



ORCA EXPLORATION GROUP INC.



2018 Q1 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

FINANCIAL AND OPERATING HIGHLIGHTS ...	2
Q1 2018 OPERATING HIGHLIGHTS ...	3
MANAGEMENT'S DISCUSSION & ANALYSIS ...	5
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED) ...	38
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION (UNAUDITED) ...	39
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS (UNAUDITED) ...	40
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF SHAREHOLDERS EQUITY (UNAUDITED) ...	41
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) ...	42
CORPORATE INFORMATION ...	61

Financial and Operating Highlights

	THREE MONTHS ENDED MARCH 31		% CHANGE 2018 vs. 2017
	2018	2017	
<i>(Expressed in US\$'000 unless indicated otherwise)</i>			
OPERATING			
Daily average gas delivered and sold (MMcfd)			
Additional Gas	37.4	43.5	(14)%
Industrial	13.9	11.6	20%
Power	23.5	31.9	(26)%
Average price (US\$/mcf)			
Industrial	7.79	7.75	1%
Power	3.60	3.57	1%
Weighted average	5.16	4.68	10%
Operating netback (US\$/mcf)⁽¹⁾	2.23	3.34	(33)%
FINANCIAL			
Revenue	14,223	18,126	(22)%
Net cash flows from operating activities	1,527	8,787	(83)%
per share - basic and diluted (US\$)	0.04	0.25	(83)%
Net (loss) income	(4,638)	2,840	n/m
per share - basic and diluted (US\$)	(0.13)	0.08	n/m
Funds flow (used in) from operations⁽¹⁾	(7,054)	5,926	n/m
per share - basic and diluted (US\$)	(0.20)	0.17	n/m
Capital expenditures (excluding transfers)	819	120	583%
		AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017	
Working capital (including cash)	65,201	69,575	(6)%
Cash	117,813	122,322	(4)%
Long-term loan	58,557	58,518	0%
		AS AT	
	MARCH 31, 2018	MARCH 31, 2017	
Outstanding shares ('000)			
Class A	1,750	1,750	0%
Class B	33,506	33,106	1%
Total shares outstanding	35,256	34,856	1%
Weighted average Class A and Class B shares	35,256	34,856	1%

⁽¹⁾ See MD&A – non-GAAP measures.

Q1 2018 Operating Highlights

- On January 18, 2018 the Company sold 7.9 percent of PAE PanAfrican Energy Corporation ("PAEM"), a wholly owned subsidiary, for a net sales price of US\$21.0 million (US\$17.0 million in cash and US\$4.0 million in preferred shares with a 10 percent coupon) based on a net enterprise value of US\$265.0 million. The effective date of the transaction was January 1, 2017, and, as a consequence, the purchase price was reduced by US\$1.4 million to reflect the buyer's share of cash flow from the effective date of the transaction until closing. The buyer has until June 30, 2018 to acquire up to a maximum of 40 percent of PAEM under the same terms and conditions.
- On January 18, 2018 the Company declared a dividend of CDN\$0.60 per share on each of its Class A voting and Class B subordinate voting shares to holders of record as of January 31, 2018; the dividend was paid on February 7, 2018. The total dividend amount paid was US\$16.9 million.
- The Company's revenue for the quarter decreased by 22% to US\$14.2 million from US\$18.1 million in Q1 2017. The decrease is the result of: (i) lower sales volumes and; (ii) lower Cost Gas allocations which resulted in an increase in Profit Gas attributable to Tanzanian Petroleum Development Corporation ("TPDC") This was a consequence of the decline in the cost pool with the Company having now recovered the cost of the 2015-2016 capital program. Additional Gas deliveries and sales for the quarter averaged 37.4 million standard cubic feet per day ("MMcfd") a decrease of 14% from 43.5 MMcfd in Q1 2017. The decrease in Additional Gas volumes between periods is primarily the result of reduced nominations of natural gas volumes by TANESCO. The decrease in volumes was partially offset by a 10% rise in the weighted average price to US\$5.16/mcf from US\$4.68/mcf in Q1 2017. The increase in price being a consequence of the change in the sales mix.
- The Company recorded a net loss of US\$4.6 million for the quarter compared to a net income of US\$2.8 million in Q1 2017. The net loss for the quarter is primarily due to: (i) the increase in finance expenses relating to participatory interest expense of US\$3.1 million to the International Finance Corporation ("IFC"); and (ii) the increase in stock based compensation of US\$3.8 million. The participatory interest expenses charged during the quarter of US\$3.1 million includes an additional payment of US\$2.6 million associated with the sale of the 7.9 percent interest in PAEM in accordance with the terms of the IFC Loan agreement. As a result of the additional payment, the annual variable participatory interest is reduced to 6.4 percent from 7.0 percent.

- The Company's net cash flows from operating activities for the year decreased by 83% to US\$1.5 million from US\$8.8 million in Q1 2017. The decrease is primarily a consequence of the exercise of stock based compensation incentives following the closing of the sale of the minority interest in PAEM.
- The Company's funds flow from operations for the quarter was an outflow of US\$7.1 million compared to an inflow of US\$5.9 million in Q1 2017. The decrease is primarily a combination of the exercise of stock appreciation rights and restrictive stock units and the US\$2.6 million participatory interest paid to the IFC in accordance with the terms of the loan agreement following the sale of the non-controlling interest in PAEM.
- Working capital decreased to US\$65.2 million at March 31, 2018 compared to US\$69.6 million at December 31, 2017. The decrease is primarily due to the increase in stock based compensation payments during the quarter.
- At March 31, 2018 the current receivable from TANESCO was US\$ nil (Q4 2017: US\$ nil). 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\$8.1 million (Q4 2017: US\$8.4 million) after the reallocation of US\$4.2 million to net field revenue during the quarter. The TANESCO long-term trade receivable at March 31, 2018 and December 31, 2017 was US\$74.4 million (provision of US\$74.4 million). Subsequent to March 31, 2018 the Company has invoiced TANESCO US\$1.3 million for 2018 gas deliveries and TANESCO has paid the Company US\$6.2 million.

ORCA EXPLORATION GROUP INC.

Q1 2018
MANAGEMENT'S
DISCUSSION
& ANALYSIS

Management's Discussion & Analysis

THIS MD&A OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2018 SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS AND NOTES FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES TOGETHER WITH THE MD&A FOR THE YEAR ENDED DECEMBER 31, 2017. THIS MD&A IS BASED ON THE INFORMATION AVAILABLE ON MAY 22, 2018.

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 Petroleum 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 2018 and 2019, which includes the tie-in of wells to processing facilities, well workovers and installation of a refrigeration unit on the Songas processing facility, to ensure gas production can continue at the requisite specification and volumes, and enable production through 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 ("Petroleum 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 production volumes will not be restricted; the anticipated effect of the recently approved 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 appeals on the decisions 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 produced profitably 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 potential 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 facilities; risk that the Company may be unable to complete additional field development to support the Songo Songo production profile through the life of the license; risk that the Company may be unable to develop additional supply or increase production values; risks associated with the Company'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 Petroleum 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 variances 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 recently approved 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 Petroleum 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.

NATURE OF OPERATIONS

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

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

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

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

TANESCO is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the Ministry for Energy ("ME"). TANESCO is responsible for the generation, transmission and distribution of electricity throughout Tanzania. Natural gas has become an integral component of TANESCO's power generation fuel mix as a more reliable source of supply over seasonal hydro power and a more cost-effective alternative to liquid fuels. The Company currently supplies gas directly to TANESCO by way of the PGSA and indirectly through the supply of Protected Gas and Additional Gas to Songas, which in turn generates and sells power to TANESCO. TANESCO is the Company's largest customer and the gas supplied by the Company to Songas and TANESCO today fires approximately 30% of the electrical power generated in Tanzania and 41% of the gas utilized for power generation in the country.

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

Consolidation

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

COMPANY	INCORPORATED	HOLDING
Orca Exploration Group Inc.	British Virgin Islands	Parent Company
Orca Exploration Italy Inc.	British Virgin Islands	100%
Orca Exploration Italy Onshore Inc.	British Virgin Islands	100%
PAE PanAfrican Energy Corporation ("PAEM")	Mauritius	92%
PanAfrican Energy Tanzania Limited ("PAET")	Jersey	92%
Orca Exploration UK Services Limited	United Kingdom	100%

Results for the three months ended March 31, 2018

SUMMARY

On January 16, 2018 the Company sold 7.933 per cent (7,933 Class A common shares) of its subsidiary, PAEM, to Swala (PAEM) Limited, a wholly owned subsidiary of Swala Oil & Gas (Tanzania) plc., ("Swala") for US\$25.8 million based on an enterprise value of US\$325 million as at January 1, 2017 (the "effective date"). After adjusting the enterprise value for long term debt of US\$60 million, the net sales price for the 7.933 per cent was US\$21.0 million. The consideration received by the Company was US\$15.7 million cash (US\$17.0 million less a purchase price adjustment of US\$1.4 million reflecting Swala's share of cash flow from the effective date of the transaction until closing) and US\$4.0 million of Swala convertible preferred shares. The transaction provides Swala with the right to acquire up to 40% of PAEM at the net value of US\$265 million adjusted for Swala's share of cash flow from the effective date until the next closing date. The Company has granted an extension of this right to June 30, 2018. The preferred shares had not been issued as at March 31, 2018 and the consideration is recorded at fair value in other receivables.

On January 18, 2018 the Company declared a dividend of CDN\$0.60 per share on each of its class A voting and class B subordinate voting shares to holders of record as of January 31, 2018; the dividend was paid on February 7, 2018.

The Company's operating revenue increased by 1% to US\$14.5 million in the quarter ended March 31, 2018 (Q1 2017: US\$14.3 million). The lower gas deliveries in the period which fell by 14% to 37.4 MMcfd (Q1 2017: 43.5 MMcfd) did not lead to a significant fall in operating revenue as a consequence of the recognition of US\$1.6 million of operating revenue during the period associated with the recognition of TANESCO deferred revenue. Revenue decreased by 22% to US\$14.2 million (Q1 2017: US\$18.1 million), the decrease is the consequence of negative current income tax adjustment as a consequence of recording a loss in the period.

The Company's net cash flows from operating activities for the quarter ended March 31, 2018 fell by 83% to US\$1.5 million (Q1 2017: US\$8.8 million). The decrease is primarily a consequence of the decrease in revenue between periods and the exercise of share awards following the completion of the sale of a minority interest of PAEM (see above).

The Company's funds flow from operations for the quarter ended March 31, 2018 was an outflow of US\$7.1 million (Q1 2017: inflow US\$5.9 million). The decrease is primarily a combination of the exercise of stock appreciation rights and restrictive stock units and the participatory interest paid to the IFC following the completion of the sale of the interest in PAEM in accordance with the terms of the Loan Agreement.

The Company recorded a net loss of US\$4.6 million in the quarter ended March 31, 2018 (Q1 2017: US\$2.8 million net income). The loss in the quarter is primarily the result of the decrease in revenue, the increase in the stock based compensation and the payment to the IFC of the participatory interest.

The Company once again exited the period in a stable financial position with US\$65.2 million in working capital (Q4 2017: US\$69.6 million), cash and cash equivalents of US\$117.8 million (Q4 2017: US\$122.3 million) and long-term debt of US\$58.6 million (Q4 2017: US\$58.5 million).

OPERATING VOLUMES

The gross sales volumes for the quarter ended March 31, 2018 were 3,365 MMcf (Q1 2017: 3,914 MMcf) or average daily volumes of 37.4 MMcfd (Q1 2017: 43.5 MMcfd). This represents a decrease in average daily volumes of 14% quarter over quarter. The decrease in gross sales volume is due to reduced consumption of natural gas by TANESCO compared to 2017. The Company's gross sales volumes were split between the Industrial and Power sectors as detailed in the table below:

	THREE MONTHS ENDED MARCH 31	
	2018	2017
Gross sales volume (MMcf)		
Industrial sector	1,251	1,041
Power sector	2,114	2,873
Total volumes	3,365	3,914
Gross daily sales volume (MMcfd)		
Industrial sector	13.9	11.6
Power sector	23.5	31.9
Total daily sales volume	37.4	43.5

Industrial sector

Industrial sales volumes for the quarter ended March 31, 2018 were 1,251 MMcf (Q1 2017: 1,041 MMcf), or average daily volumes of 13.9 MMcfd (Q1 2017: 11.6 MMcfd). This represents an increase in average daily volumes of 20% quarter over quarter. The increase in the quarterly volumes was due to the increased gas consumption by a cement plant compared to 2017 and the consumption of gas by new customers.

Power sector

Power sector sales volumes for the quarter ended March 31, 2018 were 2,114 MMcf (Q1 2017: 2,873 MMcf), or average daily volumes of 23.5 MMcfd (Q1 2017: 31.9 MMcfd). This represents a decrease in average daily volumes of 26% quarter over quarter. The decrease in the quarterly volumes was due to decreased gas consumption by TANESCO.

SONGO SONGO DELIVERABILITY

As at March 31, 2018 the Company had a well capacity of approximately 155 MMcfd, with the ability to expand to 180 MMcfd with the tie-in of well SS-12 and the installation of refrigeration. The SS-12 well was successfully completed in the first quarter of 2016 but is currently suspended awaiting tie-in. Production volumes are currently limited to 102 MMcfd as the Company is only producing through the Songas infrastructure. The Company's productive capacity will increase significantly once the refrigeration is installed at the Songas gas plant scheduled for completion in Q4 2018. Well SS-3 is currently suspended and well SS-4 has been shut-in; it is the Company's intention to undertake workovers on both the wells in the future subject to negotiations with Songas, the owner of the wells.

As at March 31, 2018 the SS-11 well is tied into both the Songas and the NNGIP infrastructure, however, gas sales through the NNGIP are subject to finalizing a new gas sales agreement ("GSA") with TPDC. The facilities for the connection of the SS-10 well and the SS-12 well to the NNGIP infrastructure are available and can be completed quickly when required. It is currently anticipated that the SS-12 well will be the first well dedicated to the NNGIP infrastructure and SS-10 and SS-11 will be used as and when further volumes to the NNGIP are contracted.

COMMODITY PRICES

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

<i>US\$/mcf</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Average sales price		
Industrial sector	7.79	7.75
Power sector	3.60	3.57
Weighted average price	5.16	4.68

Industrial sector

The average gas price achieved during the quarter ended March 31, 2018 was US\$7.79/mcf an increase of 1% from US\$7.75/mcf in Q1 2017.

Power sector

The average gas price achieved during the quarter ending March 31, 2018 was US\$3.60/mcf an increase of 1% from US\$3.57/mcf in Q1 2017.

COMPANY OPERATING REVENUE

Under the terms of the PSA, the Company is responsible for invoicing, collecting and allocating the net field 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 field 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. Currently there are no pre-approved marketing costs for TPDC.

The average Additional Gas sales volumes for the quarter ended March 31, 2018 were below 40 MMcfd; as a consequence, the Company was entitled to a 35% share of Profit Gas revenue, compared to a 40% share in Q1 2017 when the Additional Gas volumes were above 40 MMcfd. See "Principal Terms of the Tanzanian PSA and Related Agreements" in the MD&A within the audited financial statements for 2017.

The Company was allocated a total of 64% of the net field revenue for the quarter (Q1 2017: 85%). The decrease in allocation of the net field revenue is a consequence of the depletion of the Cost Pool during the latter half of 2017 following the recovery of the capital costs associated with the completion of Phase A of the Development Program.

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Industrial sector	9,747	8,068
Power sector	11,782	8,354
Gross field revenue	21,529	16,422
TPDC share of revenue	(7,038)	(2,117)
Company operating revenue	14,491	14,305
Reconciliation to net field revenue:		
Gross field revenue	21,529	16,422
Tariff for processing and pipeline infrastructure ⁽ⁱ⁾	(1,981)	(2,310)
Net field revenue	19,548	14,112
Allocation of net field revenue:		
Company Cost Gas	8,501	10,584
Company Profit Gas	4,009	1,411
Company share of net field revenue	12,510	11,995
TPDC share of revenue	7,038	2,117
Net field revenue	19,548	14,112

⁽ⁱ⁾ Under the application of IFRS 15 Revenue, the revenue is shown gross, with the tariff for transportation and pipeline tariff being included in production and distribution expenses.

The Company's operating revenue was US\$14.5 million in the quarter ended March 31, 2018 (Q1 2017: US\$14.3 million) The increase is a combination of the increase in operating revenue associated with the inclusion of TANESCO deferred revenue (see below) offsetting the decrease in operating revenue as a consequence of reduced sales.

Revenue presented on the Consolidated Interim Statements of Comprehensive (Loss) Income may be reconciled to the Company operating revenue by subtracting US\$0.3 million income tax for the quarter. The Company is liable for income tax in Tanzania, but under the terms of the PSA TPDC's Profit Gas entitlement is adjusted for the tax payable. To account for this, revenue is adjusted to include the current income tax charge grossed up at 30%.

Reconciliation of Company operating revenue to revenue:	THREE MONTHS ENDED MARCH 31	
	2018	2017
<i>US\$'000</i>		
Company operating revenue	14,491	14,305
Current income tax adjustment	(268)	3,821
Revenue	14,223	18,126
Impact of IFRS 15:	THREE MONTHS ENDED MARCH 31	
<i>US\$'000</i>	2018	2017
Revenue prior to implementation of IFRS 15	12,242	15,816
Tariff for processing and pipeline infrastructure	1,981	2,310
Revenue	14,223	18,126

There is no impact on net income as a result of the implementation of IFRS 15.

TANESCO impact on revenue

Prior to 2016 the Company had reached an understanding with TANESCO that the Company 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. This resulted 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 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.

For cash received in excess of the revenue recorded from TANESCO in any given period, the additional amounts received will be recorded as deferred revenue. In periods when the deferred revenue balance is greater than the amounts invoiced to TANESCO for gas deliveries for the previous four quarters, any amount in excess of the previous four quarter average will be recorded as current period revenue to the extent there is unrecognized revenue resulting from the approach to revenue recognition adopted on October 1, 2016. If such unrecognized revenue is reduced to nil, additional amounts collected in excess of the quarterly average will be applied to pay the oldest TANESCO invoice recorded and previously provided for.

In periods when cash received is less than revenue recorded, the deferred revenue will be reduced accordingly. If the deferred revenue amount is reduced to nil, the difference will be recorded as accounts receivable.

The percentage used to recognize TANESCO revenue will be reviewed as circumstances require. 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. The percentage was increased effective October 1, 2017 to reflect the most recent three year payment history for TANESCO compared to amounts invoiced for deliveries.

During the quarter the Company collected receipts from TANESCO in excess of the gas delivered. The total payments from TANESCO since October 1, 2016 (the date the Company began recording revenue based on the expected collectability) have exceeded the amount of invoices for gas deliveries during the same period. As a consequence, the Company recorded an increase of US\$4.2 million in gross field revenue and reallocated US\$2.6 million of TPDC Profit share entitlement, which resulted in an overall increase of US\$1.3 million in net income.

The impact of recording revenue based on the expected collectability and the impact of excess collections over deliveries for the quarter is as follows:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Increase (decrease) in gross field revenue and accounts receivable	4,172	(1,582)
Increase (decrease) in revenue	1,603	(1,905)
Increase (decrease) in net income	1,292	(1,582)
Increase (decrease) in liabilities	2,880	(323)

PRODUCTION, DISTRIBUTION AND TRANSPORTATION EXPENSES

Well maintenance costs are allocated between Protected Gas and Additional Gas in proportion to their respective sales during the period. The total cost of maintenance for the quarter ended March 31, 2018 was US\$0.2 million (Q1 2017: US\$0.2 million). Amounts allocated for Additional Gas for the quarter were US\$0.1 million (Q1 2017: US\$0.1 million).

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

The processing and transportation tariff charges for the quarter ended March 31, 2018 were US\$2.0 million (Q1 2017: US\$2.3 million). The lower tariff costs are a result of the decrease in production volumes.

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 (Q1 2017: US\$0.6 million). The production, distribution and transportation expenses are detailed in the table below:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Share of well maintenance	50	96
Other field and operating costs	207	188
	257	284
Tariff for processing and pipeline infrastructure	1,981	2,310
Ring main distribution costs	551	564
Production, distribution and transportation expenses	2,789	3,158

OPERATING NETBACKS

The netback per mcf before general and administrative expenses, tax and APT is detailed in the table below:

US\$/mcf	THREE MONTHS ENDED MARCH 31	
	2018	2017
Gas price – Industrial	7.79	7.75
Gas price – Power ⁽¹⁾	3.60	3.57
Weighted average price for gas	5.16	4.68
TPDC share of revenue	(2.09)	(0.54)
Well maintenance and other operating costs	(0.08)	(0.07)
Tariff for processing and pipeline infrastructure	(0.59)	(0.59)
Ring main distribution costs	(0.17)	(0.14)
Operating netback	2.23	3.34

⁽¹⁾ The weighted average sales price is stated before the change 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 decreased by 33% to US\$2.23/mcf from US\$3.34/mcf in Q1 2017. The decrease in the quarter is predominately due to the increase in TPDC share of revenue to US\$2.09/Mcf from US\$0.54/Mcf. The increase is the combination of the depletion of the costs pool and lower Additional Gas volumes. The increase in TPDC share was offset to an extent by the increase in the weighted average price for gas to US\$5.16/Mcf from US\$4.68/Mcf as a consequence of the change in the sales mix. The increase in the weighted average price for gas is the consequence of the relative increase of industrial sales to total sales, the overall level of industrial sales remaining constant between periods.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses are detailed in the table below:

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Employee and related costs	1,751	1,546
Office costs	1,332	751
Marketing and business development costs	136	152
Reporting, regulatory and corporate	302	226
General and administrative expenses	3,521	2,675

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. General and administrative expenses averaged US\$1.2 million (Q1 2017: US\$0.9 million) per month during the quarter.

STOCK BASED COMPENSATION

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

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Stock appreciation rights ("SARs")	2,385	67
Restricted stock units ("RSUs")	2,244	774
Stock-based compensation	4,629	841

As at March 31, 2018 a total of 885,000 SARs were outstanding compared to 2,485,000 as at December 31, 2017. A total of 1,600,000 SARs with exercise prices ranging from CDN\$2.30 to CDN\$3.87 were exercised during the quarter resulting in a total cash payout of US\$5.4 million. As at March 31, 2018 a total of 275,000 RSUs were outstanding compared to 1,147,621 at December 31, 2017. A total of 872,621 RSUs were exercised during the quarter resulting in a total cash payout of US\$4.6 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 1.0%; stock volatility of 48.8% to 56.1%; 0% dividend yield; 5% forfeiture; and a closing price of CDN\$5.50 per Class B share.

As at March 31, 2018 a total accrued liability of US\$2.4 million (Q4 2017: US\$7.9 million) has been recognized in relation to SARs and RSUs. The Company recognized an expense of US\$2.1 million for the quarter ending March 31, 2018 (Q1 2017: US\$0.8 million).

FINANCE EXPENSE

Finance income and expense is detailed in the table below:

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Interest expense	(1,538)	(1,518)
Participatory interest expense	(3,138)	(731)
Net foreign exchange loss	(383)	(70)
Indirect tax	(264)	(205)
Finance expense	(5,323)	(2,524)

Interest expense and participatory interest expense relate to the long-term loan with the International Finance Corporation ("IFC"). The amount of interest expense during the quarter was US\$1.5 million (Q1 2017: US\$1.5 million). The participatory interest expense during the quarter was US\$3.1 million (Q1 2017: US\$0.7 million); the increase is related to an additional payment of US\$2.6 million (Q1 2017: US\$ nil) associated with the sale of the 7.933% interest in PAEM in January 2018 (see Note 12).

The indirect tax of US\$0.3 million for the quarter (Q1 2017: US\$0.2 million) is for VAT associated with invoices to TANESCO for interest on late payments. These invoices are not recognized in the financial statements due to revenue recognition criteria with respect to assurance of collectability.

TANESCO

At March 31, 2018 the current receivable from TANESCO was US\$ nil (Q4 2017: US\$ nil). 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\$8.1 million (Q4 2017: US\$8.4 million) after the reallocation of US\$4.2 million to net field revenue during the quarter.

The TANESCO long-term trade receivable at March 31, 2018 and December 31, 2017 was US\$74.4 million (provision of US\$74.4 million). Subsequent to March 31, 2018, the Company has invoiced TANESCO US\$1.3 million for 2018 gas deliveries and TANESCO has paid the Company US\$6.2 million.

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:

US\$'000	AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017
Total TANESCO receivable	106,737	108,833
Unrecognized amounts for not meeting revenue recognition criteria ⁽ⁱ⁾	(40,444)	(38,710)
Invoiced amounts reduced based on TANESCO's payment history for the previous three years	–	(4,172)
Provision for doubtful accounts	(74,361)	(74,361)
TANESCO deferred revenue balance per consolidated financial statements	(8,068)	(8,410)

⁽ⁱ⁾ The amount includes invoices for interest on late payments and invoices relating to differences between natural gas contracted for delivery versus natural gas taken by TANESCO.

TAXATION

Income Tax

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

As at March 31, 2018 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\$11.5 million (Q4 2017: US\$11.8 million). During the quarter there was a deferred tax recovery of charge of US\$0.4 million compared to a deferred tax charge of US\$0.2 million in Q1 2017. The deferred tax has no impact on cash flow until it becomes a current income tax, at which point the tax is paid and recovered from TPDC's share of Profit Gas.

Additional Profits Tax

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

The timing and the effective rate of APT depends on the realized value of Profit Gas which in turn depends of the level of expenditure. The Company provides for APT by forecasting annually the total APT payable in the future 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 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 19.25% (Q1 2017: 19.4%) has been applied to Profit Gas of US\$4.0 million (Q1 2017: US\$1.4 million). Accordingly, US\$0.8 million of APT has been recorded as other income tax for the quarter ended March 31, 2018 (Q1 2017: US\$0.3 million).

	THREE MONTHS ENDED MARCH 31	
<i>US\$'000</i>	2018	2017
Additional Profits Tax	774	274

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 proved reserves. As at December 31, 2017 the estimated proved reserves remaining to be produced over the term of the PSA licence were 307 Bcf (2016: 347 Bcf). A depletion expense of US\$2.0 million for the quarter (Q1 2017: US\$2.3 million) has been recorded in the accounts at an average depletion rate to US\$0.60/mcf (Q1 2017: US\$0.57/mcf).

Non-natural gas properties are depreciated as follows:

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

CARRYING AMOUNT OF ASSETS

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

CAPITAL EXPENDITURES

During the quarter, the Company incurred US\$0.8 million (Q1 2017: US\$0.1 million) in capital expenditures, relating primarily to the completion of the SS-12 well flowline in anticipation of connection to the NNGIP infrastructure.

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Geological and geophysical and well drilling	–	27
Pipelines and infrastructure	792	93
Other equipment	27	–
	819	131
Other ⁽¹⁾	–	7,352
	819	7,472

(1) In Q1 2017, based on agreement with TPDC, the Songas share of workover costs incurred in 2015 was 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.

CASH FLOW SUMMARY

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Operating activities		
Net (loss) income	(4,638)	2,840
Non-cash adjustments	(2,416)	3,086
Interest expense	4,676	2,249
Changes in non-cash working capital ⁽¹⁾	3,905	612
Net cash flows from operating activities	1,527	8,787
Net cash used in investing activities	(811)	(216)
Net cash used in financing activities	(5,291)	(1,518)
(Decrease) increase in cash	(4,575)	7,053
Effect of change in foreign exchange on cash	66	(127)
Net (decrease) increase in cash	(4,509)	6,926

(1) See Consolidated Interim Statements of Cash Flows

The Company's net cash flows from operating activities for the quarter ended March 31, 2018 fell by 83% to US\$1.5 million (Q1 2017: US\$8.8 million). The decrease is primarily a consequence of the exercise of Stock Appreciation Rights and Restrictive Stock Units. The increase of cash used in investing activities in Q1 2018 is the combined result of a dividend of US\$16.9 million (Q1 2017: US\$ nil) and the payment of US\$2.6 million of participatory interest (Q1 2017: US\$ nil) offset by the proceeds from the sale of a minority interest in a subsidiary of US\$15.7 million (Q1 2017: US\$ nil).

WORKING CAPITAL

Working capital as at March 31, 2018 was US\$65.2 million (December 31, 2017: US\$69.6 million) and is detailed in the table below:

US\$'000	AS AT MARCH 31, 2018	AS AT DECEMBER 31 2017
Cash	117,813	122,322
Trade and other receivables	12,576	12,273
Songas	2,163	2,378
Industrial customers	7,836	6,915
Songas gas plant operations	7,004	5,827
Other receivables	941	2,521
Provision for doubtful accounts	(5,368)	(5,368)
Tax recoverable	889	–
Prepayments	944	866
	132,222	135,461
Trade and other payables	67,021	65,168
TPDC share of Profit Gas ⁽¹⁾	40,646	33,422
Songas	1,524	1,670
Other trade payables	3,609	1,961
Accrued liabilities	13,174	19,705
Deferred revenue	8,068	8,410
Tax payable	–	718
	67,021	66,886
Working capital ⁽²⁾	65,201	69,575

⁽¹⁾ The balance of US\$40.6 million payable to TPDC is the accrued liability for their share of profit gas delivered to TANESCO which has not been paid for, net of US\$0.2 million previously recorded as tax recoverable. The majority of the settlement of this liability is dependent on receipt of payment from TANESCO for arrears.

⁽²⁾ Working capital as at March 31, 2018 includes TANESCO deferred revenue of US\$8.1 million (December 31, 2017: US\$ 8.4 million). The deferred revenue is a consequence of the cumulative cash collected from TANESCO during the year ending December 30, 2017 and the quarter ending March 31, 2018 being in excess of the invoiced amounts recognized as revenue during the same period. Correspondingly, as at March 31, 2018 and December 31, 2017 there is no current receivable for TANESCO. The total of long and short-term TANESCO receivables as at March 31, 2018, including unrecorded interest and revenue as a result of issued invoices not meeting revenue recognition criteria, was US\$106.7 million. The Company is actively pursuing the collection of all the receivables that have been charged to TANESCO.

Other significant points are:

- There are no restrictions on the movement of cash from Mauritius or Tanzania, and over 90% of the Company's cash is currently held outside of Tanzania.
- Of the US\$7.8 million receivable relating to industrial customers US\$4.2 million had been received as at the date of this report.

LONG-TERM LOAN

The Company's subsidiary, PAET, entered into a loan agreement (the "Loan") in 2015 with the International Finance Corporation ("IFC"), a member of the World Bank Group, for US\$60 million. The Loan was fully drawn down in 2016.

The term of the Loan is ten years, with no required repayment of principal for the first seven years, followed by a three-year amortization period. The Loan is to be paid out through six semi-annual payments of US\$5 million starting April 15, 2022 and one final payment of US\$30 million due on April 15, 2025. 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 (December 14, 2015), 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 at its discretion 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 amount of base interest during the quarter was US\$1.5 million (Q1 2017: US\$1.5 million). To date all interest incurred has been paid when due.

In addition, the Loan included an annual variable participatory interest equating to 7% of the net cash flow from operating activities less net cash flows used in investing activities of PAET 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. The participatory interest charged during the quarter was US\$3.1 million (Q1 2017: US\$0.7 million) and includes an additional payment of US\$2.6 million (Q1 2017: US\$ nil) associated with the sale of the 7.933% interest in PAEM in January 2018 in accordance with the terms of the Loan. As a result of the additional payment, the annual variable participatory interest is reduced to 6.4%. For the quarter ended March 31, 2018 the participatory interest included in accrued liabilities is US\$4.4 million (Q4 2017: US\$3.8 million).

Dividends and distributions from PAET to the Company are restricted at any time that any amounts due for interest, principal or participating interest are outstanding.

OUTSTANDING SHARES

There were 35,256,432 shares outstanding as at March 31, 2018 as detailed in the table below:

<i>Number of shares ('000)</i>	MARCH 31, 2018	AS AT DECEMBER 31, 2017
Shares outstanding		
Class A shares	1,750	1,750
Class B shares	33,506	33,506
Class A and Class B shares outstanding	35,256	35,256
Weighted Average		
Class A and Class B shares	35,256	34,858
Convertible securities		
Options	-	-
Weighted average diluted Class A and Class B shares	35,256	34,858

As at the date of this report there were a total of 1,750,517 Class A common voting shares ("Class A shares") and 33,505,915 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 costs of US\$0.1 million (Q1 2017: US\$0.1 million) were incurred by this firm for services provided. As at March 31, 2018 the Company has a total of US\$0.1 million (December 31, 2017: US\$0.5 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 (179.8 Bcf as at March 31, 2018). 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.

Additional Gas Plan 2 ("AGP2")

During Q3 2017 the Company received approval of the AGP2 from the ME which allows PAET to produce and sell increased volumes of Additional Gas. This may be achieved through the Songas infrastructure and by accessing the NNGIP infrastructure. Wells SS-11, and SS-12 have been connected to the NNGIP infrastructure subject to TPDC finalizing certain technical matters pertaining to the operation of the wells at their facility and the establishment of a new gas sales agreement by PAET with TPDC. Well SS-10 has also been identified for possible connection to the NNGIP facility, subject to the same conditions.

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.

Although Songas notified the Company in 2014 that the Re-Rating Agreement was terminated, the parties have continued to produce, transport and sell gas volumes in line with the re-rated plant capacity. 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. This capacity is in addition to the capacity available within the NNGIP infrastructure which PAET intends to utilize now that AGP2 is approved.

Portfolio Gas Supply Agreement

In June 2011 the PGSA was signed (term to June 30, 2023) between TANESCO (as the buyer) and the Company and TPDC (collectively as the seller). Under an amendment to the PGSA (effective January 29, 2018), the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 26 MMcfd (previously 36 MMcfd) for use in any of TANESCO's current power plants, except those operated by Songas at Ubungo. Under the agreement, the basic wellhead price of approximately US\$2.98/mcf increased to US\$3.04/mcf on July 1, 2017. Previously under the PGSA any sales in excess of 36 MMcfd were subject to a 150% increase in the basic wellhead gas price.

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 improved field deliverability and provided 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. With the signing of AGP2, the Company is planning to continue with the completion of Phase A of the Development Program that includes a refrigeration unit and well workovers with an estimated cost of US\$22 million. A portion of the costs are for workovers on wells SS-3 and SS-4 and assuming that Songas, the owner of the wells, funds the costs for these workovers the net estimated cost to the Company will be US\$13.3 million.

At the date of this report, the Company has no significant outstanding contractual commitment. The Company has however placed orders for long lead items relating to the installation of refrigeration.

Italy

The Company has an agreement to farm in on Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of an appraisal well up to a maximum of US\$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US\$0.5 million. Changes in Italian environmental legislation in late 2015 have resulted in the development of this permit being postponed until the development plan is approved. As at the date of this report, the Company has no further capital commitments in Italy.

CONTINGENCIES

Petroleum Act, 2015

The Petroleum Act, 2015 (the "Petroleum Act") repeals earlier legislation, provides a regulatory framework over upstream, mid-stream and downstream gas activity, and consolidates and puts in place a comprehensive legal framework for regulating the oil and gas industry in the country. The Petroleum 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 Petroleum 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 Petroleum Activities. The Petroleum Act vests TPDC with exclusive rights in the entire petroleum upstream and the natural gas mid and downstream value chains. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Petroleum Act does provide grandfathering provisions, upholding the rights of the Company under their PSA as it was signed prior to passing of the Petroleum Act. However, it is still unclear how the provisions of the Petroleum Act will be interpreted and implemented regarding upstream and downstream activities and the Company is uncertain regarding the potential impact on its business in Tanzania.

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

Cost recovery

TPDC conducted an audit of the historic Cost Pool and in 2011 disputed approximately US\$34 million of costs that had been recovered from the Cost Pool from 2002 through to 2009. In 2014 a substantial portion of the disputed costs were agreed to be cost recoverable by TPDC. Under the dispute mechanism outlined in the PSA, TPDC are to appoint an independent specialist to assist the parties in reaching agreement on costs that are still subject to dispute. In 2014, prior to appointing an independent specialist, TPDC suspended the process. There have been no further developments regarding the dispute since this suspension and 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 amounts 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	2008-15	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).	29.6	10.0	39.6 ⁽³⁾
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.8	5.5 ⁽⁴⁾
			33.7	13.5	47.2

Management, with the advice from its legal counsels, has reviewed the Company's position on the objections and appeals related to the disputed amounts and has concluded that no provision is required with regard to these matters and that the maximum potential exposure is US\$47.2 million (December 31, 2017: US\$47.2 million).

- (1) In 2015 PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE on grossed-up amounts on staff salaries. TRAB waived interest assessed thereon. The Tax Revenue Appeals Tribunal ("TRAT") upheld Tax Revenue Appeal Board ("TRAB") decision which ruled in favour TRA on principal tax demanded but waived interest assessed thereon. In 2017 PAET appealed the TRAT ruling to the Court of Appeal of Tanzania ("CAT"). PAET is awaiting CAT hearing date to be set.
- (2) (a) 2005-2009 (US\$1.7 million): In 2016 TRA filed an application for review of the 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 July 28, 2017 TRA filed another Application for extension of time, under the certificate of urgency, for their application for CAT leave to review its judgement. During the quarter CAT ruled in favour of PAET's preliminary objection. TRA still has the right to amend and re-file its 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\$2.6 million): In 2015 TRAB ruled against PAET with respect to timing of deductibility of capital expenditures and other expenses (US\$1.8 million). In Q2 2017 PAET lost an appeal at TRAT and subsequently filed an appeal to CAT and is awaiting a hearing date to be set. In July 2017 TRA sent PAET an amended assessment claiming additional taxes, interest and penalties (US\$0.8 million). PAET has objected to the assessment for being time-barred and arbitrary and is awaiting TRA response;
- (b) 2008 (US\$0.6 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 (with tax impact of US\$0.6 million). PAET has objected to 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 timing of 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\$2.4 million): PAET filed an appeal with TRAB against a TRA assessment with respect to timing of 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 a TRA assessment with respect to foreign exchange rate application and is awaiting a response. PAET has received TRA assessments for corporation tax (US\$0.9 million) which disallowed certain operating costs included in the tax returns and tax on repatriated income (US\$5.7 million). PAET has objected to the assessments due to being time-barred and without merit. PAET has also appealed to TRAB the TRA decision not to exercise its administrative powers judiciously to grant the waiver on one-third deposit required to be paid to admit the objection and is awaiting the hearing date to be scheduled;
- (f) 2012 (US\$15.8 million): In 2016 TRA issued two assessments with respect to understated revenue, timing of deductibility of capital expenditures, expenses and tax on repatriated income. PAET filed an appeal with TRAB against the TRA decision to deny PAET a waiver for payment of a deposit which is required for its objection to be admitted but was granted a partial waiver only. PAET appealed the decision demanding full waiver of the deposit and also filed an application for the stay of execution with TRAT in response to the TRA demand notice for the payment of the deposit ruled by TRAB. TRAT upheld TRAB decision for partial waiver. Management has decided to appeal the TRAT decision and has fourteen days from the date of TRAT decision to file a Notice of Appeal;
- (g) 2014 (US\$9.2 million): In 2016 TRA issued an assessment of US\$3.3 million 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. PAET has also appealed to TRAB the TRA decision not to exercise its administrative powers judiciously to grant the waiver on one-third deposit required to be paid to admit the objection and is awaiting the hearing date to be scheduled. TRA has issued two additional assessments for the year for corporation tax of US\$3.1 million and tax on repatriated income US\$2.8 million. PAET has objected the assessments and is awaiting TRA 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) (a) 2008-2010 (US\$5.4 million): 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 the TRA assessment and is awaiting a hearing date to be scheduled;
- (b) 2012-2014 (US\$ 0.1 million): TRA has issued an assessment for VAT on other income that PAET had paid. PAET has objected the assessment and is awaiting TRA response.

FUTURE ACCOUNTING CHANGES

The Company's accounting policies are set forth in Note 3 to the audited consolidated financial statements for the year ended December 31, 2017. There have been no changes in accounting policies for the three-month period ended March 31, 2018 and the policies have been applied consistently to all periods presented in the condensed consolidated interim financial statements, except as noted below:

IFRS 9 - Financial instruments was adopted by the Company on January 1, 2018. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and de-recognition of financial instruments from IAS 39. The adoption of IFRS 9 did not have a material impact on the Company's consolidated interim financial statements.

The Company has revised the description of its accounting policy for financial instruments to reflect the new classification approach. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods depends on the classification of the financial instrument as described below:

- Fair value through profit or loss: Financial instruments under this classification include cash and cash equivalents and derivative assets and liabilities.
- Amortized cost: Financial instruments under this classification include accounts receivable, accounts payable and accrued liabilities, dividends payable, finance lease obligation, and long-term debt.

IFRS 15 – Revenue from Contracts with Customers was adopted by the Company on January 1, 2018 retrospectively. IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue from contracts with customers is recognized. The Company's revenue relates to the sale of natural gas to customers at specified delivery points at bench mark and contract prices. Adopting IFRS 15 resulted in additional disclosure relating to disaggregation of revenue with the Songas processing and transportation tariff being recorded in production, distribution and transportation costs as opposed to a direct deduction from revenue.

The Company has revised the description of its accounting policy for revenue recognition as follows:

- Revenue from contracts with customers is recognized when a performance obligation is satisfied by transferring a promised good or service to a customer.
- A good or service is transferred when the customer obtains control of that good or service. The transfer of control of natural gas occurs at the metering points at the inlet of the customers' facilities.

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.

IFRS 16 – Leases sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and replaces the previous leases standard, IAS 17 Leases. IFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of IFRS 16 on its consolidated financial statements and the extent of the impact has not yet been determined.

DIVIDEND

On January 18, 2018 the Company declared a dividend of CDN\$0.60 per share on each of its Class A voting and Class B subordinate voting shares to holders of record as of January 31, 2018; the dividend was paid on February 7, 2018.

NON-CONTROLLING INTEREST

On January 16, 2018 the Company sold 7.933 per cent (7,933 Class A common shares) of its subsidiary, PAEM, to Swala (PAEM) Limited, a wholly owned subsidiary of Swala Oil & Gas (Tanzania) plc. ("Swala"), for \$21.0 million. The consideration received by the Company was US\$15.7 million cash (US\$17.0 million less a purchase price adjustment of US\$1.4 million reflecting Swala's share of cash flow from the effective date of the transaction of January 1, 2017 until closing) and US\$4.0 million of Swala convertible preferred shares with a 10 percent coupon. The preferred shares had not been issued as at March 31, 2018 and the consideration recorded at fair value is currently recorded in long-term trade receivables and other. The agreement provides Swala with the right to acquire up to a maximum of 40% of PAEM under the same terms and conditions. The Company has granted an extension of this right to June 30, 2018.

A reconciliation of the non-controlling interest is detailed below:

US\$'000	AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017
Balance, beginning of period	–	–
Recorded at the date of disposition	178	–
Share of post- acquisition loss	(27)	–
Balance, end of period	151	–

SUMMARY QUARTERLY RESULTS

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

Figures in US\$'000 except where otherwise stated	2018	2017				2016		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q3
Financials								
Revenue	14,223	10,609	15,287	16,810	18,126	19,267	20,619	17,082
Net (loss) income	(4,638)	(4,684)	(34)	(622)	2,840	1,048	5,302	1,452
(Loss) earnings per share – basic and diluted (US\$)	(0.13)	(0.13)	(0.00)	(0.02)	0.08	0.03	0.15	0.04
Funds flow (used in) from operations ⁽¹⁾	(7,054)	63	4,241	4,610	5,926	6,211	10,024	6,772
Funds flow (used in) from operations per share – basic and diluted (US\$)	(0.20)	0.01	0.12	0.13	0.17	0.18	0.29	0.19
Net cash flows from (used in) operating activities	(0.20)	0.01	0.12	0.13	0.17	0.18	0.29	0.19
Net cash flows from operating activities	1,527	12,882	14,447	12,038	8,787	8,345	6,540	6,237
Net cash flows per share – basic and diluted (US\$)	0.04	0.37	0.41	0.35	0.25	0.24	0.19	0.18
Operating netback (US\$/mcf) ⁽¹⁾	2.23	2.26	2.94	3.44	3.34	3.35	3.31	3.32
Working capital	65,201	69,575	71,129	73,854	68,112	71,989	67,635	58,395
Long-term loan	58,557	58,518	58,501	58,468	58,399	58,399	58,398	58,368
Shareholders' equity	76,636	78,731	82,426	82,407	82,982	80,023	79,152	73,887

Capital expenditures

Geological and geophysical and well drilling	–	–	–	3	27	32	26	2,558
Pipeline and infrastructure	792	442	477	250	93	99	(71)	181
Other equipment	27	30	126	97	–	–	–	102
Other	–	–	–	–	7,352	–	–	–
Total	819	472	603	350	7,472	131	(45)	2,841

Operating

Additional Gas sold (MMcfd)								
– industrial	1,251	1,110	1,285	1,158	1,041	1,226	1,238	1,151
– power	2,114	2,428	2,867	2,437	2,873	2,895	3,047	2,521
Total	3,365	3,538	4,152	3,595	3,914	4,121	4,285	3,672
Additional Gas sold (MMcfd)								
– industrial	13.9	12.1	14.0	12.7	11.6	13.3	13.5	12.6
– power	23.5	26.4	31.1	26.8	31.9	31.5	33.1	27.7
Total	37.4	38.5	45.1	39.5	43.5	44.8	46.6	40.3
Average price per mcf (US\$)								
– industrial	7.79	7.78	7.65	7.69	7.75	7.52	7.60	7.64
– power	3.60	3.63	3.63	3.57	3.57	3.57	3.57	3.55
Weighted Average	5.16	4.93	4.87	4.90	4.68	4.75	4.61	4.83

⁽¹⁾ See non-GAAP measures

PRIOR EIGHT QUARTERS

The general decrease in revenue from Q3 2016 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 Q1 2017 to Q2 2017 is a consequence of the fall in the volume of gas sold to the industrial sector (primarily a consequence of planned and unplanned maintenance work at a cement plant) and to the power sector due to increased hydro utilization. Despite an increase in sales volumes from Q2 2017 to Q3 2017, revenue fell due to a combination of a decrease in the current income tax adjustment and the depletion of the cost pool during the quarter. The revenue fell in Q4 2017 due to the combination of a 15% fall in sales volumes, a substantial increase in TPDC share of Profit Gas and a negative current income tax adjustment. The increase in revenue in Q1 2018 is the consequence of reversal of TANESCO deferred revenue to income during the quarter and the increase in Cost Gas relative to Q4 2017 as accruals have crystalized during the quarter.

Changes in net income over the last two years were negatively impacted by the poor payment history of TANESCO. In Q2 2016 and Q3 2016 doubtful debt provisions of 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 recognized a percentage of the TANESCO invoiced amount for revenue recognition purposes in accordance with the revised estimation procedure which resulted in a net revenue reduction of US\$1.9 million in both Q4 2016 and Q1 2017, a reduction of US\$0.8 million in Q2 2017, a net revenue increase of US\$1.8 million in Q3 2017, a net revenue increase of US\$1.0 million in Q4 2017, and a net revenue increase of US\$1.6 million in Q1 2018 (see "Company Operating Revenue").
- The Company recorded an interest expense of US\$1.6 million in Q2 2016 to Q4 2016, US\$2.3 million in Q1 2017 and Q2 2017, US\$2.9 million in Q3 2017, US\$2.6 million in Q4 2017 and US\$4.7 million in Q1 2018. The increase in 2017 over 2016 is a result of the participatory interest accrual on the IFC Loan. The increase for Q1 2018 primarily relates to the participatory interest payable as a consequence of the sale of a minority interest in PAEM in accordance with the terms of the IFC loan.
- Changes in stock based compensation due to fluctuations in the Company share price and issuance of new RSUs.
 - Q2 2016: Credit of US\$0.7 million, share price closed at CDN\$3.40.
 - Q3 2016: Credit of US\$0.1 million, share price closed at CDN\$3.41.
 - Q4 2016: Charge of US\$0.6 million, share price closed at CDN\$3.82.
 - Q1 2017: Charge of US\$0.8 million predominately a consequence of the issuance of 259,067 RSUs which vested fully on the date of grant. The share price closed at CDN\$3.85.
 - Q2 2017: Charge of US\$1.6 million predominately the consequence of the issuance of 1,143,255 RSUs. The share price closed at CDN\$4.01.
 - Q3 2017: Charge of US\$2.1 million, share price closed at CDN\$4.60.
 - Q4 2017: Charge of US\$2.1 million, share price closed at CDN\$5.00.
 - Q1 2018: Charge of US\$4.6 million, as a consequence of the exercise of both stock appreciation rights and restrictive stock units together with the increase in the share price closing at CDN\$5.50.

Differences in funds flow from operations for the last seven quarters were primarily a result of changes in revenue during the periods. The decrease in funds flow from operations in Q4 2016 from Q3 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 funds flow from operations to US\$10.0 million in Q3 2016 from US\$6.7 million in Q2 2016 is primarily the result of the US\$3.2 million increase in revenue over the quarter. The difference in funds flow from operations between Q1 2017 and Q1 2018 is primarily a combination of the exercise of stock appreciation rights and restrictive stock units and the US\$2.6 million participatory interest paid the IFC in accordance with the terms of the Loan Agreement following the completion of the sale of the minority interest in PAEM. The fall in funds flow 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 funds flow 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. The decrease in funds flow from operations between Q2 2017 and Q3 2017 is a consequence of several factors, most notably the decrease in the loss between the periods being offset by the non-cash movements associated with stock based compensation and taxation. The decrease in funds flow from operations between Q3 2016 and Q3 2017 is primarily a consequence of the fall in revenue between the periods. The decrease in funds flow from operations between Q4 2017 and Q4 2016 is a consequence of the fall in revenue together with an increase in stock based compensation. The decrease between Q4 2017 and Q3 2017 is the consequence of the fall in revenue, the increase in stock based compensation offset by a lower recovery of deferred taxation in the period.

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 change in net cash flows from operating activities between Q1 2018 and Q1 2017 is primarily due to the increase in the stock based compensation and interest expense.

The progressive increase in working capital from Q2 2016 to Q4 2016 is mainly the result of US\$21.1 million in net cash flows from operating activities being offset by US\$2.9 million of capital expenditure over the same period given the Company's reduced level of drilling and related activity. The level of working capital between Q4 2016 and Q3 2017 has remained fairly consistent at an average of US\$71.3 million. The fall in working capital to US\$69.6 million in Q4 2017 from US\$71.1 million in Q3 2017 is the consequence of the increased liabilities associated with the IFC loan and TPDC share of Profit Gas, offsetting the increased collections from TANESCO. The decrease in working capital between Q4 2017 and Q1 2018 from US\$69.6 to US\$65.2 million is primarily due to the increase in stock based compensation payments between periods.

Capital expenditure for the last four quarters amounted to US\$2.2 million compared to US\$3.0 million from Q2 2016 to Q1 2017, excluding the transfer of the Songas share of workover costs incurred in 2015 to property, plant and equipment in Q1 2017.

The level of Industrial sales volumes in the four quarters ending Q1 2018 averaged of 1,201 MMcf (four quarters ending Q1 2017: 1,164 MMcf) with total Industrial sales volumes for the four quarters ending Q1 2018 increasing to 4,804 MMcf (13.2 MMcfd) compared to 4,656 MMcf (12.8 MMcfd) in the four quarters ending Q1 2017.

The level of Power sales volumes decreased by 13% in the four quarters ending Q1 2018 to an average of 2,462 MMcf (four quarters ending Q1 2017: 2,834 MMcf) with total Power sector sales volumes for the four quarters ending Q1 2018 decreasing to 9,846 MMcf (27.0 MMcfd) compared to 11,336 MMcf (31.1 MMcfd) in the four quarters ending Q1 2017. The decline is the consequence of lower offtakes by TANESCO.

BUSINESS RISKS

See "Business Risks" in the MD&A for the year ended December 31, 2017 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 the Company 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. This resulted 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 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.

Cash received in excess of the revenue recorded from TANESCO in any given period will be recorded as deferred revenue. In periods when the deferred revenue balance is greater than the amounts invoiced to TANESCO for gas deliveries for the previous four quarters, any amount in excess of the four quarter average will be recorded as current period revenue to the extent there is unrecognized revenue resulting from the approach to revenue recognition adopted on October 1, 2016. If such unrecognized revenue is reduced to nil, additional amounts collected in excess of the quarterly average will be applied to pay the oldest TANESCO invoice recorded and previously provided for.

In periods when cash received is less than revenue recorded, the deferred revenue will be reduced accordingly. If the deferred revenue amount is reduced to nil, the difference will be recorded as accounts receivable.

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. The percentage was increased effective October 1, 2017 to reflect the most recent three year payment history for TANESCO compared to amounts invoiced for deliveries.

At March 31, 2018 the current receivable from TANESCO was US\$ nil (December 31, 2017: US\$ nil). 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\$8.1 million (December 31, 2017: US\$8.4 million), after the reallocation of US\$4.2 million to net field revenue during the quarter.

The long-term trade receivable at March 31, 2018 and December 31, 2017 was US\$74.4 million (provision of US\$74.4 million). Since the quarter end the Company has invoiced TANESCO US\$1.3 million for gas deliveries and TANESCO has paid the Company US\$6.2 million.

As at March 31, 2018 Songas owed the Company US\$9.2 million (Q4 2017: US\$8.2 million), while the Company owed Songas US\$1.9 million (Q4 2017: US\$2.0 million). The amounts due to the Company are mainly for sales of gas of US\$2.2 million (Q4 2017: US\$2.4 million) and for the operation of the gas plant of US\$7.0 million (Q4 2017: US\$5.8 million) against which the Company has made a provision for doubtful accounts of US\$4.9 million (Q4 2017: US\$4.9 million) whereas the amounts due to Songas primarily relate to pipeline tariff charges of US\$1.5 million (Q4 2017: US\$1.7 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis.

Access to Songas processing and transportation

Although the Company operates the Songas gas processing plant, Songas is the owner of the plant and the 16-inch 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 the 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. This risk has been significantly mitigated with the recent signing of AGP2 which acknowledges that production from the Songas facility is to continue based on the increased re-rated capacity.

Recent Legislation

The Petroleum 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 Petroleum 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 Petroleum 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 Petroleum Act vests TPDC with exclusive rights in the entire petroleum upstream and the natural gas mid and downstream value chains. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Petroleum Act does provide grandfathering provisions upholding the rights of the Company under their PSA as it was signed prior to passing of the Petroleum 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 Petroleum Act. Under the Petroleum 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 15, 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 the Petroleum Act and legislation will be 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 are dealt with in a proposed Insufficiency Agreement ("IA"). The ARGA was initiated by all parties but both the ARGA and IA remain unsigned as at the date of this report. 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.

NON-GAAP MEASURES

The company evaluates its performance using 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.

- Funds flow from operations represents net cash flows from operating activities less interest expense 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/or service debt.

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
Net cash flow from operating activities	1,527	8,787
Interest expense	(1,538)	(1,518)
Participatory interest expense	(3,138)	(731)
Changes in non-cash working capital	(3,905)	(612)
Funds flow (used in) from operations	(7,054)	5,926

The Company's funds flow from operations for the quarter ended March 31, 2018 was an outflow of US\$7.1 million (Q1 2017: US\$5.9 million inflow). The decrease is primarily a combination of the exercise of stock appreciation rights and restrictive stock units and the US\$2.6 million participatory interest paid the IFC in accordance with the terms of the Loan Agreement following the completion of the sale of PAEM.

- Operating netbacks represent the profit margin associated with the production and sale of additional gas and is calculated as revenues less processing and transportation tariffs, government parastatal's revenue share, operating and distribution costs for one thousand standard cubic feet of additional gas. This is a key measure as it demonstrates the profit generated from each unit of production, and is widely used by the investment community.
- Funds flow from operations per share is calculated on the basis of the funds flow 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.

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, 2017. See "Critical Accounting Estimates and Judgements" in the MD&A for the year ended December 31, 2017 for a complete discussion.

Critical judgements in applying accounting policies:

A. Collectability of receivables

The Company evaluates the collectability of its receivables on the basis of payment history, frequency and predictability, as well as Management's assessment of the customer's willingness and ability to pay. Management performs impairment tests each period on the Company's current and long-term receivables. As a result of TANESCO's inability to fully pay all amounts invoiced by the Company for the past few years, management of the Company has modified its approach to revenue recognition as it relates to TANESCO only. Commencing on October 1, 2016, the Company 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 percentage used to recognize TANESCO revenue will be reviewed as 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.

B. 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.

Q1 2018
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-month period ended March 31, 2018.

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

ORCA EXPLORATION GROUP INC. US\$'000	Note	THREE MONTHS ENDED MARCH 31	
		2018	2017
Revenue	6, 7	14,223	18,126
Production, distribution and transportation		(2,789)	(3,158)
Net production revenue		11,434	14,968
Expenses			
General and administrative		(3,521)	(2,675)
Stock based compensation	13	(4,629)	(841)
Depletion		(2,021)	(2,251)
Finance income		237	81
Finance expense	8	(5,323)	(2,524)
Income before tax		(3,823)	6,758
Income tax expense – current		(391)	(3,403)
Income tax recovery (expense) - deferred		350	(241)
Additional Profits Tax		(774)	(274)
Net (loss) income		(4,638)	2,840
Net loss attributable to non-controlling interest		27	–
Net (loss) income attributable to shareholders		(4,611)	2,840
Foreign currency translation gain from foreign operations		68	119
Comprehensive (loss) income		(4,543)	2,959
Net (loss) income per share (US\$)			
Basic and diluted	14	(0.13)	0.08

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	MARCH 31, 2018	DECEMBER 31, 2017
Assets			
Current assets			
Cash and cash equivalents		117,813	122,322
Trade and other receivables	9	12,576	12,273
Tax receivable		889	–
Prepayments		944	866
		132,222	135,461
Non-current assets			
Long-term trade receivables and other	9	6,790	2,797
Property, plant and equipment	10	110,040	111,291
		116,830	114,088
Total Assets		249,052	249,549
Equity and liabilities			
Current liabilities			
Trade and other payables	11	58,953	56,758
Tax payable		–	718
Deferred revenue	9	8,068	8,410
		67,021	65,886
Non-current liabilities			
Deferred income taxes		11,461	11,811
Long-term loan	12	58,557	58,518
Additional Profits Tax		35,377	34,603
		105,395	104,932
Total Liabilities		172,416	170,818
Equity			
Capital stock	13	86,508	86,508
Contributed surplus		6,319	6,319
Accumulated other comprehensive loss		(97)	(165)
Accumulated loss		(16,245)	(13,931)
Non-controlling interest	19	151	–
		76,636	78,731
Total equity and liabilities		249,052	249,549

See accompanying notes to the condensed consolidated interim financial statements.

Nature of operations (Note 1); Contractual obligations and committed capital investments (Note 16); Contingencies (Note 17).

Condensed Consolidated Interim Statements of Cash Flows (unaudited)

ORCA EXPLORATION GROUP INC.

THREE MONTHS ENDED MARCH 31

US\$'000

Note

2018

2017

Operating activities

Net (loss) Income		(4,638)	2,840
Adjustment for:			
Depletion and depreciation	10	2,070	2,340
Provision for doubtful accounts and indirect tax	8	264	205
Stock-based compensation	13	(5,400)	(171)
Income taxes (recovery) expense - deferred	9	(350)	241
Additional Profits Tax		774	274
Unrealized loss on foreign exchange		226	197
Interest expense	8	1,538	1,518
Participatory interest expense	8	3,138	731
Change in non-cash operating working capital	18	3,905	612
Net cash flows from operating activities		1,527	8,787

Investing activities

Property, plant and equipment expenditures	10	(819)	(120)
Change in non-cash working capital		8	(96)
Net cash used in investing activities		(811)	(216)

Financing activities

Interest paid	8	(1,538)	(1,518)
Participatory interest paid	8	(2,578)	-
Dividend paid	13	(16,866)	-
Proceeds on sale of interest in a subsidiary	19	15,691	-
Net cash flow used in financing activities		(5,291)	(1,518)
(Decrease) increase in cash		(4,575)	7,053
Cash and cash equivalents at the beginning of the period		122,322	80,895
Effect of change in foreign exchange on cash for the period		66	(127)
Cash and cash equivalents at the end of the period		117,813	87,821

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	Non-controlling interest	Total
Note	13			17	19	
Balance as at January 1, 2018	86,508	6,319	(165)	(13,931)	–	78,731
Dividend declared	–	–	–	(16,866)	–	(16,866)
Foreign currency translation adjustment on foreign operations	–	–	68	–	–	68
Net loss	–	–	–	(4,611)	(27)	(4,638)
Gain on sale of interest in a subsidiary	–	–	–	19,163	–	19,163
Non-controlling interest recorded at date of acquisition	–	–	–	–	178	178
Balance as at March 31, 2018	86,508	6,319	(97)	(16,245)	151	76,636

<i>US\$'000</i>	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated loss	Total
Note	13				
Balance as at January 1, 2017	85,488	6,347	(381)	(11,431)	80,023
Foreign currency translation adjustment on foreign operations	–	–	119	–	119
Net income	–	–	–	2,840	2,840
Balance as at March 31, 2017	86,488	6,347	(262)	(8,591)	82,982

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. 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 March 31, 2018 and for the three months ended March 31, 2018 comprise accounts of the Company and all its wholly and majority owned subsidiaries (collectively, the "Company" or "Orca Exploration") and were authorized for issue in accordance with a resolution of the directors on May 22, 2018.

1

NATURE OF OPERATIONS

The Company's principal operating asset is an interest held by a subsidiary, PanAfrican Energy Tanzania Limited ("PAET") 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. The Company operates the gas processing plant and field on a 'no gain no loss' basis and receives no revenue for the Protected Gas delivered to Songas.

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 Electricity Supply Company Limited ("TANESCO") is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the Ministry for Energy ("ME"), previously known as 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. TANESCO 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, 2017. Certain comparative period amounts have been reclassified to conform with the current period presentation.

Basis of consolidation

Subsidiaries

Subsidiaries are those enterprises controlled by the Company. The following companies have been consolidated within the Orca Exploration financial statements:

COMPANY	REGISTERED	HOLDING	FUNCTIONAL CURRENCY
Orca Exploration Group Inc.	British Virgin Islands	Parent Company	US dollar
Orca Exploration Italy Inc.	British Virgin Islands	100%	Euro
Orca Exploration Italy Onshore Inc.	British Virgin Islands	100%	Euro
PAE PanAfrican Energy Corporation("PAEM")	Mauritius	92%	US dollar
PanAfrican Energy Tanzania Limited	Jersey	92%	US dollar
Orca Exploration UK Services Limited	United Kingdom	100%	British Pound

Transactions eliminated upon consolidation

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

Foreign currency

i) Foreign currency transactions

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

ii) Foreign currency translation

Foreign currency differences are recognized in comprehensive income and accumulated in the translation reserve. The assets and liabilities of these companies are translated into the functional currency at the period-end exchange rate. The income and expenses of the companies are translated into the functional currency at the average exchange rate for the period. Translation gains and losses are included in other comprehensive income.

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, 2017. There have been no changes in accounting policies for the three-month period ended March 31, 2018 and the policies have been applied consistently to all periods presented in the condensed consolidated interim financial statements, except as noted below:

IFRS 9 - Financial instruments was adopted by the Company on January 1, 2018. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and de-recognition of financial instruments from IAS 39. The adoption of IFRS 9 did not have a material impact on the Company's consolidated interim financial statements.

The Company has revised the description of its accounting policy for financial instruments to reflect the new classification approach. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods depends on the classification of the financial instrument as described below:

- Fair value through profit or loss: Financial instruments under this classification include cash and cash equivalents and derivative assets and liabilities.
- Amortized cost: Financial instruments under this classification include accounts receivable, accounts payable and accrued liabilities, dividends payable, finance lease obligations, and long-term debt.

IFRS 15 – Revenue from Contracts with Customers was adopted by the Company on January 1, 2018 retrospectively. IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue from contracts with customers is recognized. The Company's revenue relates to the sale of natural gas to customers at specified delivery points at bench mark and contractual prices. Adopting IFRS 15 resulted in additional disclosure relating to disaggregation of revenue with the Songas processing and transportation tariff being recorded in production, distribution and transportation costs as opposed to a direct deduction from revenue.

The Company has revised the description of its accounting policy for revenue recognition as follows:

- Revenue from contracts with customers is recognized when a performance obligation is satisfied by transferring a promised good or service to a customer.
- A good or service is transferred when the customer obtains control of that good or service. The transfer of control of natural gas occurs at the metering points at the inlet to the customer's facility (see Note 7).

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.

IFRS 16 – Leases sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and replaces the previous leases standard, IAS 17 Leases. IFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of IFRS 16 on its consolidated financial statements and the extent of the impact has not yet been determined.

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 interim 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, 2017.

See Note 4 of the audited consolidated financial statements for the year ended December 31, 2017 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 carrying amount of accounts receivable and the long-term receivable represents the maximum credit exposure. As at March 31, 2018 and December 31, 2017 provisions exist against the long-term TANESCO receivable, the provision for gas plant operations charges and capital expenditure receivables from Songas and the provision of US\$0.5 million for one industrial customer. No write-off any receivables occurred during the quarter (see Note 9).

All the Company's production is currently derived in Tanzania. The sales are made to the Power sector and the Industrial sector. In relation to sales to the Power sector, the Company has a contract with Songas for the supply of gas to the Ubungo power plant and a contract with TANESCO to supply gas to some of the TANESCO power plants. The contracts with Songas and TANESCO accounted for 55% of the Company's gross field revenue operating revenue during quarter and US\$2.2 million of the short and long-term receivables at March 31, 2018.

The Company manages the credit exposure related to cash and cash equivalents by selecting counterparties based on credit ratings and monitoring all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper. 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\$59.0 million of financial liabilities with regards to trade and other payables of which US\$35.6 million is due within one to three months, nil is due within three to six months, and US\$23.4 million is due within six to twelve months (see Note 11).

At the end of the year approximately 69% of the current liabilities relate to TPDC (see Note 11). 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. A large proportion of the TPDC liability is associated with the long-term TANESCO arrears and payment to TPDC will be made once cash is received for the arrears. Prior to 2017 payments from TANESCO have been irregular and insufficient and as a result, the quarterly payments to TPDC have been disrupted.

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 natural gas and exploration assets in Tanzania and had exploration and appraisal interests in Italy.

	2018			THREE MONTHS ENDED MARCH 31		
	Italy	Tanzania	Total	Italy	Tanzania	Total
<i>US\$'000</i>						2017
External revenue	–	14,223	14,223	–	18,126	18,126
Segment net income (loss) ⁽¹⁾	66	(4,704)	(4,638)	(35)	2,805	2,840
Depletion & depreciation	–	2,070	2,070	–	2,340	2,340
						AS AT
			MARCH 31, 2018			DECEMBER 31, 2017
<i>US\$'000</i>						
Capital additions ⁽²⁾	–	819	819	–	8,897	8,897
Total assets	600	248,452	249,052	2,041	247,508	249,549
Total liabilities	12	172,404	172,416	493	170,325	170,818

(1) The income in Italy relates to foreign exchange gains on the euro cash balances held in country.

(2) In Q1 2017 US\$7.4 million was transferred from accounts receivable to property, plant and equipment (see Note 9).

7

REVENUE

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Industrial sector	9,747	8,068
Power sector	11,782	11,512
Gross field revenue	21,529	16,422
TPDC share of revenue	(7,038)	(2,117)
Company operating revenue	14,491	14,305
Current income tax adjustment	(268)	3,821
Revenue	14,223	18,126

The Company records a percentage of the amounts invoiced to TANESCO for revenue recognition purposes determined by comparison of TANESCO's payment history to the amounts invoiced by the Company.

During the quarter the Company collected receipts from TANESCO in excess of the gas delivered. The total payments from TANESCO since October 1, 2016 (the date the Company began recording revenue based on the expected collectability) have exceeded the amount of invoices for gas deliveries during the same period. As a consequence, in Q1 2018 the Company recorded an increase of US\$4.2 million in gross field revenue and reallocated US\$2.6 million of TPDC Profit share entitlement, which resulted in an overall increase of US\$1.3 million in net income.

The impact of recording revenue based on the expected collectability from the effective date and impact of excess collections over deliveries is as follows:

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Increase (decrease) in gross field revenue and accounts receivable	4,172	(1,582)
Increase (decrease) in revenue	1,603	(1,905)
Increase (decrease) in net income	1,292	(1,582)
Increase (decrease) in liabilities	2,880	(323)

The Company sells its natural gas to power customers (TANESCO and Songas) and one industrial customer (a cement manufacturer) pursuant to fixed-price contracts. Sales to 37 other industrial customers (subject to certain floors and ceilings) are at fixed priced discounts to the lowest alternative fuel source in Dar es Salaam, namely Heavy Fuel Oil ("HFO") and coal. Under all contracts, the Company is required to deliver volumes of natural gas to the contract counterparty. Natural gas revenue is recognized when the Company gives up control of the natural gas which occurs at metering points located at the inlets of customers' facilities. The amount of production revenue recognized is based on the agreed transaction price and the volumes delivered.

The Company has entered into contracts with customers with terms ranging from four to eight years.

8

FINANCE EXPENSE

<i>US\$'000</i>	THREE MONTHS ENDED MARCH 31	
	2018	2017
Interest expense	(1,538)	(1,518)
Participatory interest expense	(3,138)	(731)
Net foreign exchange loss	(383)	(70)
Indirect tax	(264)	(205)
Finance expense	(5,323)	(2,524)

Interest expense and participatory interest expense relate to the long-term loan with the International Finance Corporation ("IFC"). The amount of interest expense during the quarter was US\$1.5 million (Q1 2017: US\$1.5 million). The participatory interest expense during the quarter was US\$3.1 million (Q1 2017: US\$0.7 million); the increase is related to an additional payment of US\$2.6 million (Q1 2017: US\$ nil) associated with the sale of the 7.933% interest in PAEM in January 2018 (see Note 12).

The indirect tax of US\$0.3 million for the quarter (Q1 2017: US\$0.2 million) is for VAT associated with invoices to TANESCO for interest on late payments. These invoices are not recognized in the financial statements due to revenue recognition criteria with respect to assurance of collectability (see Note 9).

9

TRADE AND OTHER RECEIVABLES

Current receivables		AS AT
<i>US\$'000</i>	MARCH 31, 2018	DECEMBER 31, 2017
Trade receivables		
Songas	2,163	2,378
Industrial customers	7,836	6,915
Less provision for doubtful accounts	(452)	(452)
	9,547	8,841
Other receivables		
Songas gas plant operations	7,004	5,827
Other	941	2,521
Less provision for doubtful accounts	(4,916)	(4,916)
	3,029	3,432
	12,576	12,273

TANESCO

At March 31, 2018 the current receivable from TANESCO was US\$ nil (December 31, 2017: US\$ nil). 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\$8.1 million (December 31, 2017: US\$8.4 million), after the reallocation of US\$4.2 million to net field revenue during the quarter.

The TANESCO long-term trade receivable at March 31, 2018 and December 31, 2017 was US\$74.4 million (provision of US\$74.4 million). Subsequent to March 31, 2018, the Company has invoiced TANESCO US\$1.3 million for 2018 gas deliveries and TANESCO has paid the Company US\$6.2 million.

Long-term trade receivables and other

<i>US\$'000</i>	AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017
TANESCO receivable	74,361	74,361
Provision for doubtful accounts	(74,361)	(74,361)
Net TANESCO receivable	–	–
VAT Songas workovers	2,205	2,205
VAT bond	377	363
Lease deposit	241	229
Receivable re sale of minority interest (see Note 19)	3,967	–
Long-term trade receivables and other	6,790	2,797

Songas

As at March 31, 2018 Songas owed the Company US\$9.2 million (December 31, 2017: US\$8.2 million) while the Company owed Songas US\$1.9 million (December 31, 2017: US\$2.0 million). The amounts due to the Company are mainly for sales of gas of US\$2.2 million (December 31, 2017: US\$2.4 million) and for the operation of the gas plant of US\$7.0 million (December 31, 2017: US\$5.8 million) against which the Company has made a provision for doubtful accounts of US\$4.9 million (December 31, 2017: US\$4.9 million), whereas the amounts due to Songas primarily relate to pipeline tariff charges of US\$1.5 million (December 31, 2017: US\$1.7 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\$74 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 continues to take action to collect the US\$14.5 million of workover costs. Amounts not collected 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, 2018	Year to date transactions	March 31, 2018	Post quarter-end payments and receipts	Outstanding as at the date of this report
Pipeline tariff – payable	(1,670)	146	(1,524)	1,524	–
Gas sales – receivable	2,378	(215)	2,163	(2,163)	–
Gas plant operation receivable	5,827	1,177	7,004	(1,188)	5,816
Provision for gas plant operation receivable	(4,916)	–	(4,916)	–	(4,916)
Other payable	(378)	–	(378)	–	(378)
Net balances	1,241	1,108	2,349	(1,827)	522

10

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, 2018	204,266	699	1,487	449	1,126	208,027
Additions	792	–	27	–	–	819
As at March 31, 2018	205,058	699	1,514	449	1,126	208,846
Accumulated depletion and depreciation						
As at January 1, 2018	93,258	694	1,315	346	1,123	96,736
Depletion and depreciation	2,021	4	20	25	–	2,070
As at March 31, 2018	95,279	698	1,335	371	1,123	98,806
Net book values						
As at December 31, 2017	111,008	5	172	103	3	111,291
As at March 31, 2018	109,779	1	179	78	3	110,040

In determining the depletion charge, it is estimated that future development costs of US\$79.6 million (Q4 2017: US\$80.4 million) will be required to bring the total proved reserves to production. The Company recorded depreciation of US\$0.05 million (Q1 2017: US\$0.1 million) in general and administrative expenses.

11

TRADE AND OTHER PAYABLES

<i>US\$'000</i>	MARCH 31, 2018	AS AT DECEMBER 31, 2017
Songas	1,524	1,670
Other trade payables	3,609	1,961
Trade payables	5,133	3,631
TPDC share of Profit Gas, net	40,646	33,422
Accrued liabilities	13,174	19,705
	58,953	56,758
TPDC share of Profit Gas		
<i>US\$'000</i>	MARCH 31, 2018	AS AT DECEMBER 31, 2017
TPDC share of Profit Gas	40,832	35,876
Less "Adjustment Factor"	(186)	(2,454)
TPDC share of Profit Gas payable	40,646	33,422

Under the PSA revenue sharing mechanism, the Company is to adjust TPDC's Profit Gas share by the "Adjustment Factor". The Adjustment Factor is equal to the amount necessary to fully pay and discharge the PAET liability for taxes on income derived from Petroleum Operations. The Adjustment Factor has previously been carried as tax recoverable in the Consolidated Statements of Financial Position and has been reclassified to trade and other payables to reflect the right and practice of net settlement.

12

LONG-TERM LOAN

The Company's subsidiary, PAET, entered into a loan agreement (the "Loan") in 2015 with the IFC, a member of the World Bank Group, for US\$60 million. The loan was fully drawn down in 2016.

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 starting April 15, 2022 and one final payment of US\$30 million due on April 15, 2025. 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 (December 14, 2015), 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 at its discretion 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 amount of base interest during the quarter was US\$1.5 million (Q1 2017: US\$1.5 million). To date all interest incurred has been paid when due.

In addition, the Loan included an annual variable participatory interest equating to 7% of the net cash flow from operating activities less net cash flows used in investing activities of PAET 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. The participatory interest charged during the quarter was US\$3.1 million (Q1 2017: US\$0.7 million) and includes an additional payment of US\$2.6 million (Q1 2017: US\$ nil) associated with the sale of the 7.933% interest in PAEM in January 2018 in accordance with the terms of the Loan. As a result of the additional payment, the annual variable participatory interest is reduced to 6.4%. For the quarter ended March 31, 2018 the participatory interest included in accrued liabilities is US\$4.4 million (Q4 2017: US\$3.8 million).

Dividends and distributions from PAET to the Company are restricted at any time that any amounts due for interest, principal or participating interest are outstanding.

<i>US\$'000</i>	MARCH 31, 2018	AS AT DECEMBER 31, 2017
Loan principal	60,000	60,000
Financing costs	(1,443)	(1,482)
	58,557	58,518

13

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 (20) votes per share and Class B shares carry one vote per share. The Class A shares are convertible at the option of the holder at any time into Class B shares on a one-for-one basis. The Class B shares are convertible into Class A shares on a one-for-one basis in the event that a take-over bid is made to purchase Class A shares which must, by reason of a stock exchange or legal requirements, be made to all or substantially all of the holders of Class A shares and which is not concurrently made to holders of Class B shares.

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

Number of shares	2018		
	Authorised (000)	Issued (000)	Amount (US\$'000)
Class A			
As at January 1 and March 31, 2018	50,000	1,751	983
Class B			
As at January 1 and March 31, 2018	100,000	33,506	84,505
First preference			
As at January 1 and March 31, 2018	100,000	–	–
Total Class A, Class B and first preference	250,000	35,257	86,508

All of the issued capital stock is fully paid.

Stock Appreciation Rights ("SARs")	SARs (000)	Exercise Price (CDN\$)
Outstanding as at January 1, 2018	2,485	2.12 to 3.87
Exercised	(1,270)	2.12 to 2.30
Exercised	(100)	2.32 to 2.70
Exercised	(175)	3.02 to 3.25
Exercised	(85)	3.84 to 3.87
Outstanding as at March 31, 2018	855	2.30 to 3.87

The number outstanding, the weighted average remaining life and weighted average exercise prices of SARs at March 31, 2018 were as follows:

Exercise Price (CDN\$)	Number outstanding (000)	Weighted average remaining contractual life (years)	Number exercisable (000)	Weighted average exercise price (CDN\$)
2.30	390	0.79	34	2.30
3.02 to 3.25	235	2.47	–	3.04
3.84 to 3.87	230	3.77	–	3.86
2.30 to 3.87	855	2.06	34	2.92

Restricted Stock Units ("RSUs")	RSUs (000)	Exercise Price (CDN\$)
Outstanding as at January 1, 2018	1,148	0.001
Exercised	(873)	0.001
Outstanding as at March 31, 2018	275	0.001

The number outstanding, the weighted average remaining life of RSUs at March 31, 2018 were as follows:

Exercise Price (CDN\$)	Number outstanding (000)	Number exercisable (000)	Weighted average remaining contractual life (years)
0.001	275	275	4.03

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 1.0%, stock volatility of 48.8% to 56.1%; 0% dividend yield; 5% forfeiture; a closing stock price of CDN\$5.50 per share.

US\$'000	AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017
SARs	1,321	4,339
RSUs	1,173	3,555
	2,494	7,894

As at March 31, 2018 a total accrued liability of US\$2.5 million (Q4 2017: US\$7.9 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\$4.6 million (Q1 2017: US\$0.8 million) as stock based compensation.

On January 18, 2018 the Company declared a dividend of CDN\$0.60 per share on each of its Class A voting and Class B subordinate voting shares to holders of record as of January 31, 2018 paid on February 7, 2018.

14**EARNINGS PER SHARE**

	AS AT MARCH 31	
('000)	2018	2017
Outstanding shares		
Weighted average number of Class A and Class B shares	35,256	34,856
Weighted average diluted number of Class A and Class B shares	35,256	34,856

The calculation of earnings per share is based on a net loss for the quarter of US\$4.6 million (Q1 2017: US\$2.8 million net income) and a weighted average number of Class A and Class B shares outstanding during the period of 35,256,432 (Q1 2017: 34,856,432).

15**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. For the quarter ended March 31, 2018 US\$0.1 million (Q1 2017: US\$0.1 million) was incurred by this firm for services provided.

As at March 31, 2018 the Company has a total of US\$0.1 million (Q4 2017: US\$0.5 million) recorded in trade and other payables in relation to the related parties.

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 (179.8 Bcf as at March 31, 2018). 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 are dealt with in a new 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.

Additional Gas Plan 2 ("AGP2")

During Q3 2017 the Company, through its subsidiary PAET received approval of the AGP2 from the ME which allows PAET to produce and sell increased volumes of Additional Gas. This can be achieved through the Songas infrastructure and 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.

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. This capacity is in addition to the capacity available within the NNGIP infrastructure which PAET intends to utilize now that AGP2 has been approved.

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.

Portfolio Gas Supply Agreement ("PGSA")

On June 17, 2011, a long term PGSA was signed (to June 2023) between TANESCO (as the buyer) and the Company and TPDC (collectively as the seller). Under the PGSA, the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 36 MMcfd for use in any of TANESCO's current power plants except those operated by Songas at Ubungo. Under the agreement, the basic wellhead price of approximately US\$2.98/mcf increased to US\$3.04/mcf on July 1, 2017. Any volumes of gas delivered under the PGSA in excess of 36 MMcfd are subject to a 150% increase in the basic wellhead gas price. In December 2017 notice was given by TANESCO to reduce the maximum daily quantity under the PGSA from 36 to 26 MMcfd effective January 2018.

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 improved field deliverability and provided 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. With the signing of AGP2, the Company is planning to continue with the completion of Phase A of the Development Program that includes a refrigeration unit and well workovers with an estimated cost of US\$22 million. A portion of the costs are for workovers on wells SS-3 and SS-4 and it is expected that Songas, the owner of the wells, will fund the costs for these workovers. Assuming Songas covers the costs of the workovers for wells SS-3 and SS-4, the Company's net estimated cost is US\$13.3 million.

During 2017 the Company connected well SS-11 to the NNGIP infrastructure and is currently finalizing commercial terms with TPDC for the sale of incremental gas volumes through the NNGIP.

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. The farm-in commits the Company to fund 30% of an appraisal well up to a maximum of US\$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US\$0.5 million. 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.

17

CONTINGENCIES

Upstream and downstream activities

The Petroleum Act, 2015 (the "Petroleum Act") provides TPDC with exclusive rights over the distribution of gas in Tanzania. The Petroleum Act has grandfathering provisions upholding the rights of the Company to develop and market natural gas produced under the PSA as it was signed prior to the Petroleum Act coming into effect in 2015. However, it is still unclear how the provisions of the Petroleum Act will be interpreted and implemented regarding upstream and downstream activities and the Company is uncertain regarding the potential impact on its business in Tanzania.

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

Cost recovery

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

Taxation

Area	Period	Tax dispute Reason for dispute	Disputed amount US\$' million		
			Principal	Interest	Total
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).	29.6	10.0	39.6 ⁽³⁾
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.8	5.5 ⁽⁴⁾
			33.7	13.5	47.2

Management, with the advice from its legal counsels, has reviewed the Company's position on the objections and appeals related to the disputed amounts and has concluded that no provision is required with regard to these matters and that the maximum exposure is US\$47.2 million (December 31, 2017: US\$47.2 million).

- (1) In 2015 PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE on grossed-up amounts on staff salaries. TRAB waived interest assessed thereon. The Tax Revenue Appeals Tribunal ("TRAT") upheld TRAB decision which ruled in favour of TRA on principal tax demanded but waived interest assessed thereon. In 2017 PAET appealed the TRAT ruling to the Court of Appeal of Tanzania ("CAT"). PAET is awaiting CAT hearing date to be set;
- (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 that no WHT was required on services performed outside Tanzania by non-resident persons 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 July 28, 2017 TRA filed another Application for extension of time, under the certificate of urgency, for their application for CAT leave to review its judgement. During the quarter CAT ruled in favour of PAET's preliminary objection. TRA still has the right to amend and re-file its 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\$2.6 million): In 2015 TRAB ruled against PAET with respect to timing of deductibility of capital expenditures and other expenses (US\$1.8 million). In Q2 2017 PAET lost an appeal at TRAT and subsequently filed an appeal to CAT and is awaiting a hearing date to be set. In July 2017 TRA sent PAET an amended assessment claiming additional taxes, interest and penalties (US\$0.8 million). PAET has objected to the assessment for being time-barred and arbitrary and is awaiting a TRA response;
- (b) 2008 (US\$0.6 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 (with tax impact of US\$0.6 million). PAET has objected to 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 timing of 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\$2.4 million): PAET filed an appeal with TRAB against a TRA assessment with respect to timing of 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 a TRA assessment with respect to foreign exchange rate application and is awaiting a response. PAET received TRA assessments for corporation tax (US\$0.9 million) which disallowed certain operating costs included in the tax returns and tax on repatriated income (US\$5.7 million). PAET has objected to the assessments due to being time-barred and without merit. PAET has also appealed to TRAB the TRA decision not to exercise its administrative powers judiciously to grant the waiver on one-third deposit required to be paid to admit the objection and is awaiting the hearing date to be scheduled;

- (f) 2012 (US\$15.8 million): In 2016 TRA issued two assessments with respect to understated revenue, timing of deductibility of capital expenditures, expenses and tax on repatriated income. PAET filed an appeal with TRAB against the TRA decision to deny PAET a waiver for payment of a deposit required for its objection to be admitted but was granted a partial waiver only. PAET appealed the decision demanding full waiver of the deposit and also filed an application for the stay of execution with TRAT in response to the TRA demand notice for the payment of the deposit ruled by TRAB. TRAT upheld the TRAB decision for partial waiver. Management has decided to appeal the TRAT decision and has fourteen days from the date of TRAT decision to file a Notice of Appeal;
- (g) 2014 (US\$9.2 million): In 2016 TRA issued an assessment of US\$3.3 million 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. PAET has also appealed to TRAB the TRA decision not to exercise its administrative powers judiciously to grant the waiver on one-third deposit required to be paid to admit the objection and is awaiting the hearing date to be scheduled. TRA issued two additional assessments for the year for corporation tax of US\$3.1 million and tax on repatriated income US\$2.8 million. PAET has objected the assessments and is awaiting TRA 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) (a) 2008-2010 (US\$5.4 million): 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 the TRA assessment and is awaiting a hearing date to be scheduled;
- (b) 2012-2014 (US\$0.1 million): TRA issued an assessment for VAT on other income that PAET had paid. PAET has objected the assessment and is awaiting TRA response.

18

CHANGE IN NON-CASH OPERATING WORKING CAPITAL

US\$'000	THREE MONTHS ENDED MARCH 31	
	2018	2017
(Increase) decrease in trade and other receivables	(1,109)	6,109
Decrease (increase) in long-term receivable	13	(2,219)
Increase in prepayments	(78)	(295)
Increase (decrease) in trade and other payables	6,686	(3,463)
(Decrease) increase in tax payable	(1,607)	570
	3,905	612

19

NON-CONTROLLING INTEREST

On January 16, 2018 the Company sold 7.933 per cent (7,933 Class A common shares) of its subsidiary, PAEM, to Swala (PAEM) Limited, a wholly owned subsidiary of Swala Oil & Gas (Tanzania) plc. ("Swala"), for US\$15.7 million cash (net of closing adjustments) and US\$4.0 million of Swala convertible preferred shares with a coupon of 10 percent. The preferred shares had not been issued as at March 31, 2018 and the consideration recorded at fair value is currently recorded in long-term trade receivables and other. The agreement provides Swala with the right to acquire up to a maximum of 40% of PAEM based on the same terms and conditions. The Company has granted an extension of this right to June 30, 2018.

A reconciliation of the non-controlling interest is detailed below:

<i>US\$'000</i>	AS AT	
	MARCH 31, 2018	DECEMBER 31, 2017
Balance, beginning of period	–	–
Recorded at the date of disposition	178	–
Share of post-acquisition loss	(27)	–
Balance, end of period	151	–

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
--	--	---	--	---

Officers

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

Operating Office

PanAfrican Energy
Tanzania Limited
Oyster Plaza Building, 5th Floor
Haile Selassie Road
P.O. Box 80139, Dar es Salaam
Tanzania
Tel: + 255 22 2138737
Fax: + 255 22 2138938

Registered Office

Orca Exploration
Group Inc.
P.O. Box 146
Road Town
Tortola
British Virgin Islands, VG110

Investor Relations

W. David Lyons
Chairman and
Chief Executive Officer
WDLyons@orcaexploration.com
www.orcaexploration.com

International Subsidiaries

PanAfrican Energy Tanzania Limited

Oyster Plaza Building, 5th Floor
Haile Selassie Road
P.O. Box 80139, Dar es Salaam
Tanzania
Tel: + 255 22 2138737
Fax: + 255 22 2138938

PAE PanAfrican Energy Corporation

1st Floor
Cnr Desroches/St Louis
Port Louis
Mauritius
Tel: + 230 207 8888
Fax: + 230 207 8833

Orca Exploration Italy Inc. Orca Exploration Italy Onshore Inc.

P.O. Box 3152,
Road Town
Tortola
British Virgin Islands

Engineering Consultants

McDaniel & Associates
Consultants Ltd.
Calgary, Canada

Auditors

KPMG LLP
Calgary, Canada

Website

orcaexploration.com

Lawyers

Burnet, Duckworth
& Palmer LLP
Calgary, Canada

Transfer Agent

AST Trust Company
Calgary, Alberta, Canada





www.orcaexploration.com