



ORCA EXPLORATION GROUP INC.



2017 Q2 INTERIM 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.

GLOSSARY

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

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Financial and Operating Highlights

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
<i>(Expressed in US\$'000 unless indicated otherwise)</i>				
OPERATING				
Daily average gas delivered and sold (MMcfd)				
Additional Gas	39.5	40.3	41.4	43.4
Industrial	12.7	12.6	12.1	11.7
Power	26.8	27.7	29.3	31.7
Average price (US\$/mcf)				
Industrial	7.69	7.64	7.72	7.87
Power	3.57	3.55	3.57	3.55
Weighted average	4.90	4.83	4.79	4.71
Operating netback (US\$/mcf)⁽¹⁾	3.44	3.32	3.40	3.19
FINANCIAL				
Revenue	14,448	14,572	29,990	30,382
Net cash flows from operating activities	12,038	6,237	20,825	5,083
per share - basic and diluted (US\$)	0.35	0.18	0.59	0.15
Net (loss) income	(622)	1,452	2,218	(4,186)
per share - basic and diluted (US\$)	(0.02)	0.04	0.06	(0.12)
Cash flows from operations⁽¹⁾	4,610	6,772	10,536	15,620
per share - basic and diluted (US\$)	0.13	0.19	0.30	0.44
Weighted average of outstanding Class A and Class B shares ('000)	34,857	34,857	34,857	34,857
Capital expenditures	350	2,841	7,822	16,838
	AS AT JUNE 30, 2017		AS AT DECEMBER 31, 2016	
Working capital (including cash)	69,718			71,989
Cash	98,285			80,895
Long-term loan	58,468			58,399
Outstanding shares ('000)				
Class A	1,751			1,751
Class B	33,106			33,106
Total shares outstanding	34,857			34,857

⁽¹⁾ The cash flow from operations and operating netback are non-GAAP measures which may not be comparable to other companies. Please refer to the Management Discussion and Analysis ("MD&A") for Information on non-GAAP measures.

Q2 2017 Operating Highlights

- Revenue for the quarter decreased by 1% to US\$14.4 million from US\$14.6 million in Q2 2016 and decreased 1% to US\$30.0 million over the six months ended June 30, 2017 compared to US\$30.4 million for the comparable prior year period. Additional Gas deliveries and sales for the quarter averaged 39.5 million of standard cubic feet per day ("MMcfd") a decrease of 2% over 40.3 MMcfd in Q2 2016 and decreased 4% to 41.4 MMcfd for the six months ended June 30, 2017 compared to 43.4 MMcfd for the comparable prior year period. The decrease in Additional Gas volumes for the quarter and the six months ended June 30, 2017 to the comparable prior year periods is primarily the result of reduced nominations of natural gas volumes by TANESCO. The decrease in volumes having been offset by a 1% rise in the weighted average price for the quarter to US\$4.90/mcf from US\$4.83/mcf in Q2 2016 and a 2% rise to US\$4.79/mcf for the six months ended June 30, 2017 from US\$4.71/mcf for the comparable prior year period.
- There was a net loss for the quarter of US\$0.6 million (US\$0.02 loss per share diluted) compared to net income of US\$1.5 million in Q2 2016 (US\$0.04 per share diluted) and US\$2.2 million net income (US\$0.06 per share diluted) for the six months ended June 30, 2017 compared to a net loss of US\$4.2 million (US\$0.12 loss per share diluted) for the comparable prior year period. The net loss for the six months ended June 30, 2016 was primarily a consequence of recording a provision for doubtful accounts of US\$11.5 million against the TANESCO receivable, which was partially offset by lower interest associated with the IFC Loan. The interest associated with servicing the IFC loan for the six months ended June 30, 2017 was US\$4.6 million compared to US\$2.6 million for the six months ended June 30, 2016.
 - Cash flows from operations for the quarter decreased by 32% to US\$4.6 million (US\$0.13 per share diluted) from US\$6.8 million (US\$0.19 per share diluted) in Q2 2016 and decreased by 33% to US\$10.5 million (US\$0.30 per share diluted) for the six months ended June 30, 2017 from US\$15.6 million (US\$0.44 per share diluted) for the comparable prior year period. The decrease for the quarter and the six months ended June 30, 2017 from the comparable prior year periods is primarily due to the fall in the Company's operating revenue due to the change in the TANESCO revenue recognition criteria, the lower Additional Gas volumes and associated Profit Gas entitlement and the increase in the costs associated with servicing the IFC loan.
 - Net cash flows from operating activities for the quarter increased by 93% to US\$12.0 million (US\$0.35 per share diluted) in the quarter compared to a US\$6.2 million (US\$0.18 per share diluted) in Q2 2016 and increased by 310% for the six months ended June 30, 2017 to US\$20.8 million (US\$0.59 per share diluted) from US\$5.1 million (US\$0.15 per share diluted) for the comparable prior year period. The increase for the quarter and the six months ended June 30, 2017 from the comparable prior year periods being primarily the consequence of improved cash receipts from TANESCO since the end of Q2 2016. A total of US\$12.1 million was received from TANESCO during the quarter and US\$23.7 million for the six months ended June 30, 2017 compared to US\$6.5 million and US\$10.2 million for the comparable prior year periods.

- Total capital expenditures for the quarter were US\$0.4 million compared to US\$2.8 million in Q2 2016 and US\$7.8 million for the six months ended June 2017 compared to US\$16.9 million for the comparable prior year period. The capital expenditure in the quarter relates to flow line and platform expenditure related to the SS-12 well, the capital expenditure in Q2 2016 relates to the final demobilization cost associated with the 2015/2016 Offshore Development Program. The capital expenditure for the six months ended June 30, 2017 includes the transfer of US\$7.4 million of the Songas share of workover costs originally incurred in 2015 from accounts receivable to property, plant and equipment.
- Working capital as at June 30, 2017 was US\$69.7 million compared to US\$72.0 million as at December 31, 2016. The decrease in the Songas receivable relating to the Songas workover program being offset by the increase in cash balances due to the continued receipts from TANESCO. The closing cash at June 30, 2017 was US\$98.5 million (December 31, 2016: US\$80.9 million).
- At June 30, 2017 the current receivable from TANESCO was US\$ nil (December 31, 2016: US\$5.7 million). During the quarter the amounts received from TANESCO were in excess of the revenue recognized for gas sales to TANESCO resulting in a deferred revenue balance of US\$4.1 million (December 31, 2016: US\$ nil) which is recorded in trade and other payables. The long-term trade receivable at June 30, 2017 was US\$74.4 million (provision of US\$74.4 million) compared to US\$80.1 million (provision of US\$74.4 million) as at December 31, 2016. Since the quarter end, TANESCO has paid the Company US\$5.3 million. As at the date of this report the TANESCO current receivable balance is US\$ nil and the deferred revenue balance is US\$6.8 million with no change in the long-term receivable or provision. The amounts do not include invoices to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability.
- Prior to 2016 the Company had reached an understanding with TANESCO that it would continue to supply gas if TANESCO remained reasonably current with payments for gas deliveries. Up to September 30, 2016 the Company recorded revenue from TANESCO based on volumes delivered, however, TANESCO payments were inconsistent and not always in compliance with the agreed understanding resulting in the Company recording provisions for doubtful accounts for amounts outstanding from TANESCO for more than 60 days. Commencing on October 1, 2016, the Company began recording revenues for sales to TANESCO based on the expected amount to be collected, which represents a percentage of the amounts invoiced to TANESCO determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The result of recording revenue from TANESCO based on the expected collectability approach was a decrease in revenue recognized in the quarter of US\$0.8 million (Q2 2016: US\$ nil) and a decrease in revenue recognized for the six months ending June 30, 2017 of US\$2.4 million compared to US\$ nil for the comparable prior year period.

ORCA EXPLORATION GROUP INC.

MANAGEMENT'S
DISCUSSION
& ANALYSIS

Management's Discussion & Analysis

THIS MD&A OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2017 SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS AND NOTES FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2017 AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES TOGETHER WITH THE MD&A FOR THE YEAR ENDED DECEMBER 31, 2016. THIS MD&A IS BASED ON THE INFORMATION AVAILABLE ON AUGUST 15, 2017.

FORWARD LOOKING STATEMENTS

This management's discussion and analysis ("MD&A") contains forward-looking statements or information (collectively, "forward-looking statements") within the meaning of applicable securities legislation. More particularly, this MD&A contains, without limitation, forward-looking statements pertaining to the following: the Company's expectations regarding supply and demand of natural gas; anticipated power sector revenues; potential impact of Tanzanian Production Development Corporation ("TPDC") future back-in rights on the economic terms of the Production Sharing Agreement ("PSA"); ability to meet all conditions under the International Finance Corporation ("IFC") financing agreement; the Company's estimated spending for the planned Development Program for 2017 and 2018, which includes tie-in of well SS-12 to the production facilities and installation of a refrigeration unit to enable production into the National Natural Gas Infrastructure Project ("NNGIP") which includes two gas processing facilities and pipelines supplying gas from the Mtwara Region of Tanzania and Songo Songo Island to Dar es Salaam; the potential impact of the Petroleum Act, 2015 ("Act") and the Finance Act, 2016 on the Company's business in Tanzania; the potential impact of the recently enacted Natural Wealth and Resources (Permanent Sovereignty) Act, 2017, the Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act, 2017 and The Written Laws (Miscellaneous Amendments) Act, 2017; the Company's belief that the parties to the unsigned Amended and Restated Gas Agreement ("ARGA") will continue to conduct themselves in accordance with the ARGA until a new Gas Sales and Purchase Agreement ("GSPA") is signed; the Company's expectation that, despite the Re-Rating Agreement of the gas processing plant owned by Songas Limited ("Songas") having expired, the Songas gas processing plant will not be de-rated or production through the plant restricted; the anticipated effect of the Second Additional Gas Plan ("AGP2") on the Company's available volumes of Additional Gas for sale; additional Songo Songo field developments contemplated in connection with AGP2; the current and potential production capacity of the Songo Songo field; the Company's ability to access new markets; the Company's ability to produce additional volumes; the Company's ability to access additional processing and transportation capacity; the status of ongoing negotiations with TPDC; the potential increase in sales volumes associated with new gas sales agreements; the Company's ability to locate and bring online additional supply in the future; the Company's expectation that it can expand and maintain the deliverability of gas volumes in excess of the existing Songas infrastructure; the forward-looking statements under "Contractual Obligations and Committed Capital Investment"; the Company's expectation that it will not have a shortfall during the term of the Protected Gas delivery obligation to July 2024; and the Company's expectations in respect of its appeal on the decision of the Tax Revenue Appeals Tribunal and other statements under "Contingencies – Taxation". In addition, statements relating to "reserves" are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. The recovery and reserve estimates of the Company's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Although management believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, access to resources and infrastructure, performance or achievement since such expectations are inherently subject to significant business, economic, operational, competitive, political and social uncertainties and contingencies.

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

Such forward-looking statements are based on certain assumptions made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors the Company believes are appropriate in the circumstances, including, but not limited to, that the Company will be able to negotiate Additional Gas Sales contracts in relation to the approval of AGP2; the ability of the Company to complete additional developments and increase its production capacity; that the Company and TPDC will agree to the terms of a Gas Sales Agreement; the actual costs to complete the Development Program are in line with estimates; that there will continue to be no restrictions on the movement of cash from Mauritius or Tanzania; that the Company will have sufficient cash flow, debt or equity sources or other financial resources required to fund its capital and operating expenditures and requirements as needed; that the Company will have adequate funding to continue operations; that the Company will successfully negotiate agreements; receipt of required regulatory approvals; the ability of the Company to increase production at a consistent rate; infrastructure capacity; commodity prices will not further deteriorate significantly; the ability of the Company to obtain equipment and services in a timely manner to carry out exploration, development and exploitation activities; future capital expenditures; availability of skilled labour; timing and amount of capital expenditures; uninterrupted access to infrastructure; the impact of increasing competition; conditions in general economic and financial markets; effects of regulation by governmental agencies; that the Company's appeal of various tax assessments will be successful; that the enactment of the Act and new legislation in Tanzania will not impair the Company's rights under the PSA to develop and market natural gas in Tanzania; current or, where applicable, proposed industry conditions, laws and regulations will continue in effect or as anticipated as described herein; and other matters.

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

NON-GAAP MEASURES

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

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

ADDITIONAL INFORMATION REGARDING ORCA EXPLORATION IS AVAILABLE UNDER THE COMPANY'S PROFILE ON SEDAR AT www.sedar.com.

NATURE OF OPERATIONS

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

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

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

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

TANESCO is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the 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 mix as a more reliable source of supply over seasonal hydro power and a more cost effective alternative to liquid fuels. The Company currently supplies gas directly to TANESCO by way of the PGSA and indirectly through the supply of Protected Gas and Additional Gas to Songas which in turn generates and sells power to TANESCO. TANESCO is the Company's largest customer and the gas supplied by the Company to Songas and TANESCO today fires approximately 33% of the electrical power generated in Tanzania and 62% of the gas utilized for power generation in the country.

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

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 ("PAET")	Jersey
Orca Exploration UK Services Limited	United Kingdom

Results for the three and six months ended June 30, 2017

SUMMARY

The Company's operating revenue decreased by 11% to US\$11.7 million in the quarter ended June 30, 2017 (Q2 2016: US\$13.2 million) and by 13% to US\$23.7 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$27.3 million). The decrease is primarily related to management of the Company modifying its approach to revenue recognition as it relates to TANESCO only. Commencing on October 1, 2016 the Company records a percentage of the amounts invoiced to TANESCO for revenue recognition purposes determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. This results in a reduction in revenue recognized from the effective date. Revenue for the quarter ended June 30, 2017 decreased by 1% to US\$14.4 (Q2 2016: US\$14.6 million) and by 1% for the six months ended June 30, 2017 to US\$30.0 million (six months ended June 30, 2016: US\$30.4 million).

The Company's cash flows from operations, which includes the net change in working capital in the period, for the quarter ended June 30, 2017 decreased 32% to US\$4.6 million (Q2 2016: US\$6.8 million) and by 33% for the six months ended June 30, 2017 to US\$10.5 million (six months ended June 30, 2016: US\$15.6 million). The decrease is primarily a consequence of the fall in the Company's operating revenue due to the change in the TANESCO revenue recognition criteria together with lower sales of Additional Gas volumes and associated Profit Gas entitlement.

The Company's net cash flows from operating activities for the quarter ended June 30, 2017 increased 93% to US\$12.0 million (Q2 2016: US\$6.2 million) and increased by 310% to US\$20.8 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$5.1 million). The increase is primarily a consequence of the continued improved collections from TANESCO since the second half of 2016.

The Company recorded a net loss of US\$0.6 million in the quarter ended June 30, 2017 (Q2 2016: US\$1.5 million net income) and a net income of US\$2.2 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$4.2 million net loss). The improved results for the first six months of the year were primarily due to the lower provision for doubtful accounts for TANESCO partially offset by participatory interest costs on the IFC loan which started to accrue in Q1 2017 and higher indirect tax in 2017.

The Company once again exited the quarter in a stable financial position with US\$69.7 million in working capital (Q4 2016: US\$72.0 million), cash and cash equivalents of US\$98.3 million (Q4 2016: US\$80.9 million) and long-term debt of US\$58.5 million (Q4 2016: US\$58.4 million).

OPERATING VOLUMES

The gross gas sales volumes for the quarter were 3,595 MMcf (Q2 2016: 3,672 MMcf) or average daily volumes of 39.5 MMcfd (Q2 2016: 40.3 MMcfd). This represents a decrease in average daily volumes of 2% quarter over quarter. The gross gas volumes sold for the six months ended June 30, 2017 fell 5% to 7,509 MMcf (41.5 MMcfd) from 7,885 MMcf (43.4 MMcfd) for the six months ended June 30, 2016.

The decrease in gross gas volumes is primarily a result of reduced nominations of natural gas volumes by TANESCO. The gross sales volumes were split between the Industrial and Power sectors as detailed in the table below:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Gross sales volume (MMcf)				
Industrial sector	1,158	1,151	2,199	2,123
Power sector	2,437	2,521	5,310	5,762
Total volumes	3,595	3,672	7,509	7,885
Gross average daily sales volume (MMcfd)				
Industrial sector	12.7	12.6	12.1	11.7
Power sector	26.8	27.7	29.3	31.7
Total daily sales volume	39.5	40.3	41.4	43.4

Industrial sector

Industrial sales volume increased by 1% to 1,158 MMcf (12.7 MMcfd) in Q2 2017 from 1,151 MMcf (12.6 MMcfd) in Q2 2016 and increased by 4% to 2,199 MMcf (12.1 MMcfd) for the six months ended June 30, 2017 from 2,123 MMcf (11.7 MMcfd) for the six months ended June 30, 2016.

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

Power sector

Power sector sales volumes decreased by 3% to 2,437 MMcf (26.8 MMcfd) in Q2 2017 from 2,521 MMcf (27.7 MMcfd) in Q2 2016 and decreased by 8% to 5,310 MMcf (29.3 MMcfd) for the six months ended June 30, 2017 from 5,762 MMcf (31.7 MMcfd) for the six months ended June 30, 2016.

The decrease in volumes is primarily a result of reduced nominations of natural gas volumes by TANESCO.

SONGO SONGO DELIVERABILITY

As at June 30, 2017 the Company had a field productive capacity of approximately 155 MMcfd, with the ability to expand production capacity to 180 MMcfd with the tie-in of well SS-12. Well SS-12 was successfully completed in the first quarter of 2016 but is currently suspended awaiting tie-in. The Company now has significant redundant production capacity with volumes currently limited to 102 MMcfd as only the Songas infrastructure is available to process gas. Well SS-3 is currently suspended and well SS-4 is brought on-line periodically; it is the Company's intention to undertake workovers on both of the wells in the future.

Subsequent to the end of Q2 2017 the Company, through its subsidiary PAET, received approval of the AGP2 from the MEM providing the opportunity to sell additional gas volumes by accessing the NNGIP infrastructure. Wells SS-10, SS-11, and SS-12 have been identified for possible connection to the NNGIP infrastructure subject to finalizing a new gas sales agreement with TPDC for incremental gas sales of up to 15 MMcfd. The approval also provides the Company the opportunity to increase sales volumes to industrial customers as capacity would no longer be constrained by the Songas infrastructure.

COMMODITY PRICES

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

US\$/mcf	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Average sales price				
Industrial sector	7.69	7.64	7.72	7.87
Power sector	3.57	3.55	3.57	3.55
Weighted average price	4.90	4.83	4.79	4.71

Industrial sector

The average gas price achieved during the quarter was US\$7.69/mcf, an increase of 1% from US\$7.64/mcf in Q2 2016. The average price for the six months ended June 30, 2017 was US\$7.72/mcf a decrease of 2% from US\$7.87/mcf for the nine months ended June 30, 2016.

The decline in the average industrial price for the six months ended June 30, 2017 is the result of re-setting the floor price for a number of industrial customers at the end of the Q3 2016. The increase in the quarter is a consequence of a change in the sales mix compared to Q2 2016.

Power sector

The average sales price to the Power sector was US\$3.57/mcf for the quarter and the six months ended June 30, 2017, an increase of 1% from US\$3.55 mcf in Q1 2016 and the six months ended June 30, 2017. The increase is a consequence of the annual price rise at the start of Q3 2016.

OPERATING REVENUE

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

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

The Additional Gas sales volumes for Q2 2017 were below 40 MMcfd and, as a consequence, the Company was entitled to a 35% share of Profit Gas revenue. The Company was entitled to a 40% share of Profit Gas revenue for Q1 2017, Q1 2016 and Q2 2016 as the Additional Gas volumes during these periods were above 40 MMcfd. See "Principal Terms of the Tanzanian PSA and Related Agreements."

The Company was allocated a total of 84% of the Songo Songo net field revenue in the quarter (Q2 2016: 85%). The decrease in allocation of net field revenue is a consequence of the fall in Profit Gas revenue entitlement relating to the decrease in sales volumes.

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Gross field revenue	16,069	17,736	32,491	37,173
Tariff for processing plant and pipeline infrastructure	(2,124)	(2,223)	(4,434)	(5,079)
Net field revenue	13,945	15,513	28,057	32,094
<i>Analysed as to:</i>				
Company Cost Gas	10,459	11,635	21,043	24,071
Company Profit Gas	1,220	1,551	2,631	3,209
Company operating revenue	11,679	13,186	23,674	27,280
TPDC share of revenue	2,266	2,327	4,383	4,814
	13,945	15,513	28,057	32,094

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

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Industrial sector	8,906	8,790	16,974	16,715
Power sector	7,163	8,946	15,517	20,458
Gross field revenue	16,069	17,736	32,491	37,173
Processing and transportation tariff	(2,124)	(2,223)	(4,434)	(5,079)
Net field revenue	13,945	15,513	28,057	32,094
TPDC share of revenue	(2,266)	(2,327)	(4,383)	(4,814)
Company operating revenue	11,679	13,186	23,674	27,280
Additional Profits Tax charge	(238)	(288)	(512)	(596)
Current income tax adjustment	3,007	1,674	6,828	3,698
Revenue	14,448	14,572	29,990	30,382

Company operating revenue for the quarter decreased by 11% to US\$11.7 million compared to US\$13.2 million in Q2 2016, due to the impact of the change in the TANESCO revenue recognition estimates together with the fall in Profit Gas entitlement, as described above. Company operating revenue for the six months ended June 30 2017 decreased by 13% to US\$23.7 million (six months ending June 30, 2016: US\$27.3 million) for the same reasons as above.

Revenue was positively impacted by the current tax adjustment as per the terms of the PSA which increased to US\$3.0 million (Q2 2016: US\$1.7 million) and US\$6.8 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$3.7 million).

Prior to 2016 the Company had reached an understanding with TANESCO that it would continue to supply gas if TANESCO remained reasonably current with payments for gas deliveries. Up to September 30, 2016 the Company recorded revenue from TANESCO based on volumes delivered, however, TANESCO payments were inconsistent and not always in compliance with the agreed understanding resulting in the Company recording provisions for doubtful accounts for amounts outstanding from TANESCO for more than 60 days. Commencing on October 1, 2016 the Company began recording revenues for sales to TANESCO based on the expected amount to be collected, which represents a percentage of the amounts invoiced to TANESCO determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The result of recording revenue from TANESCO based on the expected collectability approach was a decrease in revenue recognized in the quarter of US\$0.8 million (Q2 2016: US\$ nil) and no increase in the provision for doubtful accounts (Q2 2016: US\$3.5 million increase). The decrease in revenue recorded for the six months ending June 30, 2017 was US\$2.4 million (six months ending June 30, 2016: US\$ nil) and no increase in the provision for doubtful accounts (six months ending June 30, 2016: US\$11.5 million)

The percentage used to recognize TANESCO revenue will be reviewed on at least a semi-annual basis, more frequently if circumstances require and if there is a significant difference between the amount of revenue recorded and amounts received, the percentage used to record revenue as well as any existing receivable or deferred revenue balance will be revised accordingly. No change in the percentage was required for Q2 2017.

PROCESSING AND TRANSPORTATION TARIFF

The processing and transportation tariff charge for the quarter was US\$2.1 million (Q2 2016: US\$2.2 million) and US\$4.4 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$4.8 million). The reduction in the tariff on a year to date basis is a consequence of the cessation of paying the additional compensation on production volumes in excess of 70 MMcfd in Q2 2016.

PRODUCTION AND DISTRIBUTION EXPENSES

Well maintenance costs are allocated between Protected Gas and Additional Gas in proportion to their respective sales during the period. The total costs of maintenance for the quarter and year to date were US\$0.15 million (Q2 2016: US\$0.2 million) and US\$0.3 million (six months ended June 30, 2016: US\$0.3 million). Amounts allocated for Additional Gas for the quarter were US\$0.08 million (Q2 2016: US\$0.04 million) and US\$0.2 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$0.2 million).

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

Distribution costs represent the direct cost of maintaining the ring main distribution pipeline and pressure reduction stations (security, insurance and personnel). Ring main distribution costs for the quarter were US\$0.6 million (Q2 2016: US\$0.6 million). The production and distribution expenses are detailed in the table below:

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Share of well maintenance	80	46	176	174
Other field and operating costs	196	294	384	602
	276	340	560	776
Ringmain distribution costs	586	644	1,150	1,328
Production and distribution expenses	862	984	1,710	2,104

OPERATING NETBACKS

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

US\$/mcf	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Gas price – Industrial	7.69	7.64	7.72	7.87
Gas price – Power	3.57	3.55	3.57	3.55
Weighted average price for gas⁽¹⁾	4.90	4.83	4.79	4.71
Tariff	(0.59)	(0.61)	(0.59)	(0.64)
TPDC share of revenue	(0.63)	(0.63)	(0.58)	(0.61)
Net selling price	3.68	3.59	3.62	3.46
Well maintenance and other operating costs	(0.08)	(0.09)	(0.07)	(0.10)
Ring main distribution costs	(0.16)	(0.18)	(0.15)	(0.17)
Operating netbacks	3.44	3.32	3.40	3.19

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

The operating netback in the quarter increased by 4% to US\$3.44/mcf (Q2 2016: US\$3.32/mcf) and by 7% to US\$3.30/mcf for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$3.19/mcf). The increase for the quarter is a consequence of the following factors: i) a 1% increase in the weighted average gas price; ii) a 2% fall in the gas processing tariff as a consequence of the cessation of additional compensation to Songas for total production volumes over 70 MMcfd in June 2016; and (iii) savings associated with lower insurance premiums.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses are detailed in the table below:

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Employee and related costs	1,661	1,653	3,207	3,602
Stock based compensation (recovery)	1,560	(743)	2,401	2,115
Office costs	834	871	1,585	1,563
Marketing and business development costs	163	111	315	193
Reporting, regulatory and corporate	501	445	727	910
General and administrative expenses	4,719	2,337	8,235	8,383

General and administrative expenses include the costs of running the natural gas distribution business in Tanzania which is recoverable as Cost Gas and is relatively fixed in nature. Excluding stock based compensation and other expenses, general and administrative expenses averaged US\$1.1 million (Q2 2016: US\$1.0 million) per month during the quarter.

STOCK BASED COMPENSATION

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

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Stock appreciation rights ("SARs")	356	(992)	423	1,105
Restricted stock units ("RSUs")	1,204	249	1,978	1,010
Stock based compensation	1,560	(743)	2,401	2,115

As at June 30, 2017 a total of 2,470,000 SARs, were outstanding compared to 2,430,000 as at December 31, 2016. A total of 325,000 SARs with exercise prices ranging from CDN\$2.12 to CDN\$2.70 were exercised during Q1 2017 resulting in a total cash payout of US\$0.4 million. A total of 365,000 with an exercise price of CDN\$3.87 were granted during Q1 2017. The newly issued SARs have a five-year term and vest equally over the term, the first fifth vesting on the first anniversary of the grant date. No SARs were granted or exercised in Q2 2017.

As at June 30, 2017 a total of 1,172,621 RSUs were outstanding compared to 239,361 at December 31, 2016. During the quarter 1,143,255 RSUs were issued with an exercise price of CDN\$0.001 and a term of five years, of which 143,255 RSUs vested in full on the date of grant and 1,000,000 RSUs vesting equally over one year on a quarterly basis with the first quarter vesting on July 1, 2017. During Q1 2017 259,067 RSUs were issued, the RSUs vested in full on the date of grant have an exercise price of CDN\$0.001 and have a five-year term. A total of 259,741 RSUs were exercised during the quarter resulting in a total cash payout of US\$0.8 million. During Q1 2017 a total of 209,321 RSUs were exercised resulting in a total cash payout of US\$0.6 million.

As SARs and RSUs are settled in cash, they are re-valued at each reporting date using the Black-Scholes option pricing model with the resulting liability being recognized in trade and other payables. In the valuation of stock appreciation rights and restricted stock units at the reporting date, the following assumptions have been made: a risk-free rate of interest of 0.5%; stock volatility of 37% to 62%; 0% dividend yield; 5% forfeiture; and a closing price of CDN\$4.01 per Class B share.

As at June 30, 2017 a total accrued liability of US\$3.8 million (Q4 2016: US\$3.2 million) has been recognized in relation to SARs and RSUs. For the quarter, the Company recognized an expense of US\$1.6 million (Q2 2016: recovery of US\$0.8 million).

NET FINANCE EXPENSE

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

<i>US\$'000</i>	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Finance income	80	81	161	130
Interest expense	(1,585)	(1,548)	(3,103)	(2,553)
Participatory interest	(725)	–	(1,456)	–
Net foreign exchange gain (loss)	104	(85)	34	(113)
Indirect tax	(2,354)	(155)	(2,559)	(301)
Provision for doubtful accounts	–	(3,317)	–	(11,157)
Finance expense	(4,560)	(5,105)	(7,084)	(14,124)
Net finance expense	(4,480)	(5,024)	(6,923)	(13,994)

The total amount of interest expense during the quarter was US\$1.6 million (Q2 2016: US\$1.5 million) and US\$3.1 million for the six months ending June 30, 2017 (six months ended June 30, 2016: US\$2.6 million). The interest relates to the long-term loan with the International Finance Corporation (“IFC”) and is payable quarterly in arrears. The participatory interest is paid annually in arrears and is an accrual equating to 7% of the net cash flows from operating activities of PAET net of net cash flows used in investing activities.

The indirect tax of US\$2.4 million for the quarter (Q2 2016: US\$0.2 million) and US\$2.6 million for the six months ending June 30, 2017 (six months ending June 30, 2016: US\$0.3 million) is for VAT associated with invoices to TANESCO for interest on late payments and invoices under the Take or Pay provisions within the PGSA not recognized in the financial statements due to revenue recognition criteria with respect to assurance of collectability.

The provision for doubtful accounts for the quarter and six months ending June 30, 2016 relates to overdue TANESCO receivables.

TANESCO

At June 30, 2017 the current receivable from TANESCO was US\$ nil (December 31, 2016: US\$5.7 million). During the quarter the amounts received from TANESCO were in excess of the revenue recognized for gas sales to TANESCO (which is less than the invoiced amounts as detailed in Note 7) resulting in a deferred revenue balance of US\$4.1 million (December 31, 2016: US\$ nil) which is recorded in trade and other payables. The long-term trade receivable at June 30, 2017 was US\$74.4 million (provision of US\$74.4 million) compared to US\$80.1 million (provision of US\$74.4 million) as at December 31, 2016. Since the quarter end, TANESCO has paid the Company US\$5.3 million. As at the date of this report the current receivable balance is US\$ nil and the deferred revenue total is US\$6.8 million with no change in the long-term receivable or provision. The amounts owed do not include invoices to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability as described in Operating Revenue above.

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

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Total TANESCO receivable	111,119	100,776
Less unrecognized amounts for not meeting revenue recognition criteria:		
Interest charges	(14,245)	(10,899)
Invoices issued pursuant to contractual Take or Pay volume requirements	(21,277)	(7,842)
Invoiced amounts reduced based on TANESCO's payment history for the previous three years	(5,373)	(1,925)
Provision for doubtful accounts	(74,361)	(74,361)
TANESCO (deferred revenue) current receivable balance per consolidated financial statements	(4,137)	5,749

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 June 30, 2017 there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes under the Income Tax Act 2004. Applying the 30% Tanzanian tax rate, the Company has recognized a deferred tax liability of US\$13.3 million (Q4 2016: US\$13.0 million). During the quarter, the Company recorded a deferred tax expense of US\$0.1 million (Q2 2016: US\$0.9 million). The deferred tax has no impact on cash flow until it becomes current, at which point the tax is paid and recovered from TPDC's share of Profit Gas.

Additional Profits Tax

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

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

The effective APT rate of 19.46% (Q2 2016: 18.56%) has been applied to Profit Gas of US\$1.2 million for Q2 2017 (Q2 2016: US\$1.6 million) and US\$2.6 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$3.2 million). Accordingly US\$0.2 million for Q2 2017 (Q2 2016: US\$0.3 million) and US\$0.5 million for the six months ended June 30, 2017 (US\$0.6 million for the six months to June 30, 2016) has been netted off revenue. There is no forecasted APT payable until 2019.

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Additional Profits Tax	238	288	512	596

DEPLETION AND DEPRECIATION

Natural gas properties are depleted using the unit of production method based on the production for the period as a percentage of the total future production from the Songo Songo proven reserves. As at December 31, 2016 the proven reserves estimated to be produced over the remaining term of the PSA licence were 347 Bcf (December 31, 2015: 368 Bcf). A depletion expense of US\$2.1 million for the quarter (Q2 2016: US\$2.1 million) has been recorded in the accounts at an average depletion rate to US\$0.57/mcf (Q2 2016: US\$0.56/mcf).

CASH FLOW FROM OPERATIONS AND OTHER ACTIVITIES

Cash flows from operations was US\$5.1 million for the quarter (Q2 2016: US\$6.8 million) and is reconciled to net cash flows from operating activities in the table below:

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Operating activities				
Net (loss) income	(622)	1,452	2,218	(4,186)
Non-cash adjustments	5,232	5,320	8,318	19,806
Cash flows from operations ⁽¹⁾	4,610	6,772	10,536	15,620
Interest paid	1,585	1,548	3,103	2,553
Participatory interest	725	–	1,456	–
Change in non-cash working capital ⁽²⁾	5,118	(2,083)	5,730	(13,090)
Net cash flows from operating activities	12,038	6,237	20,825	5,083
Net cash flows used in investing activities ⁽²⁾	(326)	(5,774)	(542)	(24,836)
Net cash flows used in financing activities ⁽²⁾	(1,585)	(1,530)	(3,103)	37,216
Increase (decrease) in cash	10,127	(1,067)	17,180	17,463
Effect of change in foreign exchange on cash	337	573	210	546
Net increase (decrease) in cash	10,464	(494)	17,390	18,009

(1) See non-GAAP measures

(2) See Consolidated Statements of Cash Flows

CAPITAL EXPENDITURES

During the quarter, the Company incurred US\$0.4 million (Q2 2016: US\$2.8 million) in capital expenditures. The expenditure during the quarter is in relation to platform work on the SS-12 well in order to facilitate the future connection to the NNGIP. The expenditures in Q2 2016 relates primarily to the demobilization of the drilling rig.

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Geological and geophysical and well drilling	3	2,558	30	16,197
Pipelines and infrastructure	250	181	343	537
Other Equipment	97	102	97	104
	350	2,841	470	16,838
Other ⁽¹⁾	–	–	7,352	–
	350	2,841	7,822	16,838

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

WORKING CAPITAL

Working capital as at June 30, 2017 was US\$69.7 million (December 31, 2016: US\$72.0 million) and is detailed in the table below:

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Cash	98,285	80,895
Trade and other receivables	11,860	27,638
TANESCO	–	5,749
Songas	2,115	2,218
Industrial customers	8,034	7,463
Songas gas plant operations	6,303	6,601
Songas well workover program ⁽¹⁾	–	14,458
Other receivables	874	1,516
Provision for doubtful accounts	(5,466)	(10,367)
Tax recoverable	6,168	5,402
Prepayments	790	651
	117,103	114,586
Trade and other payables	44,251	39,707
TPDC share of Profit Gas ⁽²⁾	26,539	28,319
Songas	1,669	1,893
Other trade payables	2,718	3,245
Accrued liabilities	9,188	6,250
Deferred revenue	4,137	–
Tax payable	3,134	2,890
Working capital ⁽³⁾	69,718	71,989

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

⁽²⁾ The balance of US\$26.5 million payable to TPDC is the accrued liability for their share of profit gas delivered to TANESCO which has not been paid for. Settlement of this liability is dependent on receipt of payment from TANESCO for the arrears.

⁽³⁾ Working capital as at June 30, 2017 includes TANESCO deferred revenue of US\$4.1 million (December 31, 2016: US\$ nil). The deferred revenue being the result of the cumulative cash collected from TANESCO during the six months ending June 30, 2017 being in excess of the invoiced amounts recognized as revenue during the same period. Correspondingly, as at June 30, 2017 there is no current receivable for TANESCO (December 31, 2016: US\$5.7 million).

Working capital as at June 30, 2017 remained stable from Q4 2016 to the end of Q2 2017. Cash increased to US\$98.3 million at June 30, 2017 from US\$80.9 million at December 31, 2016 or 21.5%. The increase is primarily a result of successful collection of revenue from TANESCO and Industrial customers during the quarter. Other significant points are:

- In accordance with rights granted by the Government of Tanzania in the PSA, the Company has the right to move funds to bank accounts outside of Tanzania. As at the date of this report, approximately 87% of the Company's cash is held outside of Tanzania.
- Of the US\$8.0 million relating to other trade receivables, US\$4.4 million had been received as at the date of this report.

LONG-TERM LOAN

The Company's subsidiary, PanAfrican Energy Tanzania Limited ("PAET"), entered into a US\$60 million financing agreement in 2015 (the "Loan") with the IFC, a member of the World Bank Group.

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

Base interest on the Loan is payable quarterly at 10% per annum on a 'pay-if-you-can-basis' using a formula to calculate the net cash available for such payments as at any given interest payment date. The Company must provide notice to the IFC of the amount of any base interest which is not to be paid on any interest payment date the unpaid interest is added to the principal outstanding and may be paid out before or at the time of principal repayment. To date, all base interest incurred has been paid. In addition, an annual variable participatory interest equating to 7% of the net cash flows from operating activities of PAET net of net cash flows used in investing activities in respect of any given year. Such participatory interest will continue until October 15, 2026 regardless whether the Loan is repaid prior to its contract maturity date. An accrual for the participatory interest of US\$0.7 million and US\$1.5 million for the three and six months ended June 30, 2017 (comparable periods in 2016: US\$ nil) respectively has been made and is included in trade and other payables. Dividends and distributions from PAET to the Company are restricted at any time that any amounts of unpaid interest, principal or participatory interest are outstanding.

SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

There were 34,856,432 shares outstanding as at June 30, 2017 as detailed in the table below:

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Shares outstanding		
Class A shares	1,751	1,751
Class B shares	33,106	33,106
Class A and Class B shares outstanding	34,857	34,857
<i>Number of shares ('000)</i>		
Class A and Class B shares	34,857	34,857
Convertible securities		
Options	–	–
Weighted average diluted Class A and Class B shares	34,857	34,857

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

RELATED PARTY TRANSACTIONS

One of the non-executive Directors is counsel to a law firm that provides legal advice to the Company and its subsidiaries. During the quarter, the Company incurred US\$0.1 million (Q2 2016: US\$0.1 million) and US\$0.2 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$0.1 million) to this firm for services provided.

As at June 30, 2017 the Company has a total of US\$0.1 million (Q2 2016: US\$0.1 million) recorded in trade and other payables in relation to the related party.

CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

Protected Gas

Under the terms of the original Gas Agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, the Company is liable to pay the difference between the price of Protected Gas (US\$0.55/MMbtu escalated) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (165.1 Bcf as at June 30, 2017). The Company did not have a shortfall during the reporting period and does not anticipate a shortfall arising during the term of the Protected Gas delivery obligation to July 2024.

Re-Rating Agreement

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

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

The parties are seeking to resolve the status of the re-rating agreement. The processing capacity at the Songas facilities remains unaltered and is fully available for utilization by the Company.

Capital Commitments

Tanzania

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

The completion of the Offshore component of Phase A of the Development Program in February 2016 has improved field deliverability and provides sufficient natural gas production to fill the Songas plant and pipeline to capacity for the greater portion of the remaining life of the production licence. The Company does not expect to commit to further significant capital expenditures until agreeing commercial terms with TPDC for the supply of gas through the NNGIP.

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

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

Italy

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

CONTINGENCIES

Recent Legislation

The Act passed in 2015 repealed earlier legislation and provides a regulatory framework over upstream, mid-stream and downstream gas activity and consolidates and puts in place a comprehensive legal framework for regulating the oil and gas industry in the country. The Act also provides for the creation of an upstream regulator, the Petroleum Upstream Regulatory Authority ("PURA"). The mid and downstream oil and gas activities are proposed to be regulated by the current authority, the Energy and Water Utilities Regulatory Authority ("EWURA"). The Act also confers upon on TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in petroleum operations as well as mid and downstream natural gas activities. The Act vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Act does provide grandfathering provisions upholding the rights of the Company under their PSA as it was signed prior to passing of the Act.

On October 7, 2016 the Government of Tanzania (the "GoT") issued the Petroleum (Natural Gas Pricing) Regulation made under Sections 165 and 258 (I) of the Act. Under the Act, Article 260 (3) preserves the Company's pre-existing right with TPDC to market and sell Additional Gas together or independently on terms and conditions (including prices) negotiated with third party natural gas customers.

On July 15, 2017 the GoT passed into law the Natural Wealth and Resources (Permanent Sovereignty) Act, 2017, the Written Laws (Miscellaneous Amendments) Act, 2017, and The Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act, 2017. The first and second of these acts are forward looking and only apply to agreements entered into on or after July 15th, 2017. These acts contain new regulations including but not limited to regulations that all arbitration processes must be heard within Tanzania and restrict the ability to move funds out of Tanzania. The third act is rearward looking and provides the right of the GoT to renegotiate contract clauses that are deemed to have unconscionable terms.

It is still unclear how the provisions of new Act and legislation will be enacted and implemented and the Company is uncertain regarding the potential impact on its business in Tanzania.

Cost recovery

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

Taxation

Area	Period	Tax dispute	Disputed amount US\$' million		
		Reason for dispute	Principal	Interest	Total
Pay As You Earn ("PAYE") tax	2008-10	PAYE tax on grossed-up amounts in staff salaries which are contractually stated as net.	0.3	–	0.3 ⁽¹⁾
Withholding tax ("WHT")	2005-10	WHT on services performed outside of Tanzania by non-resident persons.	1.1	0.7	1.8 ⁽²⁾
Income Tax	2008-13	Deductibility of capital expenditures and expenses (2009 and 2012), additional income tax (2008, 2010, 2011 and 2012), tax on repatriated income (2012), foreign exchange rate application (2013 and 2015) and underestimation of tax due (2014).	24.6	9.7	34.3 ⁽³⁾
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.8	5.5 ⁽⁴⁾
			28.7	13.2	41.9

(1) In 2015 PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE on grossed-up amounts in staff salaries. TRAB waived interest assessed thereon. PAET is awaiting ruling of the Tax Revenue Appeals Tribunal ("TRAT");

(2) (a) 2005-2009 (US\$1.7 million): In 2016, TRA filed an application for review of the Court of Appeal (CAT) decision in favour of PAET and later filed another application for leave to amend its earlier application. At the CAT hearing in Q1 2017, TRA withdrew their second application for review. In Q2 2017, the CAT accepted PAET's preliminary objection against the TRA application. On 28th July 2017, TRA filed another application for extension of time, under the certificate of urgency, for their application for CAT leave to review its judgement. PAET is awaiting CAT decision on the TRA application;

(b) 2010 (US\$0.1 million): TRAB is awaiting a ruling from the review by the Court of Appeal on the 2005-2009 case, which would influence TRAB's decision on this matter accordingly;

(3) (a) 2009 (US\$1.7 million): In 2015 TRAB ruled against PAET with respect to the deductibility of capital expenditures and other expenses. In Q2 2017 PAET also lost an appeal at TRAT and is now awaiting a formal judgement to appeal to CAT;

(b) 2008 (US\$1.8 million): In Q2 2017 TRA issued an adjusted assessment which accepted PAET's position that there was no tax payable for the year. The assessment, however, did not recognize a tax loss carried forward of US\$1.8 million. PAET has objected the assessment for being time-barred, incorrect and arbitrary;

(c) 2011 (US\$2.0 million): In Q2 2017 PAET filed an appeal at TRAB against a TRA assessment with respect to deductibility of capital expenditures and other expenses (US\$1.8 million). PAET is awaiting a TRAB hearing date. PAET is also awaiting a TRA response on an objection of another assessment with respect to alleged late filing penalty and under-estimation of interest (US\$0.2 million) raised for the year;

(d) 2010 (US\$2.5 million): PAET filed an appeal with TRAB against TRA assessment with respect to the deductibility of capital expenditures and other expenses as well as underestimation of interest and penalty amounts. PAET is awaiting a hearing date to be scheduled;

(e) 2013 (US\$6.6 million): In 2016 PAET filed objections to TRA assessment with respect to a foreign exchange rate application and is awaiting a response. Subsequent to the end of Q2 2017 PAET received TRA assessments for corporation tax (US\$0.7 million), which disallowed certain operating costs included in the tax returns, and for repatriated income (US\$5.7 million). The assessments are time-barred and without merit and management intends to file an objection;

(f) 2012 (US\$15.9 million): In 2016 TRA issued two assessments with respect to understated revenue, deductibility of capital expenditures and expenses and tax on repatriated income. PAET filed an appeal with TRAB against the TRA decision to deny PAET a waiver required for its objection to be admitted. PAET is awaiting TRAB ruling after hearing the case in Q2 2017;

(g) 2014 (US\$3.4 million): In 2016 TRA issued an assessment with respect to underestimation of tax due based on the provisional quarterly payments made by PAET, delayed filings of returns and late payments. PAET filed objections to the assessments and is awaiting a response;

(h) 2015 (US\$0.4 million): In 2016 TRA issued a self-assessment. PAET filed an objection to the assessment with respect to foreign exchange rate application and is awaiting a response;

(4) In 2016 TRA responded to PAET's objection filed in 2014 and issued an assessment in respect of output VAT on imported services and SSI Operatorship services. PAET filed an appeal with TRAB against TRA assessment and is awaiting a hearing date to be scheduled.

On March 29, 2017 management received a tax audit findings report from TRA for the years 2012-14. The report covers corporation tax, repatriated income, VAT and withholding tax. Management prepared and submitted its response to TRA and is awaiting TRA's response.

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

NEW ACCOUNTING POLICIES

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

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

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

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

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

SUMMARY QUARTERLY RESULTS OUTSTANDING

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

	2017		2016				2015	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<i>Figures in US\$'000 except where otherwise stated</i>								
Financials								
Revenue	14,448	15,542	16,533	17,744	14,572	15,810	15,872	15,943
Net (loss) income	(622)	2,840	1,048	5,302	1,452	(5,638)	(6,468)	6,112
Earnings (loss) per share – basic and diluted (US\$)	(0.02)	0.08	0.03	0.15	0.04	(0.16)	(0.19)	0.18
Cash flows from operations ⁽¹⁾	4,610	5,926	6,211	10,024	6,772	8,848	8,391	9,462
Cash flows from operations per share – basic and diluted (US\$)	0.13	0.17	0.18	0.29	0.19	0.25	0.24	0.27
Net cash flows from (used in) operating activities	12,038	8,787	8,345	6,540	6,237	(1,154)	5,450	(2,963)
Net cash flows (utilized) per share – basic and diluted (US\$)	0.35	0.25	0.24	0.19	0.18	(0.03)	0.16	(0.09)
Operating netback (US\$/mcf) ⁽¹⁾	3.44	3.34	3.35	3.31	3.32	3.08	3.03	2.65
Working capital	69,718	68,112	71,989	67,635	58,395	56,340	32,521	39,660
Long-term loan	58,468	58,399	58,399	58,398	58,368	58,350	18,599	–
Shareholders' equity	82,407	82,982	80,023	79,153	73,887	72,482	78,154	84,476

Capital expenditures

Geological and geophysical and well drilling	3	27	32	26	2,558	13,639	23,099	7,578
Pipeline and infrastructure	250	93	99	(71)	181	356	1,382	547
Other equipment	97	–	–	–	102	2	59	150
Other	–	7,352	–	–	–	–	–	–

Operating

Additional Gas sold								
– industrial (MMcf)	1,158	1,041	1,226	1,238	1,151	972	1,089	1,137
– industrial (MMcfd)	12.72	11.57	13.30	13.50	12.60	10.70	11.80	11.90
Additional Gas sold								
– power (MMcf)	2,437	2,873	2,895	3,047	2,521	3,241	3,483	3,127
– power (MMcfd)	26.78	31.92	31.50	33.10	27.70	35.60	37.90	34.50
Average price per mcf								
– industrial (US\$)	7.69	7.75	7.52	7.60	7.64	8.15	7.62	7.67
Average price per mcf								
– power (US\$)	3.57	3.57	3.57	3.57	3.55	3.55	3.56	3.62

⁽¹⁾ See non-GAAP measures

PRIOR EIGHT QUARTERS

The Company's revenue for the last eight quarters has been reasonably consistent. The fall in revenue from Q3 2016 to Q2 2017 is the consequence of the Company only recognizing a percentage of the TANESCO invoiced amounts for revenue recognition purposes from Q4 2016 onwards. The fall in revenue from Q4 2016 to Q2 2017 is a consequence of the fall in the volume of gas sold to the industrial sector (primarily a consequence of planned maintenance work at a cement plant) and to the power sector due to increased hydro utilization.

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

- Commencing in Q4 2016 the Company recognizes a percentage of the TANESCO invoiced amount for revenue recognition purposes in accordance with the revised estimation procedure which resulted in a net revenue reduction of US\$1.6 million in both Q4 2016 and Q1 2017 and a reduction of US\$0.8 million in Q2 2017 (see "Operating Revenue").
- The Company recorded an interest expense of US\$2.3 million in Q2 2017 and Q1 2017, US\$1.5 million in Q2 to Q4 2016 and US\$1.0 million in Q1 2016.
- Changes in stock based compensation due to fluctuations in the Company share price and issuance of new RSUs. In Q1 2016 the Company a charge of US\$2.8 million as a consequence of an increase in the share price from CDN\$2.75 at the end of Q4 2015 to CDN\$4.14 at the end of Q1 2016.
- In Q2 2016 the Company had a decrease in the stock based compensation charge of US\$0.7 million as the share price closed at CDN\$3.40 at the end of the quarter.
- In Q3 2016 the Company recorded a credit of US\$0.1 million for stock based compensation compared to a credit of US\$1.1 million in Q3 2015.
- In Q4 2016 the Company recorded a stock based compensation charge of US\$0.6 million, as a consequence of an increase in the closing share price to CDN\$3.82 from CDN\$3.41 at the end of Q3 2016.
- In Q1 2017 the Company recorded a stock based compensation charge of US\$0.8 million predominately a consequence of the issuance of 259,067 RSUs which vested fully on the date of grant.
- In Q2 2017 the Company recorded a stock based compensation charge of US\$1.6 million predominately the consequence of the issuance of 1,143,255 RSUs.

Differences in cash flows from operations for the last seven quarters were primarily a result in changes in revenue during the periods. The decrease in cash flows from operations in Q4 2016 is a consequence of expensing indirect taxes associated with invoices that have not been recorded in the financial statements because they do not meet the revenue recognition criteria with respect to assurance of collectability. The increase in the cash flows from operations to US\$10.0 million in Q3 2016 from US\$6.7 million in Q2 2016 is primarily the result of the US\$3.3 million increase in revenue over the quarter. The difference in cash flows from operations between in Q1 2017 and Q1 2016 is primarily a consequence of US\$1.0 million paid in stock based compensation in Q1 2017 (Q1 2016: US\$ nil). The fall in cash flows from operations between Q1 2017 to Q2 2017 is a consequence of the decline in revenue due to a decline in gas sales volumes and the associated fall in the Company's share of Profit Gas. The fall in cash flows from operations between Q2 2016 and Q2 2017 is primarily a result of the fall in the Company's operating revenue as a consequence of the change in the TANESCO revenue recognition criteria together with lower Additional Gas volumes and associated Profit Gas entitlement.

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

The decrease in working capital from Q3 2015 to Q4 2015 was a consequence of the increase in payables associated with the workover and drilling program together with the additional bad debt provision against TANESCO, both of which were offset by the initial draw down of US\$18.6 million from the Loan (net of expenses). The second draw down from the Loan of US\$40 million in Q1 2016 has offset the decrease in working capital associated with the completion of the workover and drilling program from Q4 2015 to Q1 2016. The progressive increase in working capital from Q1 2016 is mainly the result of US\$30.0 million in net cash flows from operating activities being offset by US\$3.0 million of capital expenditure over the same period given the Company's reduced level of drilling and related activity. The increase in working capital between Q1 2017 and Q2 2017 is the consequence of TANESCO receipts being greater than sales recognized for revenue recognition purposes.

Capital expenditure for the last four quarters Q2 2017 to Q3 2016 amounted to US\$7.9 million compared to US\$49.7 million from Q3 2015 to Q2 2016. The capital additions in Q1 2017 were primarily a result of the transfer of the Songas share of workover costs incurred in 2015 to property, plant and equipment. The 2015 workover and drilling program commenced in Q3 2015 and was completed at the end of the second quarter 2016.

The level of Industrial sales volumes increased by 7% in the four quarters ending Q2 2017 to an average of 1,166 MMcf (four quarters ending Q2 2016: 1,087 MMcf) with total Industrial sales volumes for the four quarters ending Q2 2017 increasing to 4,663 MMcf (12.8 MMcfd) compared to 4,349 MMcf (11.9 MMcfd) in the four quarters ending Q2 2016. The increased volumes are primarily the result of fewer days of unscheduled maintenance work by a cement company and consumption by new customers connected during the first half of 2016.

The level of Power sales volumes decreased by 9% in the four quarters ending Q2 2017 to an average of 2,813 Mcf (four quarters ending Q2 2016: 3,093 MMcf) with total Power sector sales volumes for the four quarters ending Q2 2017 decreasing to 11,252 MMcf (30.8 MMcfd) compared to 12,372 MMcf (33.9 MMcfd) in the four quarters ending Q2 2016. The decline is mainly the consequence of the decision by TANESCO not to renew a contract with an emergency power plant, unscheduled maintenance at the Songo Ubungo Power generation facility and the increased competition from gas suppliers within Tanzania.

BUSINESS RISKS

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

Financing

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

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

Collectability of Receivables

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

Prior to 2016 the Company had reached an understanding with TANESCO that it would continue to supply gas if TANESCO remained reasonably current with payments for gas deliveries. Up to September 30, 2016 the Company recorded revenue from TANESCO based on volumes delivered, however, TANESCO payments were inconsistent and not always in compliance with the agreed understanding resulting in the Company recording provisions for doubtful accounts for amounts outstanding from TANESCO for more than 60 days. Commencing on October 1, 2016, the Company began recording revenues for sales to TANESCO based on the expected amount to be collected, which represents a percentage of the amounts invoiced to TANESCO determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The result of recording revenue from TANESCO based on the expected collectability approach was a decrease in revenue recognized in the quarter of US\$0.8 million (Q2 2016: US\$ nil) and no increase in the provision for doubtful accounts (Q2 2016: US\$3.5 million increase). The decrease in revenue recorded for the six months ending June 30, 2017 was US\$2.4 million (six months ending June 30, 2016: US\$ nil) and no increase in the provision for doubtful accounts (six months ending June 30, 2016: US\$11.5 million).

The percentage used to recognize TANESCO revenue will be reviewed on at least a semi-annual basis, more frequently if circumstances require and if there is a significant difference between the amount of revenue recorded and amounts received, the percentage used to record revenue as well as any existing receivable or deferred revenue balance will be revised accordingly. No change in the percentage was required for Q2 2017.

At June 30, 2017 the current receivable from TANESCO was US\$ nil (December 31, 2016: US\$5.7 million). During the quarter the amounts received from TANESCO were in excess of the invoiced amounts recognized for revenue recognition purposes which has resulted in a deferred revenue balance of US\$4.1 million (December 31, 2016: US\$ nil). The long-term trade receivable at June 30, 2017 was US\$74.4 million (provision of US\$74.4 million) compared to US\$80.1 million (provision of US\$74.4 million) as at December 31, 2016. Since the quarter end, TANESCO has paid the Company US\$5.3 million. As at the date of this report the current receivable balance is US\$ nil and the deferred revenue total is US\$6.8 million with no change in the long-term receivable or provision. The amounts owed do not include interest billed and other invoices to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability.

As at June 30, 2017 Songas owed the Company US\$8.4 million (Q4 2016: US\$23.3 million), while the Company owed Songas US\$2.1 million (Q4 2016: US\$2.3 million). In Q1 2017, based on agreement with TPDC, the Songas share of workover costs were transferred to the cost pool to recover the costs via the PSA cost recovery mechanism. This resulted in: i) US\$7.4 million of the Songas receivable being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism; ii) the write-off of the US\$4.9 million portion of the Songas receivable that had been previously provided for; and iii) US\$2.2 million relating to VAT on the workovers that had already been paid being reclassified as a long-term receivable. The Company is continuing to pursue the collection of the US\$14.5 million of workover costs from Songas.

Amounts due to Songas primarily relate to pipeline tariff charges of US\$1.7 million (Q4 2016: US\$1.9 million), whereas the amounts due to the Company are mainly for sales of gas of US\$2.1 million (Q4 2016: US\$2.2 million) and for the operation of the gas plant of US\$6.3 million (Q4 2016: US\$6.6 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis.

As at June 30, 2017 the net amount owed by Songas to the Company was US\$6.4 million (Q4 2016: US\$21.0 million). A doubtful debt provision of US\$4.9 million (Q4 2016: US\$9.8 million) is necessary recognizing the uncertainty as to the final settlement of overdue operatorship charges and the Songas share of the well workover costs. Any significant amounts not agreed will be pursued through the mechanisms provided in the agreements with Songas.

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

Access to Songas processing and transportation

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

As a result of the 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 in 2013 and no new agreement is currently in place. Without the Re-Rating Agreement Songas, the owner of the gas processing plant, may require the plant to be operated at its original capacity of 70 MMcfd which would result in a material reduction in the Company's sales volumes until such time as the new sales agreement is finalized with TPDC and gas volumes can be delivered through the NNGIP.

Recent Legislation

The Act passed in 2015 repealed earlier legislation and provides a regulatory framework over upstream, mid-stream and downstream gas activity and consolidates and puts in place a comprehensive legal framework for regulating the oil and gas industry in the country. The Act also provides for the creation of an upstream regulator, the Petroleum Upstream Regulatory Authority ("PURA"). The mid and downstream oil and gas activities are proposed to be regulated by the current authority, the Energy and Water Utilities Regulatory Authority ("EWURA"). The Act also confers upon TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in petroleum operations as well as mid and downstream natural gas activities. The Act vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Act does provide grandfathering provisions upholding the rights of the Company under their PSA as it was signed prior to passing of the Act.

On October 7, 2016 the Government of Tanzania (the "GoT") issued the Petroleum (Natural Gas Pricing) Regulation made under Sections 165 and 258 (I) of the Act. Under the Act, Article 260 (3) preserves the Company's pre-existing right with TPDC to market and sell Additional Gas together or independently on terms and conditions (including prices) negotiated with third party natural gas customers.

On July 15, 2017 the GoT passed into law the Natural Wealth and Resources (Permanent Sovereignty) Act, 2017, the Written Laws (Miscellaneous Amendments) Act, 2017, and The Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act, 2017. The first and second of these acts are forward looking and only apply to agreements entered into on or after July 15th, 2017. These acts laws contain new regulations including but not limited to regulations that all arbitration processes must be heard within Tanzania and restrict the ability to move funds out of Tanzania. The third act is rearward looking and provides the right of the GoT to renegotiate contracts clauses that are deemed to have unconscionable terms and restricts the ability to move funds out of Tanzania.

It is still unclear how the provisions of new Act and legislation will be interpreted enacted and implemented and the Company is uncertain regarding the potential impact on its business in Tanzania.

Amended and Restated Gas Agreement

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

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

Critical judgements in applying accounting policies:

Collectability of receivables

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

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

Key sources of estimation of uncertainty

Financial instrument classification and measurement

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

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

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

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

ORCA EXPLORATION GROUP INC.

Q2 2017
FINANCIAL
STATEMENTS
& NOTES

NOTIFICATION OF CONDENSED UNAUDITED
CONSOLIDATED INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the condensed unaudited consolidated interim financial statements for the three and six month periods ended June 30, 2017

Condensed Consolidated Interim Statements of Comprehensive (Loss) Income (unaudited)

ORCA EXPLORATION GROUP INC. US\$'000		THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
		NOTE	2017	2016	2017
Revenue	6, 7	14,448	14,572	29,990	30,382
Production and distribution		(862)	(984)	(1,710)	(2,104)
Net production revenue		13,586	13,588	28,280	28,278
Operating expenses					
General and administrative		(4,719)	(2,337)	(8,235)	(8,383)
Depletion		(2,066)	(2,058)	(4,317)	(4,420)
Operating income		6,801	9,193	15,728	15,475
Finance income	8	80	81	161	130
Finance expense	8	(4,560)	(5,105)	(7,084)	(14,124)
Income before tax		2,321	4,169	8,805	1,481
Income tax – current	9	(2,833)	(1,779)	(6,236)	(3,803)
Income tax – deferred	9	(110)	(938)	(351)	(1,864)
Net (loss) income		(622)	1,452	2,218	(4,186)
Foreign currency translation gain (loss) from foreign operations		47	(47)	166	(81)
Comprehensive (loss) income		(575)	1,405	2,384	(4,267)
Net (loss) income per share (US\$)					
Basic and diluted	16	(0.02)	0.04	0.06	(0.12)

See accompanying notes to the condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Financial Position (unaudited)

ORCA EXPLORATION GROUP INC.

AS AT

US\$'000

NOTE

JUNE 30, 2017

DECEMBER 31, 2016

Assets**Current assets**

Cash and cash equivalents		98,285	80,895
Trade and other receivables	11	11,860	27,638
Tax recoverable	9	6,168	5,402
Prepayments		790	651
		117,103	114,586

Non-current assets

Long-term trade and other receivables	11	2,773	525
Property, plant and equipment	12	114,760	111,421
		117,533	111,946
Total Assets		234,636	226,532

Equity and liabilities**Current liabilities**

Trade and other payables	13	44,251	39,707
Tax payable		3,134	2,890
		47,385	42,597

Non-current liabilities

Deferred income taxes	9	13,324	12,973
Long-term loan	14	58,468	58,399
Additional Profits Tax	10	33,052	32,540
		104,844	103,912
Total Liabilities		152,229	146,509

Equity

Capital stock	15	85,488	85,488
Contributed surplus		6,347	6,347
Accumulated other comprehensive loss		(215)	(381)
Accumulated loss		(9,213)	(11,431)
		82,407	80,023
Total equity and liabilities		234,636	226,532

See accompanying notes to the condensed consolidated interim financial statements.

Nature of Operations (Note 1); Contractual obligations and committed capital investment (Note 18); Contingencies (Note 19).

The consolidated financial statements were approved by the Board of Directors on August 15, 2017.

Condensed Consolidated Interim Statements of Cash Flows (unaudited)

ORCA EXPLORATION GROUP INC.		THREE MONTHS ENDED JUNE 30		THREE MONTHS ENDED JUNE 30	
US\$'000	NOTE	2017	2016	2017	2016
Operating activities					
Net (loss) Income		(622)	1,452	2,218	(4,186)
Adjustment for:					
Depletion and depreciation	12	2,143	2,226	4,483	4,734
Provision for doubtful accounts and indirect tax	8	2,354	3,472	2,559	11,458
Stock based compensation	15	790	(1,018)	619	1,777
Deferred income taxes	9	110	938	351	1,864
Additional Profits Tax	10	238	288	512	596
Unrealized loss on foreign exchange		(403)	(586)	(206)	(623)
Interest expense	8	1,585	1,548	3,103	2,553
Participatory interest expense	8	725	–	1,456	–
Change in non-cash operating working capital		5,118	(2,083)	5,730	(13,090)
Net cash flows from operating activities		12,038	6,237	20,825	5,083
Investing activities					
Property, plant and equipment expenditures	12	(350)	(2,841)	(470)	(16,838)
Change in non-cash investing working capital		24	(2,933)	(72)	(7,998)
Net cash used in investing activities		(326)	(5,774)	(542)	(24,836)
Financing activities					
Interest paid	8	(1,585)	(1,548)	(3,103)	(2,553)
Increase in long-term loan	14	–	18	–	39,769
Net cash flow (used in) from financing activities		(1,585)	(1,530)	(3,103)	37,216
Increase (decrease) in cash		10,127	(1,067)	17,180	17,463
Cash and cash equivalents at the beginning of the period		87,821	72,300	80,895	53,797
Effect of change in foreign exchange on cash for the period		337	573	210	546
Cash and cash equivalents at the end of the period		98,285	71,806	98,285	71,806

See accompanying notes to the condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Changes in Shareholders Equity (unaudited)

ORCA EXPLORATION GROUP INC.

<i>US\$'000</i>	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated loss	Total
Note	15				
Balance as at January 1, 2017	85,488	6,347	(381)	(11,431)	80,023
Foreign currency translation adjustment on foreign operations	–	–	166	–	166
Net income	–	–	–	2,218	2,218
Balance as at June 30, 2017	85,488	6,347	(215)	(9,213)	82,407

<i>US\$'000</i>	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated loss	Total
Note	15				
Balance as at January 1, 2016	85,488	6,347	(87)	(13,595)	78,153
Foreign currency translation adjustment on foreign operations	–	–	(80)	–	(80)
Net loss	–	–	–	(4,186)	(4,186)
Balance as at June 30, 2016	85,488	6,347	(167)	(17,781)	73,887

See accompanying notes to the condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)

General Information

Orca Exploration Group Inc. (the "Company" or "Orca Exploration") was incorporated on April 28, 2004 under the laws of the British Virgin Islands with registered offices located at PO Box 146, Road Town, Tortola, British Virgin Islands, VG110. The Company produces and sells natural gas to the power and industrial sectors in Tanzania.

The condensed consolidated interim financial statements of the Company as at and for the three and six months ended June 30, 2017 comprise accounts of the Company and all its wholly owned subsidiaries and were authorized for issue in accordance with a resolution of the directors on August 15, 2017.

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 ("GoT") in the United Republic of Tanzania. This PSA covers the production and marketing of certain gas from the Songo Songo Block offshore Tanzania.

The PSA defines gas in the Songo Songo field as "Protected Gas" and "Additional Gas". The "Protected Gas" is owned by TPDC and is sold under a 20-year gas agreement until July 2024 ("Gas Agreement") 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 for onward sale to customers. 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 GoT, 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.

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.

2**BASIS OF PREPARATION**

These condensed consolidated interim 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 ("US\$").

Statement of Compliance

The condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" and do not include all information required for full annual financials and should be read in conjunction with the audited financial statements for the year ended December 31, 2016.

3**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Company's accounting policies are set forth in Note 3 to the audited consolidated financial statements for the year ended December 31, 2016. There have been no changes in accounting policies for the six-month period ended June 30, 2017 and the policies have been applied consistently to all periods presented in the condensed consolidated interim financial statements.

New accounting policies

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

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

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

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

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

4

USE OF ESTIMATES AND JUDGEMENTS

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ materially from these estimates. In preparing these consolidated financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to the audited consolidated financial statements as at and for the year ended December 31, 2016.

See Note 4 of the audited consolidated financial statements for the year ended December 31, 2016 for a full discussion.

5**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.

A. 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 contracts with Songas and TANESCO accounted for 45% of the Company's gross field revenue during the quarter. The carrying amount of accounts receivable and the long-term receivable represents the maximum credit exposure. As at June 30, 2017 and December 31, 2016, other than the provisions against the long-term TANESCO receivable, the provision for gas plant operations charges and capital expenditure receivables from Songas and the provision for two industrial customers, the Company does not have an allowance for doubtful accounts against any other receivables nor was it required to write-off any receivables (see Note 11).

Sales to the Industrial sector are subject to an internal credit review to minimize the risk of non-payment.

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. The Company's cash resources are placed with reputable financial institutions with no history of default.

B. 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\$44.3 million of financial liabilities with regards to trade and other payables of which US\$37.7 million is due within one to three months, nil is due within three to six months, and US\$6.6 million is due within six to twelve months (see Note 13). As at June 30, 2017 the Company had a current tax liability of US\$3.1 million.

At the end of the quarter approximately 60% of the current liabilities relate to TPDC (see Note 13). The amounts due to TPDC represent its share of Profit Gas; in accordance with the terms of the PSA TPDC is entitled to the payment of its share of Profit Gas on a quarterly basis proportional to the cash receipts during the quarter. Given the difficulties in collecting from TANESCO, the Company has been settling these amounts on a pro rata basis as TANESCO payments are received (see Note 11).

6

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	2017			THREE MONTHS ENDED JUNE 30		
	Italy	Tanzania	Total	Italy	Tanzania	Total
External revenue	–	14,448	14,448	–	14,572	14,572
Segment (loss) income	(96)	(526)	(622)	–	1,452	1,452
Other non-cash charges ⁽¹⁾	–	2,354	2,354	–	3,472	3,472
Depletion & depreciation	–	2,143	2,143	–	2,226	2,226

US\$'000	2017			SIX MONTHS ENDED JUNE 30		
	Italy	Tanzania	Total	Italy	Tanzania	Total
External revenue	–	29,990	29,990	–	30,382	30,382
Segment (loss) income	(131)	2,349	2,218	–	(4,186)	(4,186)
Other non-cash charges ⁽¹⁾	–	2,559	2,559	–	11,458	11,458
Depletion & depreciation	–	4,483	4,483	–	4,734	4,734

US\$'000	JUNE 30, 2017			AS AT DECEMBER 31, 2016		
	Italy	Tanzania	Total	Italy	Tanzania	Total
Capital additions ⁽²⁾	–	470	470	–	16,924	16,924
Total assets	1,596	233,040	234,636	1,477	225,055	226,532
Total liabilities	82	152,147	152,229	102	146,407	146,509

(1) Other non-cash charges for 2017 includes VAT and for 2016 it includes VAT and amounts provided for doubtful accounts receivable from TANESCO expensed directly to the condensed consolidated interim statements of comprehensive income.

(2) See Notes 11 and 12.

7

REVENUE

<i>US\$'000</i>	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Industrial sector	8,906	8,790	16,974	16,715
Power sector	7,163	8,946	15,517	20,458
Gross field revenue	16,069	17,736	32,491	37,173
Processing and transportation tariff	(2,124)	(2,223)	(4,434)	(5,079)
Net field revenue	13,945	15,513	28,057	32,094
TPDC share of revenue	(2,266)	(2,327)	(4,383)	(4,814)
Company operating revenue	11,679	13,186	23,674	27,280
Additional Profits Tax charge	(238)	(288)	(512)	(596)
Current income tax adjustment	3,007	1,674	6,828	3,698
Revenue	14,448	14,572	29,990	30,382

Commencing on October 1, 2016 the Company records a percentage of the amounts invoiced to TANESCO for revenue recognition purposes determined by comparison of TANESCO's historical payment history to the amounts invoiced by the Company over the previous three years. Management believes this approach provides the best estimate of TANESCO's ability to pay and remain reasonably current and as well reflects the economic reality of the situation. The impact of recording revenue from TANESCO based on the expected collectability approach is as follows:

<i>US\$'million</i>	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Decrease in revenue and net income	797	–	2,379	–
Decrease in accounts receivable	1,543	–	3,448	–
Decrease in current liabilities	746	–	1,069	–

8

NET FINANCE EXPENSE

<i>US\$'000</i>	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Finance income	80	81	161	130
Interest expense	(1,585)	(1,548)	(3,103)	(2,553)
Participatory interest	(725)	–	(1,456)	–
Net foreign exchange gain (loss)	104	(85)	34	(113)
Indirect tax	(2,354)	(155)	(2,559)	(301)
Provision for doubtful accounts	–	(3,317)	–	(11,157)
Finance expense	(4,560)	(5,105)	(7,084)	(14,124)
Net finance expense	(4,480)	(5,024)	(6,923)	(13,994)

The total amount of interest expense during the quarter was US\$1.6 million (Q2 2016: US\$1.5 million) and US\$3.1 million for the six months ending June 30, 2017 (six months ended June 30, 2016: US\$2.6 million). The interest relates to the long-term loan with the International Finance Corporation (“IFC”) and is payable quarterly in arrears. The participatory interest is paid annually in arrears and is an accrual equating to 7% of the net cash flows from operating activities of PAET net of net cash flows used in investing activities for the six months ending June 30, 2017 (see Note 14).

The indirect tax of US\$2.4 million for the quarter (Q2 2016: US\$0.2 million) and US\$2.6 million for the six months ending June 30, 2017 (six months ending June 30, 2016: US\$0.3 million) is for VAT associated with invoices to TANESCO for interest on late payments and invoices under the Take or Pay provisions within the PGSA not recognized in the financial statements due to revenue recognition criteria with respect to assurance of collectability.

The provision for doubtful accounts for the quarter and six months ending June 30, 2016 relates to overdue TANESCO receivables.

9

INCOME TAXES

The tax charge is as follows:

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Current tax	2,833	1,779	6,236	3,803
Deferred tax expense	110	938	351	1,864
	2,943	2,717	6,587	5,667

Provisional tax payments totaling US\$2.9 million for Q2 2017 (Q2 2016: US\$1.9 million) and US\$5.8 million for the six months ending June 30, 2017 (six months ending June 30, 2016: US\$3.8 million) were made in respect of the current year.

US\$'000	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2017	2016	2017	2016
Income before tax	2,321	4,169	8,805	1,481
Provision for income tax calculated at the statutory rate of 30%	696	1,250	2,642	444
Add the tax effect of non-deductible income tax items:				
Administrative and operating expenses	404	338	752	580
Foreign exchange (gain) loss	(7)	23	(27)	8
Stock based compensation	468	(222)	720	635
TANESCO interest not recognized as interest income (Note 8)	508	258	851	502
Unrecognized tax asset	1,169	1,041	1,802	3,437
Other permanent differences	(295)	29	(153)	61
	2,943	2,717	6,587	5,667

As at June 30, 2017 the unrecognized deferred tax asset of US\$29.9 million (Q4 2016: US\$23.1 million) is a result of the provision for doubtful accounts for TANESCO. If this debt is ultimately not recovered, the Company would also be entitled to a US\$17.0 million recovery of Value Added Tax (Q4 2016: US\$13.9 million).

The deferred income tax liability includes the following temporary differences:

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Differences between tax base and carrying value of property, plant and equipment	(21,986)	(21,563)
Tax recoverable from TPDC	(4,740)	(4,142)
Provision for doubtful accounts	3,110	3,110
Deferred Additional Profits Tax	9,999	9,787
Unrealized exchange losses (gains)/other provisions	293	(165)
	(13,324)	(12,973)

Tax recoverable

The Company has a tax recoverable balance of US\$6.2 million (Q4 2016: US\$5.4 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 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.

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Tax recoverable	6,168	5,402

10**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 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 19.46% (Q2 2016: 18.56%) has been applied to Profit Gas of US\$1.2 million for Q2 2017 (Q2 2016: US\$1.6 million) and US\$2.6 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$3.2 million). Accordingly US\$0.2 million for Q2 2017 (Q2 2016: US\$0.3 million) and US\$0.5 million for the six months ended June 30, 2017 (US\$0.6 million for the six months to June 30, 2016) has been netted off revenue. There is no forecasted APT payable until 2019.

11

TRADE AND OTHER RECEIVABLES

Current receivables

<i>US\$'000</i>	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Trade receivables		
TANESCO	–	5,749
Songas	2,115	2,218
Industrial customers	8,034	7,463
	10,149	15,430
Less provision for doubtful accounts	(550)	(550)
	9,599	14,880
Other receivables		
Songas gas plant operations	6,303	6,601
Songas well workover programme	–	14,458
Other	874	1,516
	7,177	22,575
Less provision for doubtful accounts	(4,916)	(9,817)
	2,261	12,758
	11,860	27,638

Trade receivables aged analysis

<i>US\$'000</i>	AS AT JUNE 30, 2017				
	Current	>30 <60	>60 <90	>90	Total
TANESCO	–	–	–	–	–
Songas	1,111	1,004	–	–	2,115
Industrial customers	3,659	3,537	125	713	8,034
	4,770	4,541	125	713	10,149
Less provision for doubtful accounts	–	–	–	(550)	(550)
	4,770	4,541	125	163	9,599
	AS AT DECEMBER 31, 2016				
	Current	>30 <60	>60 <90	>90	Total
TANESCO	2,570	2,559	620	–	5,749
Songas	1,190	1,028	–	–	2,218
Industrial customers	2,769	3,679	235	780	7,463
	6,529	7,266	855	780	15,430
Less provision for doubtful accounts	–	–	–	(550)	(550)
	6,529	7,266	855	230	14,880

TANESCO

At June 30, 2017 the current receivable from TANESCO was US\$ nil (December 31, 2016: US\$5.7 million). During the quarter the amounts received from TANESCO were in excess of the revenue recognized for gas sales to TANESCO (which is less than the invoiced amounts as detailed in Note 7) resulting in a deferred revenue balance of US\$4.1 million (December 31, 2016: US\$ nil) which is recorded in trade and other payables (see Note 13). The long-term trade receivable at June 30, 2017 was US\$74.4 million (provision of US\$74.4 million) compared to US\$80.1 million (provision of US\$74.4 million) as at December 31, 2016. Since the quarter end, TANESCO has paid the Company US\$5.3 million. As at the date of this report the current receivable balance is US\$ nil and the deferred revenue total is US\$6.8 million with no change in the long-term receivable or provision. The amounts owed do not include invoices to TANESCO not meeting the revenue recognition criteria with respect to assurance of collectability as described in Note 8 above.

Long-term trade and other receivables	AS AT	
	JUNE 30, 2017	DECEMBER 31, 2016
<i>US\$'000</i>		
TANESCO receivable	74,361	74,361
Provision for doubtful accounts	(74,361)	(74,361)
Net TANESCO receivable	–	–
VAT receivable	2,553	318
Lease deposit	220	207
Long-term trade and other receivables	2,773	525

Songas

As at June 30, 2017 Songas owed the Company US\$8.4 million (Q4 2016: US\$23.3 million), while the Company owed Songas US\$2.1 million (Q4 2016: US\$2.3 million). Amounts due to Songas primarily relate to pipeline tariff charges of US\$1.7 million (Q4 2016: US\$1.9 million), whereas the amounts due to the Company are mainly for sales of gas of US\$2.1 million (Q4 2016: US\$2.2 million) and for the operation of the gas plant of US\$6.3 million (Q4 2016: US\$6.6 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis.

In Q1 2017, based on agreement with TPDC, the Songas share of workover costs of US\$14.5 million were transferred to the cost pool to recover the costs via the PSA cost recovery mechanism. This resulted in:

- i) US\$7.4 million of the Songas receivable being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism;
- ii) the write-off of the US\$4.9 million portion of the Songas receivable that had been previously provided for; and
- iii) US\$2.2 million relating to VAT on the workovers that had already been paid being reclassified as a long-term receivable. The Company is continuing to pursue the collection of the US\$14.5 million of workover costs from Songas. Any significant amounts not agreed will be pursued through the mechanisms provided in the agreements with Songas.

All amounts due to and from Songas have been summarized in the table below:

<i>US\$'000</i>	January 1, 2017	Year to date transactions	Gross balance June 30, 2017	Post quarter end payments and receipts	Outstanding as at the date of this report
Pipeline tariff payable	(1,893)	224	(1,669)	1,669	–
Gas sales receivable	2,218	(103)	2,115	(2,115)	–
Gas plant operation receivable	6,601	(298)	6,303	(327)	5,976
Workover programme	14,458	(14,458)	–	–	–
Other payable	(378)	–	(378)	–	(378)
Net balances	21,006	(14,635)	6,371	(773)	5,598

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PROPERTY, PLANT AND EQUIPMENT

<i>US\$'000</i>	Oil and natural gas interests	Leasehold improvements	Computer equipment	Vehicles	Fixtures & fittings	Total
Costs						
As at January 1, 2017	195,624	699	1,366	380	1,125	199,194
Additions ⁽¹⁾	7,725	–	28	69	–	7,822
As at June 30, 2017	203,349	699	1,394	449	1,125	207,016
Accumulated depletion and depreciation						
As at January 1, 2017	84,580	626	1,304	249	1,014	87,773
Depletion and depreciation	4,317	88	26	44	8	4,483
As at June 30, 2017	88,897	714	1,330	293	1,022	92,256
Net book values						
As at June 30, 2017	114,452	(15)	64	156	103	114,760
As at December 31, 2016	111,044	73	62	131	111	111,421

(1) Additions include a transfer of US\$7.4 million in relation to the Songas share of workover costs (see Note 11).

In determining the depletion charge, it is estimated that future development costs of US\$83.7 million will be required to bring the total proved reserves to production. The Company recorded depreciation of US\$0.1 million in Q2 2017 (Q2 2016: US\$0.1 million) and US\$0.2 million in the six months ended June 30, 2017 (six months ended June 30, 2016: US\$0.3 million) which is included in general and administrative expenses.

13**TRADE AND OTHER PAYABLES**

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Songas	1,669	1,893
Other trade payables	2,718	3,245
Trade payables	4,387	5,138
TPDC share of Profit Gas	26,539	28,319
Accrued liabilities	9,188	6,250
Deferred revenue (Note 11)	4,137	–
	44,251	39,707

14**LONG-TERM LOAN**

The Company's subsidiary, PanAfrican Energy Tanzania Limited ("PAET"), entered into a US\$60 million financing agreement in 2015 (the "Loan") with the IFC, a member of the World Bank Group.

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

Base interest on the Loan is payable quarterly at 10% per annum on a 'pay-if-you-can-basis' using a formula to calculate the net cash available for such payments as at any given interest payment date. To date, all base interest incurred has been paid. In addition, an annual variable participatory interest equating to 7% of the net cash flows from operating activities of PAET net of net cash flows used in investing activities in respect of any given year. Such participatory interest will continue until October 15, 2026 regardless whether the Loan is repaid prior to its contractual maturity date. An accrual for the participatory interest of US\$0.7 million and US\$1.5 million for the three and six months ended June 30, 2017 (comparable periods in 2016: US\$ nil) respectively has been made and is included in trade and other payables (see Note 8). Dividends and distributions from PAET to the Company are restricted at any time that any amounts of unpaid interest, principal or participatory interest are outstanding.

<i>US\$'000</i>	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
Total IFC facility	60,000	60,000
Loan drawdown	60,000	60,000
Financing costs	(1,532)	(1,601)
	58,468	58,399

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CAPITAL STOCK

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 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.

Changes in the capital stock of the Company were as follows:

Number of shares	2017		
	Authorised (000)	Issued (000)	Amount (US\$'000)
Class A			
As at January 1 and June 30, 2017	50,000	1,751	983
Class B			
As at January 1 and June 30, 2017	100,000	33,106	84,505
First preference			
As at January 1 and June 30, 2017	100,000	–	–
Total Class A, Class B and first preference	250,000	34,857	85,488

All of the issued capital stock is fully paid.

Stock Appreciation Rights ("SARs")	SARs (000)	Exercise Price (CDN\$)
Outstanding as at January 1, 2017	2,430	2.12 to 3.25
Exercised	(160)	2.12 to 2.30
Exercised	(165)	2.35 to 2.70
Granted	365	3.87
Outstanding as at June 30, 2017	2,470	2.12 to 3.87

The number outstanding, the weighted average remaining life and weighted average exercise prices of SARs at June 30, 2017 were as follows:

Exercise Price (CDN\$)	Number outstanding (000)	Weighted average remaining contractual life (years)	Number exercisable (000)	Weighted average exercise price (CDN\$)
2.12 to 2.30	1,570	1.46	918	2.27
2.32 to 2.70	100	0.15	100	2.70
3.02 to 3.25	435	3.27	85	3.05
3.87	365	4.52	–	3.87
2.12 to 3.87	2,470	2.18	1,103	2.66

Restricted Stock Units ("RSUs")	RSUs (000)	Exercise Price (CDN\$)
Outstanding as at January 1, 2017	239	0.01
Exercised	(468)	0.01
Granted	1,402	0.01
Outstanding as at June 30, 2017	1,173	0.01

(i) A total of 143,255 RSUs were granted during Q2 2017 and 1,402,322 for the six months ended June 30, 2017. Of the RSUs granted in the six months ended June 30, 2017, 402,322 of these RSUs vested on the date of grant, have an exercise price of CDN\$0.01 and have a five-year term while 1,000,000 RSUs vest quarterly starting April 1, 2017 over a 1 year period, have an exercise price of CDN\$0.01 and have a five-year term.

The number outstanding, the weighted average remaining life of RSUs at June 30, 2017 were as follows:

Exercise Price (CDN\$)	Number outstanding (000)	Number exercisable (000)	Weighted average exercise price (CDN\$)
0.01	160	160	3.52
0.01	1,000	–	4.79
0.01	13	13	4.79
	1,173	173	4.61

As SARs and RSUs are settled in cash, they are re-valued at each reporting date using the Black-Scholes option pricing model with the resulting liability being recognized in trade and other payables. In the valuation of stock appreciation rights and restricted stock units at the reporting date, the following assumptions have been made: a risk free rate of interest of 0.5%, stock volatility of 37% to 62%; 0% dividend yield; 5% forfeiture; a closing stock price of CDN\$4.01 per share.

The amount of accrued liability related to SARs and RSUs were as follows:

	AS AT JUNE 30, 2017	AS AT DECEMBER 31, 2016
SARs	2,518	2,495
RSUs	1,279	682
	3,797	3,177

As at June 30, 2017, a total accrued liability of US\$3.8 million (Q4 2016: US\$3.2 million) has been recognized in relation to SARs and RSUs, which is included in other payables. The Company recognized an expense for the quarter of US\$1.6 million (Q2 2016: credit US\$0.7 million) and US\$2.4 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$2.1 million) in general and administrative expenses.

16**EARNINGS PER SHARE**

<i>('000)</i>	THREE AND SIX MONTHS ENDED JUNE 30	
	2017	2016
Outstanding shares		
Weighted average number of Class A and Class B shares	34,857	34,857
Weighted average diluted number of Class A and Class B shares	34,857	34,857

The calculation of basic loss per share for Q2 2017 is based on a net loss of US\$0.6million (Q2 2016: US\$1.5 million income) and a weighted average number of Class A and Class B shares outstanding during the quarter of 34,856,432 (Q2 2016: 34,856,432). The calculation of basic earnings per share for the six months ended June 30, 2017 is based on a net income of US\$2.2 million (six months ended June 30, 2016: US\$4.2 million loss) and a weighted average number of Class A and Class B shares outstanding for the six months ended June 30, 2017 of 34,856,432 (six months ended June 30, 2016: 34,856,432).

17**RELATED PARTY TRANSACTIONS**

One of the non-executive Directors is counsel to a law firm that provides legal advice to the Company and its subsidiaries. During the quarter, the Company incurred US\$0.1 million (Q2 2016: US\$0.1 million) and US\$0.2 million for the six months ended June 30, 2017 (six months ended June 30, 2016: US\$0.1 million) to this firm for services provided.

As at June 30, 2017 the Company has a total of US\$0.1 million (Q2 2016: US\$0.1 million) recorded in trade and other payables in relation to the related parties.

18**CONTRACTUAL OBLIGATIONS
& COMMITTED CAPITAL INVESTMENTS****Protected Gas**

Under the terms of the Gas Agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, the Company is liable to pay the difference between the price of Protected Gas (US\$0.55/MMbtu escalated) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (168.7 Bcf as at June 30, 2017). The Company did not have a shortfall during the reporting period and does not anticipate a shortfall arising during the term of the Protected Gas delivery obligation to July 2024.

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

Re-Rating Agreement

In 2011 the Company signed a re-rating agreement with TANESCO, TPDC and Songas (the "Re-Rating Agreement") which evidenced an increase to the gas processing capacity of the Songas facilities to a maximum of 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 102 MMcfd). Under the terms of the Re-Rating Agreement, the Company paid additional compensation of US\$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US\$0.40/mcf for volumes above 90 MMcfd by issuing credit notes to TANESCO. This was in addition to the tariff of US\$0.59/mcf payable to Songas as set by the energy regulator, EWURA. In May 2016 the Company notified TANESCO and Songas that the additional compensation would no longer be paid effective June 2016. This additional compensation was always intended to be temporary in nature until such time as Songas applied to EWURA to obtain approval of a new tariff for the processing of volumes over 70 MMcfd. The PGSA provides for passing on to TANESCO any tariff to be charged to the Company.

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

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\$15.0 million, but only to the extent that this was not already recovered through TANESCO's or Songas' insurance policies.

Capital Commitments

Tanzania

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

The completion of the Offshore component of Phase A of the Development Program in February 2016 has improved field deliverability and provides sufficient natural gas production to fill the Songas plant and pipeline to capacity for the greater portion of the remaining life of the production licence. The Company does not expect to commit to further significant capital expenditures until agreeing commercial terms with TPDC for the supply of gas to the NNGIP.

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

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

Italy

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

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CONTINGENCIES

Taxation

Area	Period	Tax dispute Reason for dispute	Disputed amount US\$' million		
			Principal	Interest	Total
Pay-As-You-Earn ("PAYE") tax	2008-10	PAYE tax on grossed-up amounts in staff salaries which are contractually stated as net.	0.3	–	0.3 ⁽¹⁾
Withholding tax ("WHT")	2005-10	WHT on services performed outside of Tanzania by non-resident persons.	1.1	0.7	1.8 ⁽²⁾
Income Tax	2008-15	Deductibility of capital expenditures and expenses (2009 and 2012), additional income tax (2008, 2010, 2011 and 2012), tax on repatriated income (2012), foreign exchange rate application (2013 and 2015) and underestimation of tax due (2014).	24.6	9.7	34.3 ⁽³⁾
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.8	5.5 ⁽⁴⁾
			28.7	13.2	41.9

- (1) In 2015 PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE on grossed-up amounts in staff salaries. TRAB waived interest assessed thereon. PAET is awaiting ruling of the Tax Revenue Appeals Tribunal ("TRAT");
- (2) (a) 2005-2009 (US\$1.7 million): In 2016 TRA filed an application for review of the Court of Appeal (CAT) decision in favour of PAET and later filed another application for leave to amend its earlier application. At the CAT hearing in Q1 2017, TRA withdrew their second application for review. In Q2 2017, the CAT accepted PAET's preliminary objection against the TRA application. On 28th July 2017, TRA filed another application for extension of time, under the certificate of urgency, for their application for CAT leave to review its judgement. PAET is awaiting CAT decision on the TRA application;
- (b) 2010 (US\$0.1 million): TRAB is awaiting a ruling from the review by the Court of Appeal on the 2005-2009 case which would influence TRAB's decision on this matter accordingly;
- (3) (a) 2009 (US\$1.7 million): In 2015 TRAB ruled against PAET with respect to the deductibility of capital expenditures and other expenses. In Q2 2017 PAET also lost an appeal at TRAT and is now awaiting a formal judgement to appeal to CAT;
- (b) 2008 (US\$1.8 million): In Q2 2017 TRA issued an adjusted assessment which accepted PAET's position that there was no tax payable for the year. The assessment, however, did not recognise a tax loss carried forward of US\$1.8 million. PAET has objected the assessment for being time-barred, incorrect and arbitrary;
- (c) 2011 (US\$2.0 million): In Q2 2017 PAET filed an appeal at TRAB against a TRA assessment with respect to deductibility of capital expenditures and other expenses (US\$1.8 million). PAET is awaiting a TRAB hearing date. PAET is also awaiting a TRA response on an objection of another assessment with respect to alleged late filing penalty and under-estimation of interest (US\$0.2 million) raised for the year;
- (d) 2010 (US\$2.5 million): PAET filed an appeal with TRAB against TRA assessment with respect to the deductibility of capital expenditures and other expenses as well as underestimation of interest and penalty amounts. PAET is awaiting a hearing date to be scheduled;
- (e) 2013 (US\$6.6 million): In 2016 PAET filed objections to TRA assessment with respect to a foreign exchange rate application and is awaiting a response. Subsequent to the end of Q2 2017 PAET received TRA assessments for corporation tax (US\$0.7 million), which disallowed certain operating costs included in the tax returns, and for repatriated income (US\$5.7 million). The assessments are time-barred and without merit and management intends to file an objection;
- (f) 2012 (US\$15.9 million): In 2016 TRA issued two assessments with respect to understated revenue, deductibility of capital expenditures and expenses and tax on repatriated income. PAET filed an appeal with TRAB against the TRA decision to deny PAET a waiver required for its objection to be admitted. PAET is awaiting TRAB ruling after hearing the case in Q2 2017;
- (g) 2014 (US\$3.4 million): In 2016 TRA issued an assessment with respect to underestimation of tax due based on the provisional quarterly payments made by PAET, delayed filings of returns and late payments. PAET filed objections to the assessments and is awaiting a response;
- (h) 2015 (US\$0.4 million): In 2016 TRA issued a self-assessment. PAET filed an objection to the assessment with respect to foreign exchange rate application and is awaiting a response;
- (4) In 2016 TRA responded to PAET's objection filed in 2014 and issued an assessment in respect of output VAT on imported services and SSI Operatorship services. PAET filed an appeal with TRAB against TRA assessment and is awaiting a hearing date to be scheduled.

On March 29, 2017 management received a tax audit findings report from TRA for the years 2012-14. The report covers corporation tax, repatriated income, VAT and withholding tax. Management prepared and submitted its response to TRA and is awaiting TRA's response.

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

Corporate Information

Board of Directors

W. David Lyons Chairman and Chief Executive Officer Queensway Gibraltar	David W. Ross Non-Executive Director Calgary, Alberta Canada	William H. Smith Non-Executive Director Calgary, Alberta Canada	E. Alan Knowles Non-Executive Director Calgary, Alberta Canada	Glenn D. Gradeen Non-Executive Director Calgary, Alberta Canada
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Officers

W. David Lyons Chairman and Chief Executive Officer Queensway Gibraltar	Blaine E. Karst Chief Financial Officer Calgary, Alberta Canada	David K. Roberts Vice President of Operations Kansas City, Missouri United States of America
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