Company will have sufficient deliverability through the existing wells to provide additional natural gas sales volumes, and that there may be significant capital expenditures associated with any remedial work, workovers, 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 the Company. The Company is currently producing the existing wells at maximum capacity. There will be no redundant capacity in the facility or pipeline until workovers of existing wells can be performed and /or additional wells can be drilled in the field and facilities expanded. A loss or material reduction in the production of any given well will have a material adverse effect on the total production and funds flow from operations of the Company. The Italian licences in which the Company has an interest are currently in the exploration phase of their cycle and it may be several years before the Company is able to obtain a revenue stream from these assets.

## Environmental and Other Regulations

Extensive national, state, and local environmental laws and regulations in foreign jurisdictions will affect nearly all of the Company'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 the Company will not incur substantial financial obligations in connection with environmental compliance. Significant liability could be imposed on the Company 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 the Company or non-compliance with environmental laws or regulations. Such liability could have a material adverse effect on the Company. Moreover, the Company 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 the Company for the installation and operation of systems and equipment for remedial measures, any or all of which may have a material adverse effect on the Company. As party to various licenses, the Company may have an obligation to restore producing fields to a condition acceptable to the authorities at the end of their commercial lives. The PSA does not contain abandonment obligations for the Company. In addition, the Company expects the Songo Songo field to produce well beyond the term of the current licence.

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

The Company's petroleum and natural gas operations are subject to extensive governmental legislation and regulation and increased public awareness concerning environmental protection.

In accordance with the terms of the PSA, no provision has been recognised for future decommissioning costs in Tanzania as it is forecast that there will still be commercial gas reserves when the Company relinquishes the license in 2026. The Company expects that the cost of complying with environmental legislation and regulations will increase in the future. Compliance with existing environmental legislation and regulations has not had a material effect on capital expenditures, earnings or competitive position of the Company to date. Although management believes that the Company's operations and facilities are in material compliance with such laws and regulations, future changes in these laws, regulations or interpretations thereof or the nature of its operations may require the Company to make significant additional capital expenditures to ensure compliance in the future.



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

The Company'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 the Company. Any substantial decline in the prices of oil and natural gas could have a material adverse effect on the Company 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 the Company.

No assurance can be given that oil and natural gas prices will be sustained at levels which will enable the Company to operate profitably. From time to time the Company 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.

There has been a significant increase in exploration activity in Tanzania, which has yielded world class discoveries of natural gas that could, when developed, lead to increased competition for gas markets and lower gas prices in the future.

In addition, various factors, including the availability and capacity of oil and 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 the Company's ability to market its gas production.

## **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 the Company. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from the Company's properties have been independently evaluated by McDaniel & Associates Consultants Ltd. 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, TPDC "back-in" methodology 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 the Company. Actual production and cash flows derived therefrom will vary from these evaluations, and such variations could be material.

## **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 the Company which could result in a reduction of the revenue received by the Company.

## **Acquisition Risks**

The Company intends to acquire natural gas infrastructure and possibly additional oil and gas properties. Although the Company 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, the Company 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. The Company 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 the Company's acquisitions will be successful.

### Reliance on Key Personnel

The Company is 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 the Company. The Company does not maintain key life insurance on any of its employees or officers.

### Controlling Shareholder

W David Lyons, the Company's Chairman, and Chief Executive Officer is the beneficial controlling shareholder of the Company and holds approximately 99.5% of the outstanding Class A shares and approximately 16.5% of the Class B shares. Consequently, Mr. Lyons is the beneficial holder of approximately 20.6% of the equity (20.4% fully diluted) and controls 59.4% of the total votes of the Company.

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## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In applying the Company's accounting policies, which are described in Note 4 to the Consolidated Financial Statements, management makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, vary to the actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

### i) Reserves

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 the Company. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from the Company's Exploration's properties have been evaluated by McDaniel & Associates Consultants Ltd., independent petroleum engineers. 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, TPDC "back-in" methodology 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 the Company. For the purpose of the reserves certification as at 31 December 2014 it was assumed that TPDC will 'back-in' for 20% for all future new drilling activities as determined by the current development plan and this is reflected in the Company's net reserve position.

Reserves are integral to the amount of depletion recognised.

## ii) **Carrying value of exploration and evaluation assets and property, plant and equipment**

Under the Company's accounting policy expenditures incurred on the exploration for, and evaluation of, reserves are capitalized as intangible assets. These intangible assets are then assessed for impairment on each balance sheet date to determine if circumstances suggest that the carrying amount may exceed its recoverable value. Such circumstances include but are not limited to:

- the period for which the Company has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;
- no further expenditure on exploration and evaluation is budgeted or planned;
- no reserves have been encountered;
- the evaluation of seismic data indicates that the reserves are unlikely to be of a commercial quantity;
- the quantity of hydrocarbon reserves are deemed not to be of commercially viable quantities and the entity has decided to discontinue further activities; and
- sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

An assessment for impairment involves estimates as to (i) the likely future commerciality of the asset and when such commerciality should be determined, (ii) future revenues and costs associated with the asset, and (iii) the discount rate to be applied to such revenues and costs for the purpose of deriving a recoverable value.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are grouped by concession.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. A review of each exploration license or field is carried out, at least annually, to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within property and equipment referred to as oil and natural gas interests.

Management performs impairment tests on the Company's property, plant and equipment assets if indicators of impairment are present. The assessment of impairment indicators is subjective and considers the various internal and external factors such as the financial performance of individual CGUs, market capitalization and industry trends. If impairment indicators are present an impairment test is required to be performed and the CGU is written down to its recoverable amount. Key assumptions to determine the recoverable amount relate to prices that are based on forward curves, long-term assumptions and discount rates that are risked to reflect conditions specific to individual assets.

## iii) **Fair value of stock based compensation**

All stock options issued or stock appreciation rights granted by the Company are required to be valued at their fair value. In assessing the fair value of the equity based compensation, estimates have to be made as to (i) the volatility in share price, (ii) the risk free rate of interest, and (iii) the level of forfeiture. In the case of stock options, this fair value is estimated at the date of issue and is not revalued, whereas the fair value of stock appreciation rights is recalculated at each reporting period.

## iv) **Cost Recovery**

The Company is able to recover reasonable costs incurred on the development of the Songo Songo project out of 75% of the gross revenues less processing and pipeline tariffs ("Net Revenue"). There are inherent uncertainties in estimating when costs have been recovered as these costs are subject to audit by TPDC and potential reassessment in certain circumstances after the elapse of a considerable period of time. Currently approximately US\$34 million in cost recoveries for the period 2002 to 2009 have been rejected by TPDC, which audit finding is now the subject of a Notice of Dispute by the Company.

## v) **Collectability of Receivables**

Management reviews the accounts receivable aging and payment history on a weekly basis. Accounts which are in excess of 60-days in arrears are identified as potential doubtful accounts. When sustained arrears performance is exhibited over a quarter, together with an assessment by management of the customer's willingness and ability to pay, an account is deemed "doubtful" and a provision against that account is made for the reporting period based on an assessment of that amount of arrears which are unlikely to be paid in the immediate future. Both Songas and the Company have been impacted by TANESCO's inability to pay.

Notwithstanding the previous reclassification of TANESCO arrears as a long-term receivable and the subsequent provision against same (see Note 13 – Trade and Other Receivables), the Company and TANESCO continue to operate in accordance with the terms of the PGSA and in accordance with the understanding between the Company and TANESCO whereby natural gas continues to be delivered by the Company and TANESCO would pay for current deliveries on a current basis with payments to be applied firstly to pay for the current deliveries and excess amounts applied to accumulated arrears.

Historically, TANESCO has paid outstanding quarterly balances in full subsequent to each quarter. The delays in payments from TANESCO first began in late 2011 as a result of TANESCO experiencing financial difficulties due to its dependence on high cost power generation based on liquid fuels following severe draughts in Tanzania. TANESCO's financial difficulties increased as a result being mandated by the Government under an Emergency Power Plan to provide additional power generation. Whilst the Company received assurances from the Government of Tanzania that it was arranging financing for TANESCO, the receivables continued to build to levels where it became apparent in 2013 that some time would be required for the ultimate payment of the arrears.

In Q2 2013 the Company reclassified all amounts of the TANESCO receivable in excess of 60 days in arrears as a long-term receivable. Having established a long-term receivable, the Company then estimated the discount to apply reflecting the estimated cost of the delay in timing of receipts. In parallel with the reclassification, the Company, through a series of meetings with TANESCO, reached an understanding with the state utility that the Company would continue to supply gas only if TANESCO remained current on payments for current gas deliveries, and any excess payments received over and above the current balances would be applied to the arrears balance.

In late 2013, the Company issued formal demands to TANESCO for payment, and in April 2014 issued a formal Notice of Dispute as a first step in the collection process set out in the PGSA.

In April 2014 and again in May, TANESCO advised the Company of its intention to make weekly payments of TZS 3 billion (approximately US\$1.8 million) against ongoing deliveries of gas, and undertook to obtain outside financing and pay the balance of the arrears by the end of 2014. Weekly payments substantially ceased during Q4 and TANESCO failed to clear the arrears by year-end 2014. Following certain changes to senior officials within TANESCO and the Ministry of Energy and Minerals (which has statutory oversight of TANESCO), weekly payments resumed in Q1 2015. TANESCO has confirmed its understanding with the parties that payments would be applied firstly to pay for the current gas deliveries and that remaining amounts, if any, would be applied to the accumulated arrears.

The Company has a substantial "Tax Recoverable" balance. 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. These amounts are collected by way of an offset against TPDC's share of revenue, as and when the Company pays its tax.

ORCA EXPLORATION GROUP INC.

FINANCIAL  
STATEMENTS  
& NOTES

## Management's Report to Shareholders

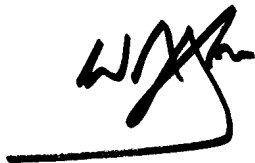
The accompanying consolidated financial statements of Orca Exploration Group Inc. are the responsibility of Management. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

The consolidated financial statements have been prepared by Management, on behalf of the Board, in accordance with the accounting policies disclosed in the notes to the consolidated financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards appropriate in the circumstances.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures and has concluded that such disclosure controls and procedures are effective.

Management maintains appropriate systems of internal controls. Policies and procedures are designed to give reasonable assurance that transactions are properly authorised, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements. An independent firm of Chartered Accountants, as appointed by the Shareholders, audited the consolidated financial statements in accordance with the Canadian Generally Accepted Auditing Standards to enable them to express an opinion on the fairness of the consolidated financial statements in accordance with International Financial Reporting Standards.

The Board of Directors carries out its responsibility for the financial reporting and internal controls of the Company principally through an Audit Committee. The committee has met with the external auditors and Management in order to determine if Management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



W. David Lyons  
Chairman and Chief Executive Officer  
6 May 2015



Robert S. Wynne  
Chief Financial Officer and Director  
6 May 2015

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# Independent Auditors' Report

## To the Shareholders of Orca Exploration Group Inc.

We have audited the accompanying consolidated financial statements of Orca Exploration Group Inc., which comprise the consolidated statements of financial position as at December 31, 2014, December 31, 2013 and January 1, 2013, the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the years ended December 31, 2014 and December 31, 2013, and notes, comprising a summary of significant accounting policies and other explanatory information.

### **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Orca Exploration Group Inc. as at December 31, 2014, December 31, 2013 and January 1, 2013 and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2014 and December 31, 2013 in accordance with International Financial Reporting Standards.

### **Comparative Information**

Without modifying our opinion, we draw attention to Note 2 to the consolidated financial statements which indicates that the comparative information presented as at and for the year ended December 31, 2013 has been restated and that the comparative information presented as at January 1, 2013 has been derived from the consolidated financial statements as at and for the year ended December 31, 2012.

*KPMG LLP*

Chartered Accountants

6 May 2015

Calgary, Canada

# Consolidated Statement of Comprehensive Loss

## ORCA EXPLORATION GROUP INC.

YEAR ENDED 31 DECEMBER

<i>US\$'000s except per share amounts</i>	NOTE	<b>2014</b>	2013 (restated - note 2)
<b>REVENUE</b>	7, 8	<b>56,607</b>	53,482
<b>Expenses</b>			
Production and distribution expenses		<b>(5,493)</b>	(4,426)
Depletion expense		<b>(13,567)</b>	(12,166)
		<b>37,547</b>	36,890
General and administrative expenses		<b>(17,914)</b>	(16,163)
Exploration asset impairment	14	<b>(5,086)</b>	(158)
Net finance costs	10	<b>(41,410)</b>	(25,953)
Loss before tax		<b>(26,863)</b>	(5,384)
Income tax	11	<b>(11,438)</b>	(2,256)
Net loss		<b>(38,301)</b>	(7,640)
Foreign currency translation gain/(loss) from foreign operations		<b>73</b>	(392)
Comprehensive loss		<b>(38,228)</b>	(8,032)
<b>Loss per share</b>			
Basic and diluted	19	<b>(1.10)</b>	(0.22)
<b>Weighted average shares outstanding (millions)</b>			
Basic and diluted	19	<b>34.9</b>	34.7

Accompanying notes to the consolidated financial statements.



# Consolidated Statement of Financial Position

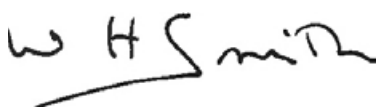
ORCA EXPLORATION GROUP INC. US\$'000	NOTE	AS AT 31 DECEMBER		AS AT 1 JANUARY
		2014	2013 (restated - note 2)	2013 (restated - note 2)
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash		57,659	32,588	16,047
Trade and other receivables	13	49,324	39,851	73,495
Tax recoverable	11	11,815	10,866	12,209
Prepayments		642	281	246
		<b>119,440</b>	83,586	101,997
<b>Non-Current Assets</b>				
Long-term trade receivable	13	634	27,275	–
Exploration and evaluation assets	14	–	5,564	5,720
Property, plant and equipment	15	78,418	90,832	102,044
		<b>79,052</b>	123,671	107,764
Total Assets		<b>198,492</b>	207,257	209,761
<b>EQUITY AND LIABILITIES</b>				
<b>Current Liabilities</b>				
Trade and other payables	16	76,747	54,153	46,662
Bank loan	17	–	1,659	5,842
Tax payable		8,545	6,917	7,707
		<b>85,292</b>	62,729	60,211
<b>Non-Current Liabilities</b>				
Deferred income taxes	11	7,606	8,069	18,662
Deferred Additional Profits Tax	12	28,959	21,679	8,250
		<b>36,565</b>	29,748	26,912
Total Liabilities		<b>121,857</b>	92,477	87,123
<b>Equity</b>				
Capital stock	18	85,637	85,428	84,983
Contributed surplus		6,356	6,482	6,753
Accumulated other comprehensive (loss)/income		(230)	(303)	89
Accumulated (loss)/income		(15,128)	23,173	30,813
		<b>76,635</b>	114,780	122,638
Total Equity and Liabilities		<b>198,492</b>	207,257	209,761

See accompanying notes to the consolidated financial statements.

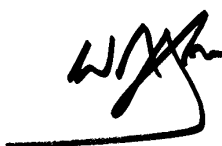
Nature of Operations (Note 1); Restatement of previously issued consolidated financial statements (Note 2);

Contractual obligations and committed capital investment (Note 21); Contingencies (Note 22).

The consolidated financial statements were approved by the Board of Directors on 6 May 2015.



Director



Director

# Consolidated Statement of Cash Flows

YEAR ENDED 31 DECEMBER

ORCA EXPLORATION GROUP INC.

US\$'000

NOTE

2014

2013  
(restated - note 2)

## OPERATING ACTIVITIES

<b>Net loss</b>		<b>(38,301)</b>	(7,640)
Adjustment for:			
Depletion and depreciation	15	<b>14,197</b>	12,498
Exploration asset impairment	14	<b>5,086</b>	158
Loss on disposal of fixtures and fittings	15	<b>7</b>	–
Provision for doubtful debt / Discount on long-term receivable	10	<b>37,047</b>	24,968
Stock-based compensation	18	<b>3,482</b>	(209)
Deferred income taxes	11	<b>(457)</b>	(10,593)
Deferred Additional Profits Tax	4, 12	<b>7,280</b>	13,429
Interest expense	10	<b>24</b>	678
Unrealised loss/(gain) on foreign exchange		<b>4,071</b>	(895)
<b>Funds flow from operating activities</b>		<b>32,436</b>	32,394
(Increase)/decrease in trade and other receivables		<b>(12,840)</b>	25,845
(Increase)/decrease in tax receivable		<b>(949)</b>	1,343
Decrease in prepayments		<b>(361)</b>	(35)
Increase/(decrease) in trade and other payables		<b>18,287</b>	8,082
Increase/(decrease) in tax payable		<b>1,624</b>	(790)
Increase/(decrease) in long-term receivable		<b>(8,440)</b>	(44,348)
<b>Cash flows from operating activities</b>		<b>29,757</b>	22,491
<b>INVESTING ACTIVITIES</b>			
Exploration and evaluation expenditures	14	<b>–</b>	(2)
Property, plant and equipment expenditures	15	<b>(1,312)</b>	(1,286)
<b>Cash used in investing activities</b>		<b>(1,312)</b>	(1,288)
<b>FINANCING ACTIVITIES</b>			
Bank loan proceeds	17	<b>–</b>	4,000
Bank loan repayments	17	<b>(1,659)</b>	(8,183)
Interest paid	10	<b>(24)</b>	(678)
Proceeds from exercise of options	18	<b>83</b>	174
<b>Cash used in financing activities</b>		<b>(1,600)</b>	(4,687)
<b>Increase in cash</b>		<b>26,845</b>	16,516
<b>Cash at the beginning of the year</b>		<b>32,588</b>	16,047
<b>Effect of change in foreign exchange on cash in hand</b>		<b>(1,774)</b>	25
<b>Cash at the end of the year</b>		<b>57,659</b>	32,588

See accompanying notes to the consolidated financial statements.



## Consolidated Statement of Changes in Shareholders' Equity

ORCA EXPLORATION GROUP INC. <i>US\$'000</i>	Capital stock	Contributed surplus	Cumulative Translation adjustment	Accumulated (loss)/income	Total
<b>Note</b>	18				
<b>Restated balance as at 1 January 2014</b>	85,428	6,482	(303)	23,173	114,780
Options exercised	209	(126)	–	–	83
Foreign currency translation adjustment on foreign operations	–	–	73	–	73
Net loss	–	–	–	(38,301)	(38,301)
<b>Balance as at 31 December 2014</b>	<b>85,637</b>	<b>6,356</b>	<b>(230)</b>	<b>(15,128)</b>	<b>76,635</b>

<i>US\$'000</i>	Capital stock	Contributed surplus	Cumulative Translation adjustment	Accumulated income (restated)	Total
<b>Balance as at 1 January 2013</b>	84,983	6,753	89	34,110	125,935
Net effect of restatement (note 2)	–	–	–	(3,297)	(3,297)
<b>Restated balance as at 1 January 2013</b>	84,983	6,753	89	30,813	122,638
Options exercised	445	(271)	–	–	174
Foreign currency translation adjustment on foreign operations	–	–	(392)	–	(392)
Net loss	–	–	–	(7,640)	(7,640)
<b>Restated balance as at 31 December 2013</b>	<b>85,428</b>	<b>6,482</b>	<b>(303)</b>	<b>23,173</b>	<b>114,780</b>

See accompanying notes to the consolidated financial statements.

# Notes to the Consolidated Financial Statements

## 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 consolidated financial statements of the Company as at and for the year ended 31 December 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 6 May 2015.

## 1

### NATURE OF OPERATIONS

The Company's principal operating asset is its interest in a Production Sharing Agreement ("PSA") with the Tanzania Petroleum Development Corporation ("TPDC") and the Government of Tanzania in the United Republic of Tanzania. This PSA covers the production and marketing of certain gas from the Songo Songo Block offshore Tanzania.

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

Songas utilizes the Protected Gas as feedstock for its gas turbine electricity generators at Ubungu, for onward sale to the Wazo Hill Cement Plant and for electrification of some villages along the pipeline route. The Company receives no revenue for the Protected Gas delivered to Songas and operates the field and gas processing plant on a 'no gain no loss' basis.

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

The Tanzania Electric Supply Company Limited ("TANESCO") is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the Ministry of Energy and Minerals ("MEM"). TANESCO is responsible for the generation, transmission and distribution of electricity throughout Tanzania. The Company currently supplies gas directly to TANESCO by way of a Portfolio Gas Supply Agreement ("PGSA") and indirectly through the supply of Protected Gas and Additional Gas to Songas which in turn generates and sells power to TANESCO. The state utility is the Company's largest customer and the gas supplied by the Company to TANESCO today fires approximately 60% of the electrical power generated in Tanzania. See Note 13 – Trade and Other Receivables.

In addition to gas supplied to Songas and TANESCO for the generation of power, the Company has developed and supplies an industrial gas market in the Dar es Salaam area consisting of some 39 industrial customers.

## 2

## RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED STATEMENTS

Orca has restated its consolidated statements of financial position as at 31 December 2013 and 1 January 2013; and its consolidated statement of comprehensive loss, consolidated statement of cash flows and consolidated statement of changes in shareholders' equity for the year ended 31 December 2013.

In the course of preparing the Company's consolidated financial statements for the year ended 31 December 2014, errors were discovered involving the computation of Tanzania income tax from 2005 through and to 30 September 2014. In addition, the Company is correcting reported finance income and finance costs previously recognized on overdue trade receivables for 2013 and 2014. The restatement adjustments are described in the paragraphs following the tables below.

The following tables present the impact of the restatement adjustments on the Company's previously reported consolidated financial statements as at and for the year ended 31 December 2013, as well as the impacts on the consolidated statement of financial position as at 1 January 2013. The "Restated" columns for 2013 reflect final adjusted balances after the restatement.

### EFFECT ON CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS

<i>(US\$000s except per share amounts)</i>	YEAR ENDED 31 DECEMBER 2013		
	As reported	Adjustment	Restated
REVENUE	54,718	(1,236)	53,482
<b>Expenses</b>			
Production and distribution expenses	(4,426)	–	(4,426)
Depletion expense	(12,166)	–	(12,166)
	38,126	(1,236)	36,890
General and administrative expenses	(15,428)	(735)	(16,163)
Exploration asset impairment	(158)	–	(158)
Net Finance costs	(26,262)	309	(25,953)
<b>Loss before tax</b>	(3,722)	(1,662)	(5,384)
Income tax	(1,743)	(513)	(2,256)
<b>Net loss</b>	(5,465)	(2,175)	(7,640)
Foreign currency translation loss from foreign operations	(392)	–	(392)
<b>Total comprehensive loss</b>	(5,857)	(2,175)	(8,032)
<b>Loss per share</b>			
Basic and diluted	(0.16)	(0.06)	(0.22)
<b>Weighted average shares outstanding (millions)</b>			
Basic and diluted	34.7	–	34.7

## EFFECT ON CONSOLIDATED STATEMENT OF FINANCIAL POSITION

US\$'000	AS AT 31 DECEMBER 2013			AS AT 1 JANUARY 2013		
	As reported	Adjustment	Restated	As reported	Adjustment	Restated
<b>ASSETS</b>						
<b>Current Assets</b>						
Cash	32,588	–	32,588	16,047	–	16,047
Trade and other receivables	37,215	2,636	39,851	73,495	–	73,495
Tax recoverable	14,585	(3,719)	10,866	14,692	(2,483)	12,209
Prepayments	281	–	281	246	–	246
	84,669	(1,083)	83,586	104,480	(2,483)	101,997
<b>Non-Current Assets</b>						
Long-term trade receivable	29,911	(2,636)	27,275	–	–	–
Exploration and evaluation assets	5,564	–	5,564	5,720	–	5,720
Property, plant and equipment	90,832	–	90,832	102,044	–	102,044
	126,307	(2,636)	123,671	107,764	–	107,764
<b>Total Assets</b>	<b>210,976</b>	<b>(3,719)</b>	<b>207,257</b>	<b>212,244</b>	<b>(2,483)</b>	<b>209,761</b>
<b>EQUITY AND LIABILITIES</b>						
<b>Current Liabilities</b>						
Trade and other payables	53,296	857	54,153	45,496	1,166	46,662
Bank loan	1,659	–	1,659	5,842	–	5,842
Tax payable	1,958	4,959	6,917	6,322	1,385	7,707
	56,913	5,816	62,729	57,660	2,551	60,211
<b>Non-Current Liabilities</b>						
Deferred income taxes	12,132	(4,063)	8,069	20,399	(1,737)	18,662
Deferred Additional Profits Tax	21,679	–	21,679	8,250	–	8,250
	33,811	(4,063)	29,748	28,649	(1,737)	26,912
<b>Total Liabilities</b>	<b>90,724</b>	<b>1,753</b>	<b>92,477</b>	<b>86,309</b>	<b>814</b>	<b>87,123</b>
<b>Equity</b>						
Capital stock	85,428	–	85,428	84,983	–	84,983
Contributed surplus	6,482	–	6,482	6,753	–	6,753
Accumulated other comprehensive income/(loss)	(303)	–	(303)	89	–	89
Accumulated income	28,645	(5,472)	23,173	34,110	(3,297)	30,813
	120,252	(5,472)	114,780	125,935	(3,297)	122,638
<b>Total Equity and Liabilities</b>	<b>210,976</b>	<b>(3,719)</b>	<b>207,257</b>	<b>212,244</b>	<b>(2,483)</b>	<b>209,761</b>

## EFFECT ON CONSOLIDATED STATEMENT OF CASH FLOWS

US\$'000	YEAR ENDED 31 DECEMBER 2013		
	As reported	Adjustment	Restated
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
<b>Net loss</b>	(5,465)	(2,175)	(7,640)
Adjustment for:			
Depletion and depreciation	12,498	–	12,498
Exploration asset impairment	158	–	158
Provision for doubtful debt / Discount on long-term receivable	27,604	(2,636)	24,968
Stock-based compensation	(209)	–	(209)
Deferred income taxes	(8,267)	(2,326)	(10,593)
Deferred Additional Profits Tax	13,429	–	13,429
Interest expense	678	–	678
Unrealised loss/(gain) on foreign exchange	(586)	(309)	(895)
<b>Funds flow from operating activities</b>	<b>39,840</b>	<b>(7,446)</b>	<b>32,394</b>
Decrease in trade and other receivables	25,845	–	25,845
Decrease in tax receivable	107	1,236	1,343
Increase in prepayments	(35)	–	(35)
Increase in trade and other payables	8,082	–	8,082
(Decrease)/increase in taxation payable	(4,364)	3,574	(790)
(Decrease)/increase in long term receivable	(46,984)	2,636	(44,348)
<b>Net cash flows from operating activities</b>	<b>22,491</b>	<b>–</b>	<b>22,491</b>
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>			
Exploration and evaluation expenditures	(2)	–	(2)
Property, plant and equipment expenditures	(1,286)	–	(1,286)
<b>Net cash used in investing activities</b>	<b>(1,288)</b>	<b>–</b>	<b>(1,288)</b>
<b>CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES</b>			
Bank loan proceeds	4,000	–	4,000
Bank loan repayments	(8,183)	–	(8,183)
Interest paid	(678)	–	(678)
Proceeds from exercise of options	174	–	174
<b>Net cash flow used in financing activities</b>	<b>(4,687)</b>	<b>–</b>	<b>(4,687)</b>
Increase in cash	16,516	–	16,516
Cash at the beginning of the year	16,047	–	16,047
Effect of change in foreign exchange on cash on hand	25	–	25
<b>Cash at the end of the year</b>	<b>32,588</b>	<b>–</b>	<b>32,588</b>

## EFFECT ON ACCUMULATED INCOME

US\$'000	YEAR ENDED 31 DECEMBER 2013		
	As reported	Adjustment	Restated
<b>ACCUMULATED INCOME</b>			
Balance, beginning of year	34,110	(3,297)	30,813
Net loss	(5,465)	(2,175)	(7,640)
Balance, end of year	28,645	(5,472)	23,173

**Net changes to prior periods**

The following is a description of the matters corrected in the restatement adjustments.

**Incorrect computation of Tanzania income tax**

The Songo Songo PSA, which governs substantially all of the Company's business in Tanzania, provides a mechanism to keep the Company whole for income taxes paid in Tanzania. Pursuant to the PSA, the Company is reimbursed for all income tax payable on income derived from Petroleum Operations (as defined) by way of an "adjustment factor", under which the Company is allocated additional Profit Gas of a value equal to the taxes paid/payable, thus reducing the allocation to the Company's partner in the field, the TPDC. The adjustment factor is determined by grossing up tax payable on the current year's profit, to the level necessary for the Company to remain neutral in the payment of income tax.

Computation of the adjustment factor, over a number of years, incorrectly included tax paid in respect of prior years taxes in the gross up calculation. The net effect of which was to overstate reported revenue, deferred tax expense, net loss and funds flow from operating activities, as well as tax recoverable and deferred income taxes payable.

In Tanzania, taxpayers are required to pay at least 80% of the estimated year's taxes in four quarterly instalments during the year, with a final tax payment for the balance owing to be made in the following year after completion of the financial statements. The PSA requires that taxable income for any year include the tax paid in respect of the previous year. The calculation of taxable income for any given year incorrectly included only the final payment for the previous year, rather than the sum of all of the five payments.. This resulted in the understatement of taxable income.

The combined effect of these errors was an understatement of taxable income and a cumulative underpayment of tax from 2005 to 31 December 2013 of US\$3.5 million, which the Company has reported and paid. The Tanzania Revenue Authority has the right to assess penalties and interest on overdue taxes, which if assessed could be up to US\$1.6 million and would not be recoverable under the PSA. An estimate of these penalties and interest has been included in the restatement reflected in the periods for which they relate.

The cumulative impact of the income tax errors, including applicable penalties and interest, as at 1 January 2013 results in a decrease in accumulated income of US\$2.5 million, a decrease in Tax recoverable from TPDC of US\$2.5 million, an increase in tax payable of US\$1.4 million, a decrease in deferred income taxes payable of US\$1.4 million.



**Elimination of Finance Income and Finance Costs relating to TANESCO receivables**

In addition, the Company is correcting reported finance income and finance costs previously recognized on overdue trade receivables for 2013 and 2014. Finance income and finance costs in the amount of \$2.6 million for the year ended 31 December 2013 are eliminated in the restatement. As the finance income was fully provided for as finance cost, there is no impact on the net loss after tax, accounts receivable or cash flows from operating activities for 2013. The Company determined that the recognition of finance income, reflecting interest on amounts overdue from TANESCO, coupled with a full provision of the same amount was in error, as collection was not probable.

**Foreign exchange**

In addition, the Company is correcting reported trade and other payables in relation to the calculation of foreign exchange on amounts due to TPDC whereby payments made to TPDC are required to be made in the currency collected for gas sales. The cumulative impact of the foreign exchange as at 1 January 2012 results in an increase in trade and other payables of US\$1.2 million, a decrease in accumulated income of US\$0.8 million and an decrease in deferred income taxes of US\$0.4 million. The cumulative impact on the 2013 consolidated financial statements results in an increase in trade and other payables of US\$0.9 million, a decrease in net finance costs of US\$0.3 million and a decrease in accumulated income of US\$1.2 million.

**Cumulative impact of combined income tax, finance income and foreign exchange errors**

The cumulative impact of the combined income tax, finance income and foreign exchange errors, including applicable penalties and interest, on the 2013 consolidated financial statements results in a decrease of revenue from US\$54.7 million to US\$53.5 million, an increase in general and administrative expenses from US\$15.4 million to US\$16.2 million, a decrease in net finance costs from US\$26.3 million to US\$26.0 million, an increase in income tax expense from US\$1.7 million to US\$2.3 million, an increase in net loss from US\$5.5 million to US\$7.6 million, a decrease in tax recoverable from TPDC from US\$14.6 million to US\$10.9 million, an increase in trade and other payables from US\$53.3 million to US\$54.2 million, an increase in the tax payable from US\$2.0 million to US\$6.9 million, a decrease in deferred income taxes payable from US\$12.1 million to US\$8.1 million, and a decrease in accumulated income from US\$28.6 million to US\$23.2 million.

## 3

## BASIS OF PREPARATION

These consolidated financial statements have been prepared on a historical cost basis and have been prepared using the accrual basis of accounting. The consolidated financial statements are presented in US dollars.

**A) Statement of Compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

**B) Basis of consolidation**

## i) Subsidiaries

The consolidated financial statements include the accounts of Orca Exploration Group Inc. and all its wholly owned subsidiaries (collectively, the "Company"). Subsidiaries are those enterprises controlled by the Company. The following companies have been consolidated within the Orca Exploration financial statements:

<b>Subsidiary</b>	<b>Registered</b>	<b>Holding</b>	<b>Functional currency</b>
Orca Exploration Group Inc.	British Virgin Islands	Parent Company	US dollar
Orca Exploration Italy Inc.	British Virgin Islands	100%	Euro
Orca Exploration Italy Onshore Inc.	British Virgin Islands	100%	Euro
PAE PanAfrican Energy Corporation	Mauritius	100%	US dollar
PanAfrican Energy Tanzania Limited	Jersey	100%	US dollar
Orca Exploration UK Services Limited	United Kingdom	100%	British Pound Sterling

## ii) Transactions eliminated upon consolidation

Inter-company balances and transactions, and any unrealised gains or losses arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

**C) Foreign currency**

## i) Foreign currency transactions

Transactions in foreign currencies are recorded at the rate of exchange prevailing at the date of the 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 recognized in the profit and loss.

## ii) Foreign currency translation

Orca Exploration Italy Inc. and Orca Exploration Italy Onshore Inc. use the Euro and Orca UK Services uses British Pound Sterling as their functional currencies. The assets and liabilities of these companies are translated into U.S. dollars at the period-end exchange rate. The income and expenses of the companies are translated into U.S. dollars at the average exchange rate for the period. Translation gains and losses are included in other comprehensive income.

**4****SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

**A) EXPLORATION AND EVALUATION ASSETS, PROPERTY, PLANT AND EQUIPMENT****i) *Exploration and evaluation assets***

Exploration and evaluation costs are capitalised as intangible assets. Intangible assets includes lease and license acquisition costs, geological and geophysical costs and other direct costs of exploration and evaluation which the directors consider to be unevaluated until reserves are appraised to be commercially viable and technologically feasible as commercial, at which time they are transferred to property, plant and equipment following an impairment review and depleted accordingly. Where properties are appraised to have no commercial value or are appraised at values less than book values, the associated costs are treated as an impairment loss in the period in which the determination is made.

**ii) *Property, plant and equipment***

Property, plant and equipment comprises the Company's tangible natural gas assets, development wells, together with leasehold improvements, computer equipment, motor vehicles and fixtures and fittings and are carried at cost, less any accumulated depletion, depreciation and accumulated impairment losses. Cost includes purchase price and construction costs for qualifying assets. Depletion of these assets commences when the assets are ready for their intended use. Only costs that are directly related to the discovery and development of specific oil and gas reserves are capitalised. The cost associated with tangible natural gas assets are amortised on a field by field unit of production method based on commercial proven reserves. The calculation of the unit of production amortisation takes into account the estimated future development cost of the field.

**iii) *Impairment of exploration and evaluation assets, property, plant and equipment***

At each balance sheet date, the Company reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets are grouped together as a cash generating unit ("CGU") for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are independent from other group assets. In the case of exploration and evaluation assets, this will normally be at the CGU level. If any such indication of impairment exists, the Company makes an estimate of its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. In assessing the value in use, the estimated future cash flows are adjusted for the risks specific to the cash generating unit and are discounted to their present value with a pre-tax discount rate that reflects the current market indicators. The fair value less costs to sell is the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. Where an impairment loss subsequently reverses, the carrying amount of the asset CGU is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the CGU in prior years. A reversal of an impairment loss is recognised as income immediately.

**B) OPERATORSHIP**

The Company operates the Songo Songo gas field, flow lines and gas processing plant. The Songas wells, flowlines and gas plant are operated by the Company on behalf of Songas on a no cost no profit basis. The cost of operating and maintaining the wells and flow lines is paid for by the Company 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 were incurred to accomplish Additional Gas sales. The cost of operating the gas processing plant and pipeline to Dar es Salaam is paid by Songas. Costs incurred by the Company in connection with the operatorship of the Songas plant are recorded as receivables, which are re-charged to Songas. Subsequent payments received from Songas are credited to receivables. When there are Additional Gas sales, a tariff is paid to Songas as compensation for using the gas processing plant and pipeline. This tariff is netted against revenue.

**C) 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) Stock options**

The stock option plan provides for the granting of stock options to directors, Company officers, key personnel and employees to acquire shares at an exercise price determined by the market value at the date of grant. The exercise price of each stock option is determined at the closing market price of the Class B shares on the day prior to the day of grant. Each stock option granted permits the holder to purchase one Class B share at the stated exercise price. The Company records a charge to the profit and loss account using the Black-Scholes fair valuation option pricing model. The valuation is dependent on a number of estimates, including the risk free interest rate, the level of stock volatility, together with an estimate of the level of forfeiture. The level of stock volatility is calculated with reference to the historic traded daily closing share price at the date of issue.

**iii) Stock appreciation rights and restricted stock units**

Stock appreciation rights ("SARs") and restricted stock units ("RSUs") are issued to certain key managers, officers, directors and employees. The fair value of SARs and RSUs is expensed in the profit and loss in accordance with the service period. The fair value of the SARs and RSUs is revalued every reporting date with the change in the value recognized in the income statement.

**D) ASSET RETIREMENT OBLIGATIONS**

No provision has been made for future site restoration costs in Tanzania because the Company currently has no legal or contractual or constructive obligation under the Songo Songo Production Sharing Agreement ("PSA") to restore the fields at the end of their commercial lives, should such occur within the term of the PSA. At such a time as the Company may be granted an extension of the term of the PSA, which encompasses the end of the field life, or other amendment to the PSA which requires the Company to do so, a provision will be made for future site restoration costs.

**E) REVENUE RECOGNITION, PRODUCTION SHARING AGREEMENTS AND ROYALTIES**

Pursuant to the terms of the PSA, the Company has exclusive rights to (i) to carry on Exploration Operations in the Songo Songo Gas Field; (ii) to carry on Development Operations in the Songo Songo Gas Field and (iii) jointly with Tanzania Petroleum Development Corporation ("TPDC"), a "parastatal entity" to sell or otherwise dispose of Additional Gas. Additional Gas is all the gas produced in excess of Protected Gas. Songas utilizes the Protected Gas (maximum 45.1 MMcfd on any given day, non-cumulative) as feedstock for its gas turbine electricity generators at Ubungo, for onward sale to the Wazo Hill cement plant and for electrification of certain villages along the pipeline route. The Company receives no revenue for the Protected Gas delivered to Songas.

The Company recognises revenue related to Additional Gas sales from the sale of gas to all customers, including both TANESCO and Songas, when title passes to the customer at fiscal gas meters which are installed at the respective customer's plant gate in Dar es Salaam. Under the terms of the PSA, the Company pays both its share and the parastatal's share of operating, administrative and capital costs. The Company recovers all reasonably incurred operating, administrative and capital costs including the parastatal's share of these costs from future revenues over several years ("Cost Gas"). 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 'Property, plant and equipment'. All recoveries are recorded as Cost Gas in the year of recovery.

The Company has a gas sales contract under which the customer is required to take, or pay for, a minimum quantity of gas. In the event that the customer has paid for gas that was not delivered, the additional income received by the Company is carried on the balance sheet as "deferred income". During the following three years, if the customer consumes volumes in excess of the minimum, it will be charged at the current rate, but may receive a credit for volumes paid but not delivered. At the end of each reporting period the Company reassesses the volumes for which the customer may receive credit, any remaining balance is credited to income.

In any given year, the Company is entitled to recover as Cost Gas up to 75% of the net revenue (gross revenue less processing and pipeline tariffs). Any net revenue in excess of the Cost Gas ("Profit Gas") is shared between the Company and TPDC in accordance with the terms of the PSA. Under the PSA the Company's share of Profit Gas is further increased by the amount necessary to fully pay and discharge any liability for taxes on income. Revenue represents the Company's share of Profit Gas and Cost Gas during the period.

Historically, TANESCO has paid outstanding quarterly balances in full subsequent to each quarter. The delays in payments from TANESCO first began in late 2011 as a result of TANESCO experiencing financial difficulties due to its dependence on high cost power generation based on liquid fuels following severe draughts in Tanzania. TANESCO's financial difficulties increased as a result being mandated by the Government under an Emergency Power Plan to provide additional power generation. Whilst the Company received assurances from the Government of Tanzania that it was arranging financing for TANESCO, the receivables continued to build to levels where it became apparent in 2013 that some time would be required for the ultimate payment of the arrears.

In Q2 2013 the Company reclassified all amounts of the TANESCO receivable in excess of 60 days in arrears as a long-term receivable. Having established a long-term receivable, the Company then estimated the discount to apply reflecting the estimated cost of the delay in timing of receipts. In parallel with the reclassification, the Company, through a series of meetings with TANESCO, reached an understanding with the state utility that the Company would continue to supply gas only if TANESCO remained current on payments for current gas deliveries, and any excess payments received over and above the current balances would be applied to the arrears balance.

In late 2013, the Company issued formal demands to TANESCO for payment, and in April 2014 issued a formal Notice of Dispute as a first step in the collection process set out in the PGSA.

In April 2014 and again in May, TANESCO advised the Company of its intention to make weekly payments of TZS 3 billion (approximately US\$1.8 million) against ongoing deliveries of gas, and undertook to obtain outside financing and pay the balance of the arrears by the end of 2014. Weekly payments substantially ceased during Q4 and TANESCO failed to clear the arrears by year-end 2014. Following certain changes to senior officials within TANESCO and the Ministry of Energy and Minerals (which has statutory oversight of TANESCO), weekly payments resumed in Q1 2015. TANESCO has confirmed the understanding between the parties that payments would be applied firstly to pay for the current gas deliveries and that remaining amounts, if any, would be applied to the accumulated arrears. There is no assurance that consistent weekly payments will be made. See Note 13 – Trade and Other Receivables.

**F) ADDITIONAL PROFITS TAX**

Under the terms of the PSA, in the event that all costs have been recovered with an annual return from the PSA of 25% plus the percentage change in the United States Industrial Goods Producer Price Index, an Additional Profits Tax ("APT") is payable to the Government of Tanzania. This tax is considered to be a royalty and is netted against revenue. Deferred APT is provided for by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of PSA license. The actual APT that will be paid is dependent on the achieved value of the Additional Gas sales and the quantum and timing of the operating costs and capital expenditure programme.

The PSA states that APT shall be calculated for each year and shall vary with the real rate of return earned by the Company on the net cash flow from the Contract Area (as defined). The calculation of APT includes a working capital adjustment reflecting the effect of the timing of actual receipt of amounts owing from TANESCO on net cash flow available to APT.

**G) INCOME TAXES**

The Company is liable for Tanzanian income tax on the profit for the year; this comprises current and deferred tax. Where current income tax is payable this is shown as a current tax liability. Deferred tax is provided using the balance sheet 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 amounts of assets and liabilities using tax rates substantively 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 asset 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.

The Company operates in a jurisdiction with complex tax laws and regulations, which are evolving over time. The Company has taken certain tax positions in its tax filings and these filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax impact may differ significantly from that estimated and recorded by management.

**H) DEPRECIATION**

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

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

**I) FINANCIAL INSTRUMENTS**

All financial instruments are initially recognized at fair value on the consolidated statement of financial position. The Company has classified each financial instrument into one of the following categories: (i) fair value through profit and loss, (ii) loans and receivables, and (iii) other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset and the net amount is reported on the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

### Initial recognition

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

**(i) Financial assets and liabilities at fair value through profit and loss:**

A financial asset or liability classified in this category is recognized at each period at fair value with gains and losses from revaluation being recognized in net income. A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

**(ii) Loans and receivables:**

Loans and receivables are initially measured at fair value plus directly attributable transaction costs and are subsequently recorded at amortized cost using the effective interest method.

Long-term receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Long-term receivables are initially recognized at fair value based on the discounted cash flows. The discount rate is based on the credit quality and term of the financial instrument. The financial instrument is subsequently valued at amortized costs by accreting the instrument over the expected life of the assets. The accretion associated with instrument valued at amortized cost is reported on the statement of comprehensive loss each reporting period. The carrying amount of the long-term receivable less discounts represents the fair value of the receivable.

The fair value of the Company's trade and other receivables approximates their carrying values due to the short-term nature of these instruments.

**(iii) Other financial liabilities:**

Trade and other payables and the bank loan are classified as other financial liabilities and are initially measured at fair value less directly attributable transaction costs and are subsequently recorded at amortized cost using the effective interest method. The fair value of the other financial liabilities approximates the carrying amounts due to the short-term nature of these instruments.

### Cash and cash equivalents

Cash and cash equivalents include cash on hand, term deposits and short term highly liquid investments with the original term to maturity of three months or less, which are convertible to known amounts of cash and which, in the opinion of management, are subject to an insignificant risk of changes in value. The fair value of cash and cash equivalents approximates their carrying amount. As at 31 December 2014 US\$37.2 million was held in Tanzania and there are no restrictions on the movement of funds out of Tanzania.

### Impairment of financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

**J) CONTRIBUTED SURPLUS**

This is used to record two types of transactions:

- (i) To recognise the fair value of equity settled stock based compensation expensed in the year.
- (ii) To account for the difference between the aggregated book value of the shares purchased under the normal course issuer bid and the actual consideration.

**K) EARNINGS OR LOSS PER SHARE ("EPS")**

Basic earnings or loss per share is calculated by dividing profit or loss after tax attributable to owners of the Company (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period. The denominator is calculated by adjusting the shares outstanding at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor.

Diluted EPS is calculated by adjusting the earnings and number of shares for the effects of all dilutive potential ordinary shares deemed to have been converted at the beginning of the period or if later, the date of issuance. The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS. All options are considered anti-dilutive when the Company is in a loss position.

**L) NEW ACCOUNTING STANDARDS AND INTERPRETATIONS****Changes in accounting policies**

On 1 January, 2014, the Company adopted the following new standards and amendments in accordance with the transition provisions of each standard, which became effective for annual periods on or after 1 January, 2014:

Amendments to IAS 36, "Impairment of Assets," the retrospective adoption of these amendments impacts the Company's disclosures in the notes to its financial statements in periods when an impairment loss or impairment reversal is recognised.

Amendments to the recognition, presentation and disclosure to pension accounting under IAS 19 "Employee Benefits". The adoption of this amendment had no impact on the Company's consolidated financial statements.

IFRIC 21, "Levies," the adoption of this standard had no impact on the amounts recorded in the Company's consolidated financial statements.

**Future accounting policies**

In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The new standard is effective for annual periods beginning on or after 1 January, 2017 with earlier adoption permitted. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on 1 January, 2017. The extent of the impact of adoption of the standard has not yet been determined.

On 24 July, 2014, the IASB issued the complete IFRS 9, "Financial Instruments" to replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 is effective for years beginning on or after 1 January, 2018. Early adoption is permitted if IFRS 9 is adopted in its entirety at the beginning of a fiscal period. The Company is currently evaluating the impact of adopting IFRS 9 on its consolidated financial statements.



## 5

## USE OF ESTIMATES AND JUDGEMENTS

In applying the Company's accounting policies, which are described in Note 4, management makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, vary to the actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

### I) RESERVES

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 the Company. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from the Company's properties have been independently evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel"), independent petroleum engineers. 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, TPDC "back-in" methodology 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 the Company. For the purpose of the reserves certification as at 31 December 2014 it was assumed that TPDC will 'back-in' for 20% for all future new drilling activities as determined by the current development plan and this is reflected in the Company's net reserve position.

Reserves are integral to the amount of depletion recognized.

### II) CARRYING VALUE OF EXPLORATION AND EVALUATION ASSETS AND PROPERTY, PLANT AND EQUIPMENT

Under the Company's accounting policy expenditures incurred on the exploration for, and evaluation of, reserves are capitalized as intangible assets. These intangibles assets are then assessed for impairment when circumstances suggest that the carrying amount may exceed its recoverable value. Such circumstances include but are not limited to:

- the period for which the Company has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;
- no further expenditure on exploration and evaluation is budgeted or planned;
- no reserves have been encountered;
- the evaluation of seismic data indicates that the reserves are unlikely to be of a commercial quantity;
- the quantity of hydrocarbon reserves are deemed not to be of commercially viable quantities and the entity has decided to discontinue further activities; and
- sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

The assessment for impairment involves estimates as to (i) the likely future commerciality of the asset and when such commerciality should be determined, (ii) future revenues and costs associated with the asset, and (iii) the discount rate to be applied to such revenues and costs for the purpose of deriving a recoverable value.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are grouped by concession.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. A review of each exploration license or field is carried out, at least annually, to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within property and equipment referred to as oil and natural gas interests.

Management performs impairment tests annually on the Company's property, plant and equipment assets and at any time when indicators of impairment are present. The assessment of impairment indicators is subjective and considers the various internal and external factors such as the financial performance of individual CGUs, market capitalization and industry trends. If impairment indicators are present an impairment test is required to be performed and the CGU is written down to its recoverable amount. Key assumptions to determine the recoverable amount relate to prices that are based on forward curves, long-term assumptions and discount rates that are risked to reflect conditions specific to individual assets.

### III) FAIR VALUE OF STOCK BASED COMPENSATION

All stock options issued or stock appreciation rights granted by the Company are required to be valued at their fair value. In assessing the fair value of the equity based compensation, estimates have to be made as to (i) the volatility in share price, (ii) the risk free rate of interest, and (iii) the level of forfeiture. In the case of stock options, this fair value is estimated at the date of issue and is not revalued, whereas the fair value of stock appreciation rights is recalculated at each reporting period.

### IV) COST RECOVERY

The Company is able to recover reasonable costs incurred on the development of the Songo Songo project out of 75% of the gross revenues less processing and pipeline tariffs ("Net Revenue"). There are inherent uncertainties in estimating when costs have been recovered as these costs are subject to government audit and in exceptional circumstances a potential reassessment after the elapse of a considerable period of time. Currently approximately US\$34 million in cost recoveries for the period 2001 to 2009 have been rejected by TPDC, which audit finding is now the subject of a Notice of Dispute by the Company.

### V) COLLECTABILITY OF RECEIVABLES

The Company evaluates the collectability of its receivables on the basis of payment history, frequency and predictability, as well as Management's assessment of the customer's willingness and ability to pay. Both Songas and the Company have been impacted by TANESCO's inability to pay.

Notwithstanding the previous reclassification of TANESCO arrears as a long-term receivable and the subsequent provision against same (see Note 13 – Trade and Other Receivables), the Company and TANESCO continue to operate in accordance with the terms of the PGSA and in accordance with the understanding between the Company and TANESCO whereby natural gas continues to be delivered by the Company and TANESCO would pay for current deliveries on a current basis with payments to be applied firstly to pay for the current deliveries and excess amounts applied to accumulated arrears.

In April and in May 2014, TANESCO advised the Company of its intention to make weekly payments of TZS 3 billion (approximately US\$1.8 million) against ongoing deliveries of gas, and undertook to obtain outside financing and pay the balance of the arrears by the end of 2014. Weekly payments substantially ceased during Q4 and TANESCO failed to clear the arrears by year-end 2014. Following certain changes to senior officials within TANESCO and MEM (which has statutory oversight of TANESCO), weekly payments resumed in Q1 2015. TANESCO has confirmed the understanding between the parties that payments would be applied firstly to pay for the current gas deliveries and that remaining amounts, if any, would be applied to the accumulated arrears. There is no assurance that consistent weekly payments will be made. See also Note 13 – Trade and Other Receivables.

## 6

## RISK MANAGEMENT

The Company, by its activities in oil and gas exploration, development and production, is exposed to the risk associated with the unpredictable nature of the financial markets as well as political risk associated with conducting operations in an emerging market. The Company seeks to manage its exposure to these risks wherever possible.

### I) FOREIGN EXCHANGE RISK

Foreign exchange risk arises when transactions and recognised assets and liabilities of the Company are denominated in a currency that is not the US dollar functional currency.

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposures to U.S. dollars. The main currencies to which the Company has an exposure are: Tanzanian shillings, British pounds sterling, Euros and Canadian dollars.

The majority of the expenditure associated with the operation of the gas distribution system is denominated in Tanzanian shillings. Whilst conversion of Tanzanian shillings into US dollars is unrestricted, the foreign exchange market for shillings is limited and not highly liquid, reducing the Company's ability to convert large amounts of shillings into US dollars at any given time. To mitigate the risk of shilling devaluation, the Company regularly converts shilling payments into US dollars to the extent practicable. The majority of the consultants' contracts are denominated in British pounds Sterling. All of the capital stock, equity financing and any associated stock based compensation are denominated in Canadian dollars. All of the operational revenue and the majority of capital expenditure are denominated in US dollars.

There are no forward exchange rate contracts in place.

A 10% increase in the US dollar against the relevant foreign currency would result in an overall increase in working capital of US\$4.3 million to US\$38.4 million and a decrease in the loss before tax to US\$22.6 million. The sensitivity includes only outstanding foreign currency denominated monetary items and adjusts their translation at period end for a 10% change in the foreign currency rates. A 10% sensitivity rate is used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonable possible change in foreign exchange rates.

The following balances are denominated in foreign currency (stated in US Dollars at period end exchange rates):

Balances as at December 31, 2014 US\$'000s	Canadian Dollars	Tanzanian Shillings	Other currencies	Total
Cash	109	28,450	5,731	34,290
Trade and other receivables	–	28,191	–	28,191
Trade and other payables	(177)	(19,285)	(138)	(19,599)
	(68)	39,579	5,594	42,882

### II) COMMODITY PRICE RISK

The Company negotiated industrial gas sales contracts with gas prices which, subject to certain floors and ceilings, are determined as a discount to the lowest cost alternative fuels in Dar es Salaam, namely Heavy Fuel Oil ("HFO") and coal. The price of HFO is exposed to the volatility in the market price of crude oil.

### III) INTEREST RATE RISK

Currently the Company has no interest rate exposures.

#### IV) CREDIT RISK

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from TANESCO and Songas. The carrying amount of accounts receivable and the long-term receivable represents the maximum credit exposure. As of December 31, 2014 and 2013, other than the provisions against the long-term TANESCO receivable and gas plant operations charges receivable from Songas, the Company does not have an allowance for doubtful accounts against any other receivables nor was it required to write-off any receivables.

All of the Company's production is currently derived in Tanzania. The sales are made to the Power sector and the Industrial sector. In relation to sales to the Power sector, the Company has a contract with Songas for the supply of gas to the Ubungo power plant and a contract with TANESCO to supply approximately 37 MMcfd in 2014 to fire 147 MW of TANESCO power generation. The contracts with Songas and TANESCO accounted for 55% of the Company's operating revenue during 2014 and US\$83.7 million of the short- and long-term receivables prior to provision at year-end. Songas itself is heavily reliant on the payment of capacity and energy charges by TANESCO for its liquidity.

TANESCO is in financial difficulty, which has resulted in irregular and inconsistent payments for gas deliveries, in addition to the provision for the entire amount of arrears due from TANESCO in the amount of US\$52.2 million as at 31 December 2014.

Current TANESCO receivables as at 31 December 2014 amounted to US\$7.7 million (Q4 2013 US\$9.6 million). Since the year-end TANESCO has paid the Company US\$18.7 million, and as at the date of this report the total TANESCO receivable is US\$52.9 million (of which US\$52.2 million is provided for).

Sales to the Industrial sector, currently 39 customers, are subject to an internal credit review to minimize the risk of non-payment. As of the date of this report, all amounts outstanding at the year-end have been collected from Industrial customers.

The Company is currently in discussions with TPDC, acting in its proposed capacity as a gas aggregator, concerning the commercial terms for the sale of gas volumes associated with a planned expansion of Songo Songo production, the conditions for which are described under V) below. The Company has no history with TPDC as a debtor. Any contract with TPDC will expose the Company to additional credit risk with a parastatal entity in Tanzania. Management intends to manage such credit exposure by securing guarantees against future payments under such contracts from the World Bank or other institutions.

The Company manages the credit exposure related to cash and cash equivalents by selecting counterparties based on credit ratings and monitoring all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

## V) LIQUIDITY RISK

Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities. Cash forecasts identifying liquidity requirements of the Company are produced on a regular basis. These are reviewed to ensure sufficient funds exist to finance the Company's current operational and investment cash flow requirements. The Company has US\$76.7 million of financial liabilities with regards to trade and other payables identified in Note 16 of which US\$69.1 million is due within one to three months, nil is due within three to six months, and US\$7.6 million is due within six to twelve months. See Note 16 – Trade and Other Payables. As at year-end the Company had a current tax liability of US\$8.5 million, which after recent payments is US\$5.4 million as at the date of this report.

At the year-end a significant proportion of the current liabilities related to Songas and TPDC, though overall transactions between the Company and Songas showed a net receivable from Songas. Since the year end Songas and the Company have settled outstanding tariff and gas sales invoices, leaving a net receivable from Songas in respect of the gas plant operations. The amounts due to TPDC represent a distribution of its share of Profit Gas; however given the difficulties in collecting from TANESCO, the Company has been settling and intends to continue to settle these amounts on a pro rata basis in accordance with amounts received from TANESCO. See Note 13 – Trade and Other Receivables.

## VI) CAPITAL RISK MANAGEMENT

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to achieve an optimal capital structure to reduce the cost of capital. The level of risk currently in Tanzania prohibits the optimisation of capital structure as many sources of traditional capital are unavailable.

## VII) COUNTRY RISK

In late 2011, there was resolution by Parliament advising the Government to terminate the Company's Songo Songo PSA on the grounds of an allegation by TPDC that the Company had over-recovered approximately US\$21 million in Cost Gas revenue. Parliament itself does not have the authority to amend or terminate PSAs in Tanzania and in February 2012 on the recommendation of MEM, the Government announced that it was establishing a Government Negotiating Team ("GNT") to discuss a number of issues raised in parliament in relation to the Company's Songo Songo PSA. This included, but is not limited to, TPDC back in rights, profit sharing arrangements, the unbundling of the downstream assets, cost recovery and the Company's management of the upstream operations. In July 2012, a conditional agreement in principle was reached on a number of major points to resolve the issues. The conditional agreement in principle contemplated completing this process by the end of 2012 as well as a number of undertakings from TPDC and the Government. As at the date of this report none of undertakings of the Government or TPDC have been met and, with the exception of the alleged US\$21 million Cost Gas over recovery discussed below, none of the issues are resolved.

In response to a Notice of Dispute delivered by the Company, in March 2014, TPDC retracted its claim that the Company had over-recovered approximately US\$21 million in Cost Gas, which in the opinion of management substantially exonerated the Company of allegations made by Parliament. Accordingly, the Company continues to rely upon its rights under the existing PSA and has initiated notices of dispute to resolve any remaining issues.

## VIII) EVOLVING REGULATORY ENVIRONMENT

The fiscal and regulatory environment for oil & gas exploration and development in Tanzania is in its infancy. Following the discovery of significant offshore natural gas resources by international exploration and development companies, there was pressure on the Government to create a clear fiscal and regulatory framework for the industry. In October 2013, the Government of Tanzania introduced a National Natural Gas Policy. The policy contemplates, among other things, a restructuring of TPDC, increasing government ownership and control over infrastructure and resources, strategic involvement in the LNG value chain, the establishment of TPDC as monopoly gas aggregator in the country, and the establishment of Government controlled natural gas prices. The policy as contemplated conflicts in a number of areas with the rights of the Company under the PSA and has the potential, if implemented by law in its current form, to materially affect the Company's business. The PSA has provisions to cause the parties to meet and agree changes in terms which would offset any changes in economic entitlement associated with a change in law.

## IX) 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.

## 7

## 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 and exploration assets in Tanzania and had exploration and appraisal interests in Italy.

US\$'000	2014			2013 restated		
	Italy	Tanzania	Total	Italy	Tanzania	Total
External Revenue	–	56,607	56,607	–	53,482	53,482
Segment loss	(6)	(38,295)	(38,301)	(676)	(6,964)	(7,640)
Non-cash charge <sup>1</sup>	–	37,047	37,047	–	24,968	24,968
Depletion & Depreciation	–	14,197	14,197	–	12,498	12,498
Exploration asset impairment	–	5,086	5,086	158	–	158
Capital Additions	–	1,312	1,312	–	1,288	1,288
Total Assets	1,931	196,561	198,492	257	207,000	207,257
Total Liabilities	272	121,585	121,857	221	92,256	92,477

(1) Non-cash charge represent amounts provided for doubtful accounts receivable from TANESCO and Songas.

## 8

## REVENUE

<i>US\$'000</i>	YEARS ENDED 31 DECEMBER	
	2014	2013 restated
Operating revenue	<b>52,619</b>	53,855
Current income tax adjustment	<b>11,268</b>	13,056
Additional Profits Tax (Note 12)	<b>(7,280)</b>	(13,429)
Revenue	<b><u>56,607</u></b>	53,482

The Company's total revenues for the year amounted to US\$56,607 after adjusting the Company's operating revenue of US\$52,619 by:

- i) adding US\$11,268 for income tax for the current year. 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 11); and
- ii) subtracting US\$7,280 for deferred Additional Profits Tax charged in the year – this tax is considered a royalty and is presented as a reduction in revenue. The APT charge for the year 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 from the PSA 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 results for the year 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 during the year.

The following table shows the impact on the Company's operating revenue for the year resulting from adjusting the cost pool. The net amount which is included in the Company's operating revenue of US\$52,619, has been recovered from TPDC's share of revenue as follows:

<i>US\$'000</i>	YEAR ENDED 31 DECEMBER
	2014
Non-recoverable costs	<b>(1,024)</b>
Recoverable costs 2011-2013	<b>7,360</b>
Cost Gas recorded in the period	<b>6,336</b>
Reduction in Profit Gas in the period	<b>(3,342)</b>
Net impact on Company share of operating revenue	<b><u>2,994</u></b>

## 9

## PERSONNEL EXPENSES

The average number of employees during the year was 94 (2013: 91). The costs are as follows:

US\$'000	YEARS ENDED 31 DECEMBER	
	2014	2013 restated
Wages and salaries	8,958	8,040
Social security costs	675	981
Other statutory costs	321	258
	9,954	9,279
Stock based compensation	3,482	(209)
	<b>13,436</b>	9,070

Stock based compensation is recorded under general and administrative expenses in the statement of comprehensive loss. The balance of personnel expenses for 2014 of US\$10.0 million (2013: US\$9.3 million) is recorded in distribution and production expenses and general administrative expenses at US\$3.0 million (2013: US\$2.7 million) and US\$7.0 million (2013: US\$6.6 million) respectively. Personnel expenses include Company employees who operate the plant on behalf of Songas, which expenses are recharged to Songas. The comparative figure has been restated to include Company employees who are engaged full-time in the operation of the gas plant on behalf of Songas.

## 10

## NET FINANCE COSTS

US\$'000	YEARS ENDED 31 DECEMBER	
	2014	2013 restated
Interest charged on overdue trade receivables	98	–
Gain on disposal of motor vehicle	–	10
Finance income	98	10
Interest expense	(24)	(678)
Net foreign exchange loss	(4,437)	(317)
Provision for doubtful accounts / Discount on long-term receivable	(37,047)	(24,968)
Finance costs	(41,508)	(25,963)
Net finance costs	<b>(41,410)</b>	(25,953)

During 2014, the Company billed TANESCO US\$2.2 million (2013: US\$2.6 million) of interest for late payments. The interest income is not recorded in the financial statements because it does not meet IAS 18 revenue recognition criteria. The Company is pursuing collection and amounts will be recognised in earnings when collected.



## 11

## INCOME TAXES

The tax charge is as follows:

<i>US\$'000</i>	YEARS ENDED 31 DECEMBER	
	2014	2013 restated
Current tax	11,895	12,849
Deferred tax/(recovery)	(457)	(10,593)
	<b>11,438</b>	2,256

Tax of US\$1.5 million (2013: US\$5.8 million) was paid during the year in relation to the settlement of the prior year's tax liability. In addition, provisional tax payments US\$8.8 million (2013: US\$8.4 million) were made in respect of the current year. These are presented as a reduction in Tax Payable on the balance sheet.

## Tax Rate Reconciliation

<i>US\$'000</i>	YEARS ENDED 31 DECEMBER	
	2014	2013 restated
Loss before taxation	(26,863)	(5,384)
Provision for income tax calculated at the statutory rate of 30%	(8,059)	(1,615)
Add the tax effect of non-deductible income tax items:		
Administrative and operating expenses	1,387	2,697
Unrealized exchange loss	349	(16)
Tax penalties	272	221
Stock-based compensation	1,045	(104)
Impact of reversing provision against interest (Note 10)	650	791
Unrecognized tax asset	15,646	–
Other permanent differences	148	282
	<b>11,438</b>	2,256

As at 31 December 2014, the uncertainty with regards to the collection of the TANESCO receivables has resulted in a US\$15,646 unrecognised deferred tax asset.

The deferred income tax asset (liability) includes the following temporary differences:

<i>US\$'000</i>	AS AT 31 DECEMBER	
	2014	2013 restated
Differences between tax base and carrying value of property, plant and equipment	(15,498)	(16,980)
Tax recoverable from TPDC	(5,116)	(5,852)
Discount on receivable and provision for doubtful debt	2,945	7,490
Deferred Additional Profits Tax	8,688	6,504
Unrealised exchange losses/other provisions	1,375	499
	<b>(7,606)</b>	(8,069)

### Tax Recoverable

The Company has a "Tax Recoverable" balance of US\$11.8 million (2013: US\$10.9 million). This arises from the revenue sharing mechanism within the PSA, which entitles the Company to recover from TPDC, by way of a deduction from TPDC's Profit Gas share an amount, the "adjustment factor", equal to the actual income taxes payable by the Company. The recovery, by deduction from TPDC's share of revenue, is dependent upon payment of income taxes relating to prior period adjustment factors as they are assessed.

<i>US\$'000</i>	AS AT 31 DECEMBER	
	2014	2013 restated
Tax Recoverable	<u>11,815</u>	10,866

## 12

### ADDITIONAL PROFITS TAX

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

The Company provides for deferred APT by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA. The effective APT rate of 21.9% (2013: 30.8%) has been applied to Profit Gas of US\$37.4 million (2013: US\$43.6 million). Accordingly, US\$7.3 million (2013: US\$13.4 million) has been netted off revenue for the year ended 31 December 2014. The APT charge for the year 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 8.

<i>US\$'000</i>	AS AT 31 DECEMBER	
	2014	2013
Deferred APT	<u>7,280</u>	13,429

## TRADE AND OTHER RECEIVABLES

Current Receivables	AS AT 31 DECEMBER	
	2014	2013 restated
<i>US\$'000</i>		
TANESCO	7,671	9,624
Songas	23,864	11,560
Other debtors	7,532	10,874
Trade receivables	39,067	32,058
Songas gas plant operations	19,300	13,280
Other receivables	773	2,408
Less provision for doubtful accounts	(9,816)	(7,895)
	<b>49,324</b>	39,851

## Trade Receivables Age Analysis

<i>US\$'000</i>	AS AT 31 DECEMBER 2014				
	Current	>30 <60	>60 <90	>90	Total
TANESCO	3,893	3,778	–	–	7,671
Songas	1,107	1,067	1,135	20,555	23,864
Other debtors	3,469	2,758	810	495	7,532
Trade receivables	8,469	7,603	1,945	21,050	<b>39,067</b>

<i>US\$'000</i>	AS AT 31 DECEMBER 2013				
	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	<b>32,058</b>

## TANESCO

At 31 December 2014, TANESCO owed the Company US\$59.8 million excluding interest (of which arrears were US\$52.2 million) compared to US\$54.0 million (including arrears of US\$44.3 million) as at 31 December 2013. During the year, the Company received a total of US\$46.7 million (2013: US\$49.6 million) from TANESCO against sales totaling US\$54.7 million (2013: US\$72.9 million). Current TANESCO receivables as at 31 December 2014 amounted to US\$7.7 million (2013 US\$9.6 million). Since the year-end, TANESCO has paid the Company US\$18.7 million in 2015, and as at the date of this report the total TANESCO receivable is US\$52.9 million (of which US\$52.2 million has been provided for). The amounts owed do not include interest billed to TANESCO (Note 10).

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 estimated that if these payments continued they would result in approximately US\$1.5 million per month credited against arrears. During Q4 2014 TANESCO made only one payment, although subsequent to the year-end TANESCO resumed weekly payments and as of the date of this report the Company has received US\$18.7 million in 2015. Whilst weekly payments against current deliveries have re-commenced, there is still no set schedule or repayment plan for TANESCO arrears agreed with the Company and payments continue to be irregular and unpredictable. As a result, there continues to be significant doubt about TANESCO's ability to settle arrears.

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 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. In April 2014 and again in May, TANESCO advised the Company of its intention to make weekly payments of TZS 3.0 billion (approximately US\$1.8 million) to the Company against ongoing deliveries of gas and as continue to seek third-party financing to repay the balance of arrears. TANESCO has confirmed the understanding between the parties that payments would be applied firstly to pay for the current gas deliveries, and that remaining amounts, if any, would be applied to the accumulated arrears.

At 31 December 2014, the Company re-assessed the TANESCO arrears in light of (i) the discontinuance of weekly payments during Q4 2014; (ii) the fact that TANESCO did not pay down substantially all of the arrears by year-end pursuant to a formal commitment made earlier during the year which was tied to Government receipt of World Bank funding; (iii) the lack of a definitive plan to repay arrears in light of (ii) above; and (iv) the absence of any evidence of the availability of external funding for TANESCO, including World Bank funding. As a result of increased uncertainty with respect to the timing and amount of ultimate collection of amounts in arrears, the Company recorded a provision for doubtful accounts against the entire long-term receivable of US\$52.2 million as at 31 December 2014. Amounts collected with respect to the long-term receivable in the future will be reflected in earnings when payment is received. Notwithstanding this provision, the Company and TANESCO continue to operate in accordance with the terms of the Portfolio Gas Supply Agreement and in accordance with the understanding between the Company and TANESCO whereby natural gas continues to be delivered by the Company and TANESCO would pay for current deliveries on a current basis with payments to be applied firstly to pay for the current deliveries and any excess amount applied to accumulated arrears. This provision against the TANESCO long-term receivable will not prejudice the Company's rights to payment in full or its ability to pursue collection in accordance with the terms of the agreement with TANESCO. Whilst the Company is unable to recognise interest revenue in accordance with International Accounting Standards, it will continue to charge TANESCO interest in accordance with the terms of the PGSA.

### Long-Term Receivables

US\$'000	AS AT 31 DECEMBER	
	2014	2013
TANESCO receivable > 60 days	52,154	44,348
Discount on long-term receivable	(17,073)	(17,073)
Provision for doubtful debts	(35,081)	–
Net TANESCO receivable	–	27,275
VAT bond	369	–
Lease deposit	265	–
Total long-term receivables	634	27,275

### Songas

As at 31 December 2014, Songas owed the Company US\$43.2 million (2013: US\$24.8 million), whilst the Company owed Songas US\$30.4 million (2013: US\$16.9 million). There was no contractual right to offset these amounts at 31 December 2014. Amounts due to Songas primarily relate to pipeline tariff charges of US\$28.9 million (2013: US\$15.4 million), whereas the amounts due to the Company are mainly for sales of gas of US\$23.9 million (2013: US\$11.6 million) and for the operation of the gas plant for US\$19.3 million (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.

All amounts due to and from Songas have been summarized in the net Songas balance (see Note 16) of US\$12.7 million (2013: US\$7.9 million). A provision for doubtful debts of US\$9.8 million (2013: US\$7.9 million) has been recognised against the gas plant operation receivable of US\$19.3 million (2013 : US\$13.3 million).

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 second half of 2014 Songas began to make payments in respect of the gas plant operations, and in Q4 2014 the Company received four payments totaling US\$1.7 million, bringing the total for the year to US\$2.6 million. Subsequent to year-end, Songas has made a further three payments totaling US\$5.7 million.

Management continued to work with Songas throughout 2014 towards an agreement to set-off outstanding sales, purchases and gas plant operating charges. In February 2015 management decided that agreement was unlikely to be reached in the short-term, and began to pay the outstanding tariff charges. Songas responded by commencing settlement of outstanding gas sales invoices. As at the date of this report the Company has paid US\$29.8 million in respect of outstanding tariff charges and has received US\$23.9 million in settlement of outstanding gas sales invoices. Management has reviewed the current provision of US\$9.8 million (2013: US\$7.9 million) against the outstanding gas plant operating charges and has decided to retain the provision pending further progress in resolving disputed charges. The provision will be released as and when the Company is able to collect the outstanding debt amounts. Any amounts not agreed will likely be pursued by the Company through the mechanisms provided in its agreements with Songas.

## 14

### EXPLORATION AND EVALUATION ASSETS

<i>US\$'000</i>	<b>Italy</b>	<b>Tanzania</b>	<b>Total</b>
<b>Costs</b>			
As at 1 January 2014	–	5,564	5,564
Impairment	–	(5,086)	(5,086)
Transfer to Oil & Natural Gas assets	–	(478)	(478)
<b>As at 31 December 2014</b>	<b>–</b>	<b>–</b>	<b>–</b>

<i>US\$'000</i>	<b>Italy</b>	<b>Tanzania</b>	<b>Total</b>
<b>Costs</b>			
As at 1 January 2013	158	5,562	5,720
<b>Additions</b>	–	2	2
Impairment	(158)	–	(158)
<b>As at 31 December 2013</b>	<b>–</b>	<b>5,564</b>	<b>5,564</b>

#### TANZANIA

The exploration and evaluation assets represented site survey costs and materials purchased in preparation for the drilling of the first Songo Songo West well. The Company has no current plans to drill this well, therefore the site survey costs of US\$5,086 have been impaired and related materials of US\$478 available for use in relation to development drilling and workovers have been transferred to Oil and Natural Gas interests.

## 15

## PROPERTY, PLANT AND EQUIPMENT

<i>US\$'000</i>	<b>Oil and natural gas interests</b>	<b>Leasehold improvements</b>	<b>Computer equipment</b>	<b>Vehicles</b>	<b>Fixtures &amp; Fittings</b>	<b>Total</b>
<b>Costs</b>						
As at 1 January 2014	139,072	885	1,158	137	1,082	142,334
Additions	1,103	72	75	12	50	1,312
Transfer from Exploration & Evaluation assets	478	–	–	–	–	478
Disposals	–	(258)	–	–	(7)	(265)
<b>As at 31 December 2014</b>	<b>140,653</b>	<b>699</b>	<b>1,233</b>	<b>149</b>	<b>1,125</b>	<b>143,859</b>
<b>Depletion and Depreciation</b>						
As at 1 January 2014	49,967	245	761	137	392	51,502
Depletion and depreciation	13,567	183	194	(17)	270	14,197
Cost of disposals	–	(258)	–	–	–	(258)
<b>As at 31 December 2014</b>	<b>63,534</b>	<b>170</b>	<b>955</b>	<b>120</b>	<b>662</b>	<b>65,441</b>
<b>Net Book Values</b>						
<b>As at 31 December 2014</b>	<b>77,119</b>	<b>529</b>	<b>278</b>	<b>29</b>	<b>463</b>	<b>78,418</b>
<b>US\$'000</b>						
<b>Costs</b>						
As at 1 January 2013	138,958	256	833	202	864	141,113
Additions	114	629	325	–	218	1,286
Disposals	–	–	–	(65)	–	(65)
<b>As at 31 December 2013</b>	<b>139,072</b>	<b>885</b>	<b>1,158</b>	<b>137</b>	<b>1,082</b>	<b>142,334</b>
<b>Depletion and Depreciation</b>						
As at 1 January 2013	37,801	219	649	194	206	39,069
Charge for period	12,166	26	112	8	186	12,498
Depreciation on disposals	–	–	–	(65)	–	(65)
<b>As at 31 December 2013</b>	<b>49,967</b>	<b>245</b>	<b>761</b>	<b>137</b>	<b>392</b>	<b>51,502</b>
<b>Net Book Values</b>						
<b>As at 31 December 2013</b>	<b>89,105</b>	<b>640</b>	<b>397</b>	<b>–</b>	<b>690</b>	<b>90,832</b>

In determining the depletion charge, it is estimated that future development costs of US\$252 million (31 December 2013: US\$239 million) will be required to bring the total proved reserves to production. During the year the Company recorded depreciation of US\$0.6 million (2013: US\$0.3 million) in General and Administrative expenses.

## 16

## TRADE AND OTHER PAYABLES

US\$'000	AS AT 31 DECEMBER	
	2014	2013 – restated
Songas <sup>(1)</sup>	28,871	15,355
Other trade payables	1,961	3,857
Trade payables	30,832	19,212
TPDC share of Profit Gas	33,409	21,501
Deferred income	2,780	6,271
Accrued liabilities	9,726	7,169
	<b>76,747</b>	54,153

(1) A summary of all Songas balances is presented below. This shows the opening position, movements during the year and details of post year-end settlements made in cash by the Company and by Songas. See Note 13 – Trade and Other Receivables.

	1 January 2014	Year to date transactions	Gross balance 31 Dec 2014	Post year-end payments and receipts	Outstanding as at the date of this report
Pipeline tariff - payable	(15,355)	(13,516)	(28,871)	28,871	–
Gas sales - receivable	11,560	12,304	23,864	(23,864)	–
Gas plant operation - receivable	13,280	6,020	19,300	(5,680)	13,620
Other payable	(1,544)	(30)	(1,574)	–	(1,574)
Net balances	7,941	4,778	12,719	(673)	12,046

## 17

## BANK LOAN

The loan was fully paid by February 2014. Total payments during the year ended 31 December 2014 were US\$1.7 million (2013: US\$8.2 million).

## 18

## CAPITAL STOCK

- a) Authorised
- |             |                                   |              |
|-------------|-----------------------------------|--------------|
| 50,000,000  | Class A Common Shares             | No par value |
| 100,000,000 | Class B Subordinate Voting Shares | No par value |
| 100,000,000 | First Preference 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 (20) 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.

- b) Changes in the capital stock of the Company were as follows:

Number of Shares (000's)	2014			2013		
	Authorised	Issued	Amount (US\$'000)	Authorised	Issued	Amount (US\$'000)
<b>Class A</b>						
As at 1 January 'and 31 December	50,000	1,751	983	50,000	1,751	983
<b>Class B</b>						
As at 1 January	100,000	33,072	84,445	100,000	32,892	84,000
Stock options exercised	–	92	209	–	180	445
As at 31 December 2014	100,000	33,164	84,654	100,000	33,072	84,445
<b>First Preference</b>						
As at 31 December	100,000	–	–	100,000	–	–
Total Class A, Class B and First Preference shares	250,000	34,915	85,637	250,000	34,823	85,428

All of the issued capital stock is fully paid.

Stock Options Thousands of options or CDN\$	2014		2013	
	Options	Exercise Price	Options	Exercise Price
Outstanding as at 1 January	1,742	1.00 to 3.60	1,922	1.00 to 3.60
Forfeited	(250)	3.60	–	–
Exercised	(92)	1.00	(180)	1.00
Expired unexercised	(1,000)	1.00	–	–
Outstanding as at 31 December	400	3.18	1,742	1.00 to 3.60



The weighted average remaining life and weighted average exercise prices of options at 31 December 2014 were as follows:

Exercise Price	2014		2013	
	Number Outstanding as at 31 Dec 2014	Weighted Average Remaining Contractual Life	Number Exercisable as at 31 Dec 2014	Weighted Average Exercise Price
(CDN\$)	('000)	(years)	('000)	(CDN\$)
	400	3.00	400	3.18

Stock Appreciation Rights	2014		2013	
	SAR	Exercise Price	SAR	Exercise Price
<i>Thousands of stock appreciation rights or CDN\$</i>				
<b>Outstanding as at 1 January 2014</b>	1,130	2.12 to 4.20	845	2.35 to 5.30
Expired			(15)	5.30
Granted <sup>(i)</sup>	1,780	2.30	300	2.12
<b>Outstanding as at 31 December 2014</b>	2,910	2.12 to 4.20	1,130	2.12 to 4.20

<sup>(i)</sup> A total of 1,780,000 SARs were issued in January 2014 with an exercise price of CDN\$2.30. These rights have a term of five years and vest in five equal instalments, the first tranche vesting on the anniversary of the grant date. There is no maximum liability associated with these rights.

Restricted Stock Units	2014		2013	
	SAR	Grant/Exercise Price	SAR	Grant/Exercise Price
<i>Thousands of restricted stock units or CDN\$</i>				
<b>Outstanding as at 1 January</b>	–	–	–	–
Granted <sup>(i)</sup>	792	3.70	–	–
Exercised	(147)	3.79	–	–
<b>Outstanding as at 31 December</b>	645	2.90	–	–

<sup>(i)</sup> 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 52.4% to 60.7%; 0% dividend yield; 0% forfeiture; a closing stock price of CDN\$2.90 per share.

US\$'000	YEAR ENDED 31 DECEMBER	
	2014	2013
SARs	1,369	(209)
RSUs	2,113	–
	3,482	(209)

As at 31 December 2014, a total accrued liability of US\$3.4 million (2013: US\$0.4 million) has been recognised in relation to SARs and RSUs which is included in other payables. The Company recognised an expense for the year of US\$3.5 million (2013: credit US\$0.2 million) in G&A expenses.

The increase over 2013 is the result of the share price increasing to US\$2.90 (2013: US\$2.35), the granting in January 2014 of an additional 1.8 million SARs and the issue in September 2014 of 0.8 million RSUs.

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## EARNINGS PER SHARE

<i>Number of shares ('000)</i>	AS AT 31 DECEMBER	
	2014	2013
<b>Weighted average number of shares outstanding</b>		
Class A and Class B shares	34,863	34,719
<b>Convertible securities</b>		
Stock options	-	-
Weighted average diluted Class A and Class B shares	<u>34,863</u>	<u>34,719</u>

The calculation of basic earnings per share is based on a net loss for the year of US\$38.3 million (2013: loss US\$7.6 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,862,588 (2013: 34,718,662).

In computing the diluted earnings per share, the effect of stock options is added to the weighted average number of common shares outstanding during the year. For 2014 the effective number was nil (2013: nil) shares, resulting in a diluted weighted average number of Class A and Class B shares of 34,862,588 for the year ended 31 December 2014 (2013: 34,718,662). No adjustments were required to the reported earnings from operations in computing diluted per share amounts.

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## RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm. During the year, the Company incurred US\$0.2 million (2013: US\$0.1 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 year the Company incurred US\$0.6 million (2013 US\$0.6 million) to this firm for services provided. As at 31 December 2014 the Company has a total of US\$ nil (2013: US\$ nil) recorded in trade and other payables in relation to the related parties.

## CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENTS

### 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 (127.7 Bcf as at 31 December 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, which is currently unsigned, provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and contract terms dealing with the consequences of any insufficiency are dealt with in 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. As at the date of this report, the ARGA remains an initialled agreement only, however the parties thereto, in certain respects, are conducting themselves as though the ARGA is in full force and effect.

### 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's 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 TANESCO (as the buyer) and the Company and TPDC (collectively as the seller). 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**

#### ***Italy***

On 31 May 2010, the Company signed an agreement with Petroceltic International plc ("Petroceltic") to farm in on Petroceltic's Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US\$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay Petroceltic fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US\$0.5 million.

No activity has occurred on the Adriatic Sea block during 2014. In 2012, a new law modified restrictions on offshore oil and gas exploration and production originally introduced by DLGS 128/2010 in August 2010. The Elsa-2 appraisal well is now expected to be drilled in 2016 following finalisation of an environmental impact study. The Company will not be liable to any costs associated with the drilling of Elsa-2 until a rig contract is signed. As of the date of this report, there is no rig contract. There are no further capital commitments in Italy.

#### ***Tanzania – Songo Songo***

Until such a time as the Company enters into a drilling contract for the Phase I development of Songo Songo, there are no capital commitments in Tanzania.

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### **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 year 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 the related assets – see Cost Pool Adjustments Note 8.

### **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 2014, 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 the Company is awaiting the appointment of 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 during the year. See Note 8 Revenue -- Cost Pool Adjustments. 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\$16.9 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. If the Company is unsuccessful in its appeals against these assessments, the amounts of interest and penalties could be materially higher.

The Tax Revenue Appeals Board (TRAB) considered the Company's appeal against a withholding tax assessment of US\$2.2 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\$7.1 million, including penalties related to 2008, 2009 and 2010 tax years. During the year, TRA notified the Company that it would not accept the objection relating to 2009 and issued a notice confirming the assessment for US\$2.3 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. If the Company is unsuccessful in its appeals against these assessments, the amounts of interest and penalties could be materially higher.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US\$6.9 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.

During the year 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\$1.1 million should be paid in respect of employment costs, income and withholding taxes. The Company considers it to be without merit and is preparing to respond to TRA.

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### DIRECTORS AND OFFICERS EMOLUMENTS

US\$'000	Year	Base	Bonus	Share based Compensation Expense	Total
Directors	2014	1,412	660	2,412	4,484
Directors	2013	1,454	335	–	1,789
Officers	2014	748	210	334	1,292
Officers	2013	1,227	175	–	1,402

The table above provides information on compensation relating to the Company's officers and directors. Four officers and two non-executive directors comprised the key management personnel during the year ended 31 December 2014 (2013: five officers and two non-executive directors). Two of the officers are also directors and as such their remuneration has been included under directors' emoluments in the table above.

## Corporate Information

### Board of Directors

W. David Lyons Chairman and Chief Executive Officer Winchester United Kingdom	David W. Ross Non-Executive Director Calgary, Alberta Canada	William H. Smith Non-Executive Director Calgary, Alberta Canada	Robert S. Wynne Chief Financial Officer Calgary, Alberta Canada
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### Officers

W. David Lyons Chairman and Chief Executive Officer Winchester United Kingdom	Robert S. Wynne Chief Financial Officer Calgary, Alberta Canada	Stephen Huckerby Chief Accounting Officer St. Peters, Jersey Channel Islands	David K. Roberts Vice President of Operations Kansas City, Missouri United States of America
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### Operating Office

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Chief Executive Officer  
  
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British Virgin Islands

### Engineering Consultants

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Consultants Ltd.  
Calgary, Canada

### Auditors

KPMG LLP  
Calgary, Canada

### Website

orcaexploration.com

### Lawyers

Burnet, Duckworth  
& Palmer LLP  
Calgary, Canada

### Transfer Agent

CIBC Mellon  
Trust Company  
Toronto & Montreal, Canada





[www.orcaexploration.com](http://www.orcaexploration.com)