ORCA

ORCA EXPLORATION GROUP INC.

Q2

2018 Q2 INTERIM REPORT

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

GLOSSARY

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

Operating and Financial Highlights

(Expressed in $'000 unless indicated otherwise)	THREE MONTHS ENDED JUNE 30 2018	2017	% CHANGE Q2/18 vs. Q2/17	SIX MONTHS ENDED JUNE 30 2018	2017	% CHANGE YTD/18 vs. YTD/17
OPERATING						
Daily average gas delivered and sold *(MMcfd)*						
Additional Gas	**33.7**	39.5	(15)%	**35.6**	41.5	(14)%
Industrial	**14.2**	12.7	12%	**14.1**	12.1	16%
Power	**19.5**	26.8	(27)%	**21.5**	29.3	(27)%
Average price *($/mcf)*						
Industrial	**7.80**	7.69	1%	**7.80**	7.72	1%
Power	**3.62**	3.57	1%	**3.61**	3.57	1%
Weighted average	**5.39**	4.90	10%	**5.27**	4.79	10%
Operating netback *($/mcf)* [1]	**3.18**	3.44	(8)%	**2.68**	3.40	(21)%
FINANCIAL						
Revenue	**14,959**	16,810	(11)%	**29,182**	34,936	(16)%
Net cash from operating activities	**12,657**	12,038	5%	**14,184**	20,825	(32)%
per share - basic and diluted *($)*	**0.36**	0.35	3%	**0.40**	0.60	(33)%
Net income (loss)	**12,487**	(622)	n/m	**7,849**	2,218	254%
per share - basic and diluted *($)*	**0.35**	(0.02)	n/m	**0.22**	0.06	267%
Funds flow from (used in) operations [1]	**4,398**	4,610	(5)%	**(2,656)**	10,536	n/m
per share - basic and diluted *($)*	**0.12**	0.13	(8)%	**(0.08)**	0.30	n/m
Capital expenditures	**1,042**	350	198%	**1,861**	7,822	(76)%

	JUNE 30, 2018	AS AT DECEMBER 31, 2017	
Working capital (including cash)	**72,129**	69,575	4%
Cash	**54,182**	122,322	(56)%
Investments in short term bonds	**62,870**	–	n/m
Long-term loan	**58,596**	58,518	0%

	JUNE 30, 2018	AS AT 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 of outstanding Class A and Class B shares	**35,256**	34,856	1%

[1] *Please refer to the Management Discussion and Analysis ("MD&A") for Information on non-GAAP measures.*

Q2 2018 Operating Highlights

- Revenue for the quarter decreased by 11% to $15.0 million from $16.8 million in Q2 2017 and decreased 16% to $29.2 million over the six months ended June 30, 2018 compared to $34.9 million for the comparable prior year period. The decrease for the quarter and year-to-date amounts are a result of lower power sales volumes and lower Cost Gas allocations which resulted in an increase in Profit Gas allocations to the Tanzanian Petroleum Development Corporation ("TPDC") and a lower current income tax adjustment. Additional Gas deliveries and sales for the quarter averaged 33.7 million standard cubic feet per day ("MMcfd") a decrease of 15% over 39.5 MMcfd in Q2 2017 and decreased 14% to 35.6 MMcfd for the six months ended June 30, 2018 compared to 41.5 MMcfd for the comparable prior year period. The decrease in Additional Gas volumes for the quarter and the six months ended June 30, 2018 to the comparable prior year periods is primarily a result of reduced consumption of natural gas volumes by the Tanzanian Electric Supply Company ("TANESCO"). The decrease in volumes having been partially offset by a 10% rise in the weighted average price for the quarter to $5.39/mcf from $4.90/mcf in Q2 2017 and a 10% rise to $5.27/mcf for the six months ended June 30, 2018 from $4.79/mcf for the comparable prior year period. The increase in price is a consequence of the change in sales mix.
- The Company had a net income of $12.5 million for the quarter ($0.35 per share diluted) compared to a net loss of income of $0.6 million in Q2 2017 ($0.02 loss per share diluted) and $7.8 million net income ($0.22 per share diluted) for the six months ended June 30, 2018 compared to a net income of $2.2 million ($0.06 per share diluted) for the comparable prior year period. The increase in net income for the quarter and six months ended June 30, 2018 was primarily a consequence of the increase in finance income as a result of the reversal of the provision for doubtful accounts of $13.4 million related to the collection of TANESCO arrears previously provided for.
- Net cash from operating activities for the quarter increased by 5% to $12.7 million ($0.36 per share diluted) in the quarter compared to $12.0 million ($0.35 per share diluted) in Q2 2017 and decreased by 32% for the six months ended June 30, 2018 to $14.2 million ($0.40 per share diluted) from $20.8 million ($0.60 per share diluted) for the comparable prior year period. The decrease for the quarter is primarily the consequence of the decrease in revenue being offset by the increased collections from TANESCO. The decrease for the six months ended June 30, 2018 from the comparable prior year period is primarily a consequence of the exercise of Stock Appreciation Rights and Restrictive Stock Units.

- Funds flows from operations for the quarter decreased by 5% to $4.4 million ($0.12 per share diluted) from $4.6 million ($0.13 per share diluted) in Q2 2017 and for the six months ended June 30, 2018 there was a funds outflow of $2.7 million ($0.08 outflow per share diluted) compared to a funds inflow of $10.5 million ($0.30 per share diluted) for the six months ended June 30, 2017. The decrease for the quarter and the six months ended June 30, 2017 from the comparable prior year periods is primarily due to the lower net cash from operating activities combined with an increase in interest expense and the non-cash working capital.
- Total capital expenditures for the quarter were $1.0 million compared to $0.4 million in Q2 2017 and $1.9 million for the six months ended June 30, 2018 compared to $7.8 million for the comparable prior year period. The capital expenditure in the quarter and first six months ended June 30, 2018 relate primarily to costs for the installation of a refrigeration unit. The capital expenditure for the six months ended June 30, 2017 includes the transfer of $7.4 million of the Songas Limited share of workover costs originally incurred in 2015 from accounts receivable to property, plant and equipment.
- Working capital increased 4% to $72.1 million as at June 30, 2018 compared to $69.6 million as at December 31, 2017. The increase is primarily due to the cumulative cash collections from TANESCO for current deliveries and arrears offset by an increase in stock based compensation during the period. The closing cash at June 30, 2018 was $54.2 million (December 31, 2017: $122.3 million). The decrease in cash is primarily a result of the investment in short and long-term bonds of $70.0 million at June 30, 2018 (December 31, 2017: $ nil), of which $7.2 million mature in August 2019 and have been classified as non-current assets.
- At June 30, 2018 the current receivable from TANESCO was $ nil (Q4 2017: $ nil). During the quarter the amounts received from TANESCO continued to be in excess of the revenue recognized for gas sales to TANESCO. As a consequence, $13.4 million of cumulative excess receipts over sales invoiced since Q3 2017, of which $5.4 million was in the current quarter, was allocated to the long-term arrears together with the associated reversal of the provision for doubtful accounts. The TANESCO long-term trade receivable at June 30, 2018 was $60.9 million with a provision of $ 60.9 million compared to $74.4 million (with a provision of $74.4 million) at December 31, 2017. Subsequent to June 30, 2018, the Company has invoiced TANESCO $2.7 million for 2018 gas deliveries and TANESCO has paid the Company $5.8 million.
- On June 18, 2018 the Company received the preference share consideration of $4.0 million relating to the sale of 7.933% (7,933 Class A common shares) of its subsidiary, PAE PanAfrican Energy Corporation ("PAEM"), to Swala (PAEM) Limited, a wholly owned subsidiary of Swala Oil & Gas (Tanzania) plc. ("Swala"). The net consideration received by the Company for the transaction was $19.7 million of which $15.7 million cash was received on closing of tranche 1 in January 2018. The preference shares entitle the holder to a 10% per annum distribution payable 15 days after each quarter end. The Company has indefinitely extended the right for Swala to complete tranches 2 and 3 of the transaction to acquire up to 40% of PAEM (an additional 32.067%) on the same terms and conditions as tranche 1. The Company has retained the right to terminate the extension for tranches 2 and 3 at any time.

ORCA EXPLORATION GROUP INC.

Q2 2018 MANAGEMENT'S DISCUSSION & ANALYSIS

Management's Discussion & Analysis

THIS MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018 SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS AND NOTES FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 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 AUGUST 14, 2018.

NATURE OF OPERATIONS

The Company's principal operating asset is its interest in the Production Sharing Agreement ("PSA") with the Tanzanian 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 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 Limited ("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.

The Tanzanian Electric 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"). 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 Portfolio Gas Sales 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 and the gas supplied by the Company to Songas and TANESCO today fires approximately 37% of the electrical power generated in Tanzania and 42% 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 consolidated in the financial statements 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 and six months ended June 30, 2018

SUMMARY

The Company's operating revenue decreased by 7% to $12.8 million in the quarter ended June 30, 2018 (Q2 2017: $13.8 million) and by 3% to $27.3 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $28.1 million). Revenue decreased by 11% to $15.0 million in the quarter ended June 30, 2018 (Q2 2017: $16.8 million) and by 16% to $29.2 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $34.9 million). The decrease in revenue for the first six months of the year is primarily due to lower power sales volumes and a lower current income tax adjustment.

The Company's net cash from operating activities for the quarter ended June 30, 2018 increased by 5% to $12.7 million (Q2 2017: $12.0 million) and fell by 32% to U$14.2 million for the six months ended June 30, 2018 ($20.8 million for the six months ended June 30, 2017). The increase in the quarter is primarily the consequence of the decrease in revenue being offset by the increased collections from TANESCO. The decrease for the six months ended June 30, 2018 is primarily a consequence of the exercise of Stock Appreciation Rights and Restrictive Stock Units in Q1 2018.

The Company's funds flow from operations for the quarter ended June 30, 2018 decreased 5% to $4.4 million (Q2 2017: $4.6 million) and for the six month period ending June 30, 2018 there was an outflow of $2.7 million (six month period ending June 30, 2017: funds inflow of $10.5 million). The difference in funds flow between Q2 2018 and Q2 2017 is a consequence of the decline in revenue offset to an extent by the fall in stock based compensation between the quarters. The decrease in funds flow from operations for the first six months of the year is due to lower net cash from operating activities combined with an increase in interest expense and non-cash working capital.

The Company recorded a net income of $12.5 million in the quarter ended June 30, 2018 (Q2 2017: $0.6 million net loss) and a net income of $7.8 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $2.2 million). The increase in net income is primarily a consequence of the increase in finance income as a result of the reversal of the provision for doubtful accounts of $13.4 million relating to the collection of TANESCO arrears which had been previously provided for.

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 $25.8 million based on a net enterprise value of $265 million as at January 1, 2017 (the "effective date"). The net enterprise value is calculated by reducing the agreed enterprise value of $325 million for the long term debt of $60 million. The net sales price for the 7.933 per cent was $21.0 million. The consideration received by the Company was $15.7 million cash ($17.0 million less a purchase price adjustment of $1.3 million reflecting Swala's share of cash flow from the effective date of the transaction until closing) and $4.0 million of Swala convertible preferred shares. The preferred shares were issued to the Company on June 18, 2018 and entitle the holder to a 10% per annum distribution payable 15 days after each quarter end commencing from the closing date, January 16, 2018. If Swala fails to make the payment, any unpaid amounts are accrued until December 31, 2021 at which time the Company can request a return of an amount of shares sold in PAEM sufficient to cover any unpaid distribution amounts.

The transaction provides Swala with the right to acquire up to 40% of PAEM at the net value of $265 million adjusted for Swala's share of cash flow from the effective date until the next closing date. The Company has indefinitely extended the right for Swala to acquire the additional interest but retains the right to terminate the extension at any time.

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 once again exited the period in a stable financial position with $72.1 million in working capital (December 31, 2017: $69.6 million), cash and cash equivalents of $54.2 million (December 31, 2017: $122.3 million) and long-term debt of $58.6 million (December 31, 2017: $58.5 million). The reduction in cash is a result of the Company investing $70.0 million in short and long-term bonds. The Company's intention is to hold the bond investments to maturity; however, the bonds are highly liquid by their nature and may readily be transferred to cash when necessary.

OPERATING VOLUMES

The gross sales volumes for the quarter ended June 30, 2018 were 3,068 MMcf (Q2 2017: 3,595 MMcf) or average daily volumes of 33.7 MMcfd (Q2 2017: 39.5 MMcfd). This represents a decrease in average daily volumes of 15% quarter over quarter. The gross gas volumes sold for the six months ended June 30, 2018 fell by 14% to 6,433 MMcf (35.6 MMcfd) from 7,509 MMcf (41.4 MMcfd) for the six months ended June 30, 2017.

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 JUNE 30		SIX MONTHS ENDED JUNE 30	
	2018	2017	**2018**	2017
Gross sales volume *(MMcf)*				
Industrial sector	**1,294**	1,158	**2,545**	2,199
Power sector	**1,774**	2,437	**3,888**	5,310
Total volumes	**3,068**	3,595	**6,433**	7,509
Gross daily sales volume *(MMcfd)*				
Industrial sector	**14.2**	12.7	**14.1**	12.1
Power sector	**19.5**	26.8	**21.5**	29.3
Total daily sales volume	**33.7**	39.5	**35.6**	41.4

Industrial sector

Industrial sales volumes for the quarter ended June 30, 2018 increased 12% to 1,294 MMcf (14.2 MMcfd) from 1,158 MMcf (12.7MMcfd) for the quarter ended June 30, 2017. The Industrial sales volumes for the six months ended June 30, 2018 increased by 16% to 2,545 MMcf (14.1 MMcfd) from 2,199 MMcf (12.1 MMcfd) for the six months ended June 30, 2017. The increase was due to the increased consumption by a cement plant compared to 2017 and additional consumption by new customers.

Power sector

Power sector sales volumes for the quarter ended June 30, 2018 decreased 27% to 1,774 MMcf (19.5 MMcfd) from 2,437 MMcf (26.8 MMcfd) for the quarter ended June 30, 2017. The Power sales volumes for the six months ended June 30, 2018 decreased by 27% to 3,888 MMcf (21.5 MMcfd) from 5,310 MMcf (29.3 MMcfd) for the six months ended June 30, 2017. The decrease in volumes was due to decreased gas consumption by TANESCO.

SONGO SONGO DELIVERABILITY

As at June 30, 2018 the Company had a well capacity of approximately 155 MMcfd, with the ability to expand to 180 MMcfd by producing well SS-12 through the National Natural Gas Infrastructure Project ("NNGIP") and the installation of refrigeration which is scheduled for completion in the first half of 2019. Currently production is limited to the Songas infrastructure capacity of 102 MMcfd. Well SS-12 was successfully completed in the first quarter of 2016 and is tied in to the NNGIP plant on Songo Songo Island but is currently suspended subject to agreeing a new gas sales agreement ("GSA") with TPDC. 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.

As at June 30, 2018 the SS-11 well is tied into both the Songas and the NNGIP infrastructure while the SS-12 well is tied into the NNGIP infrastructure only. The facilities for the connection of well SS-10 to the NNGIP infrastructure are available and can be completed quickly when required. It is currently anticipated that well SS-12 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 respective periods are detailed in the table below:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$/mcf	**2018**	2017	**2018**	2017
Average sales price				
Industrial sector	**7.80**	7.69	**7.80**	7.72
Power sector	**3.62**	3.57	**3.61**	3.57
Weighted average price	**5.39**	4.90	**5.27**	4.79

Industrial sector

The average gas price achieved during the quarter ended June 30, 2018 was $7.80/mcf, an increase of 1% from $7.69/mcf in Q2 2017. The average price for the six months ended June 30, 2018 was $7.80/mcf, an increase of 1% from $7.72/mcf for the six months ended June 30, 2017.

Power sector

The average gas price achieved during the quarter ending June 30, 2018 was $3.62/mcf, an increase of 1% from $3.57/mcf in Q2 2017. The average price for the six months ended June 30, 2018 was $3.61/mcf, an increase of 1% from $3.57/mcf for the six months ended June 30, 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 and six months ended June 30, 2018 were below 40 MMcfd; as a consequence, the Company was entitled to a 35% share of Profit Gas revenue. The average Additional Gas volumes for the quarter ended June 30, 2017 were also below 40 MMcfd whilst the Additional Gas volumes for the quarter ended March 31, 2017 were above 40 MMcfd which entitled the Company to a 40% share of Profit Revenues for Q1 2017. See "Principal Terms of the Tanzanian PSA and Related Agreements" in the MDA within the audited financial statements for 2017.

The Company was allocated a total of 75% of the net field revenue for the quarter ended June 30, 2018 (Q2 2017: 84%) and 69% for the six months ended June 30, 2018 (six months ended June 30, 2017: 84%). 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 offshore phase of the Development Program.

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Industrial sector	**10,099**	8,906	**19,846**	16,974
Power sector	**6,431**	7,163	**18,213**	15,517
Gross field revenue	**16,530**	16,069	**38,059**	32,491
TPDC share of revenue	**(3,689)**	(2,266)	**(10,727)**	(4,383)
Company operating revenue	**12,841**	13,803	**27,332**	28,108
Reconciliation to net field revenue:				
Gross field revenue	**16,530**	16,069	**38,059**	32,491
Tariff for processing and pipeline infrastructure [(i)]	**(1,786)**	(2,124)	**(3,767)**	(4,434)
Net field revenue	**14,744**	13,945	**34,292**	28,057
Allocation of net field revenue:				
Company Cost Gas	**9,068**	10,459	**17,569**	21,043
Company Profit Gas	**1,987**	1,220	**5,996**	2,631
Company share of net field revenue	**11,055**	11,679	**23,565**	23,674
TPDC share of revenue	**3,689**	2,266	**10,727**	4,383
Net field revenue	**14,744**	13,945	**34,292**	28,057

(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 $12.8 million in the quarter ended June 30, 2018 (Q2 2017: $13.8 million). The decrease for the quarter is a consequence of the increase in TPDC profit share offsetting the increase in gross field revenue for the quarter. The increase in gross field revenue for the quarter is a combination of the increase in the weighted average sales price and the recognition of all the TANESCO sales invoices for the quarter as opposed to only a percentage recognized in Q2 2017. The Company's operating revenue for the six months ended June 30, 2018 decreased by 3% to $27.3 million from $28.1 million for the six months ended June 30, 2017. The decrease is a combination of increase in gross field revenue associated with the inclusion of TANESCO deferred revenue in Q1 2018 offsetting the decrease in gross field revenue as a consequence of reduced sales volumes. The increase in TPDC profit share for the six months ended June 30, 2018 is a consequence of lower volumes and the depletion of the cost pool offset by the increase in gross field revenue for the same period.

Revenue presented on the Consolidated Interim Statements of Comprehensive Income may be reconciled to the Company operating revenue by adding $2.1 million income tax for the quarter and adding $1.9 million for the six months ending June 30, 2018. 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 JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Company operating revenue	**12,841**	13,803	**27,332**	28,108
Current income tax adjustment	**2,118**	3,007	**1,850**	6,828
Revenue	**14,959**	16,810	**29,182**	34,936

Impact of IFRS 15:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Revenue prior to implementation of IFRS 15	**13,173**	14,686	**25,415**	30,502
Tariff for processing and pipeline infrastructure	**1,786**	2,124	**3,767**	4,434
Revenue	**14,959**	16,810	**29,182**	34,936

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 October 1, 2017 and January 1, 2018 to reflect the most recent three year payment history for TANESCO compared to amounts invoiced for deliveries.

During the quarter the Company again 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 invoiced for gas deliveries during the same period. Since July 1, 2017 the Company has invoiced TANESCO U$28.2 million (excluding the $16.6 million take or pay invoice for the twelve months ending June 30, 2018) and has received $42.9 million. Based on the consistent payments from TANESCO, the percentage estimate used to record revenue was again revised during the quarter. As a result the Company: (i) recognized all amounts invoiced in Q2 2018 for gas deliveries as revenue; (ii) recognized $8.1 million of previously deferred revenue, as finance income (which represented excess cash received over invoiced amounts for gas deliveries which was not offset against long term TANESCO arrears previously provided for at the end of Q1 2018) and (ii) recognized a further $5.3 million of long term TANESCO arrears previously provided for as finance income. The revenue recorded for the six months ended June 30, 2018 includes the release of $4.2 million of deferred revenue to gross field revenue and the reallocation of $2.6 million TPDC Profit share entitlement which resulted in an overall increase of $1.3 million in net income year to date.

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

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Increase (decrease) in gross field revenue and accounts receivable	**–**	(797)	**4,172**	(2,379)
Increase (decrease) in revenue	**–**	(1,543)	**1,603**	(3,448)
Increase (decrease) in net income	**–**	(797)	**1,292**	(2,379)
Increase (decrease) in liabilities	**–**	(746)	**2,880**	(1,069)

PRODUCTION, DISTRIBUTION AND TRANPORTATION 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 June 30, 2018 was $0.2 million (Q2 2017: $0.2 million) and $0.3 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $0.3 million). Amounts allocated for Additional Gas for the quarter ended June 30, 2018 were $0.1 million (Q2 2017: $0.1 million) and $0.2 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $0.2 million).

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

The processing and transportation tariff charges for the quarter ended June 30, 2018 were $1.8 million (Q2 2017: $2.1 million) and $3.8 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $4.4 million). The lower tariff expenses 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 ended June 30, 2018 were $1.0 million (Q2 2017: $0.6 million) and $1.5 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $1.2 million). The production, distribution and transportation expenses are detailed in the table below:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Share of well maintenance	**126**	80	**176**	176
Other field and operating costs	**232**	196	**439**	384
	358	276	**615**	560
Tariff for processing and pipeline infrastructure	**1,786**	2,124	**3,767**	4,434
Ring main distribution costs	**953**	586	**1,504**	1,150
Production, distribution and transportation expenses	**3,097**	2,986	**5,886**	6,144

OPERATING NETBACKS

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

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$/mcf	**2018**	2017	**2018**	2017
Gas price - Industrial	**7.80**	7.69	**7.80**	7.72
Gas price - Power [(1)]	**3.62**	3.57	**3.61**	3.57
Weighted average price for gas	**5.39**	4.90	**5.27**	4.79
TPDC share of revenue	**(1.20)**	(0.63)	**(1.67)**	(0.58)
Well maintenance and other operating costs	**(0.12)**	(0.08)	**(0.10)**	(0.07)
Tariff for processing and pipeline infrastructure	**(0.59)**	(0.59)	**(0.59)**	(0.59)
Ring main distribution costs	**(0.30)**	(0.16)	**(0.23)**	(0.15)
Operating netback	**3.18**	3.44	**2.68**	3.40

[(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 8% to $3.18/mcf (Q2 2017: $3.44/mcf) and by 21% to $2.68/mcf for the six months ended June 30, 2018 (six months ended June 30, 2017: $3.40/mcf). The decrease in the quarter and for the six months ended June 30, 2018 is predominately due to the increase in TPDC share of revenue in the quarter to $1.20/mcf (Q2 2017: $0.63/mcf) and to $1.67/mcf for the six months ended June 30, 2018 (six months ended June 30, 2017: $0.58/mcf). The increase is a combination of the depletion of the cost pool and lower Additional Gas volumes. The increase in TPDC share was partially offset by the increase in the weighted average price of gas to $5.39/Mcf (Q2 2017: $4.90/mcf) in the quarter and to $5.27/mcf for the six months ended June 30, 2018 (six months ended June 30, 2017: $4.79/mcf) as a consequence of a change in the sales mix. The increase in the weighted average price is the consequence of the relative increase of industrial sales to total sales and overall level of industrial sales remaining relatively constant between periods.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses are detailed in the table below:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Employee and related costs	**1,531**	1,661	**3,282**	3,207
Office costs	**1,189**	834	**2,521**	1,585
Marketing and business development costs	**62**	163	**198**	315
Reporting, regulatory and corporate	**309**	501	**611**	727
General and administrative expenses	**3,091**	3,159	**6,612**	5,834

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 $1.0 million (Q2 2017: $1.1 million) per month during the quarter and $1.1 million per month for the six months ended June 30, 2018 (six months ended June 30, 2017: $1.0 million).

STOCK BASED COMPENSATION

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

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Stock appreciation rights ("SARs")	**356**	356	**2,741**	423
Restricted stock units ("RSUs")	**67**	1,204	**2,311**	1,978
Stock-based compensation	**423**	1,560	**5,052**	2,401

As at June 30, 2018 a total of 855,000 SARs were outstanding compared to 2,485,000 as at December 31, 2017. A total of 1,630,000 SARs with exercise prices ranging from CDN$2.30 to CDN$3.87 were exercised during Q1 2018 resulting in a total cash payout of $5.4 million. As at June 30, 2018 a total of 237,500 RSUs were outstanding compared to 1,147,621 at December 31, 2017. A total of 37,500 RSUs were exercised during the quarter, resulting in a total cash payout of $0.2 million and a total of 872,621 RSUs were exercised during Q1 2018 resulting in a total cash payout of $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 46.4% to 51.4%; 0% dividend yield; 5% forfeiture; and a closing price of CDN$5.28 per Class B share.

As at June 30, 2018 a total accrued liability of $2.6 million (December 31, 2017: $7.9 million) has been recognized in relation to SARs and RSUs. The Company recognized an expense of $0.4 million for the quarter ended June 30, 2018 (Q2 2017: $1.6 million) and an expense of $5.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $2.4 million).

FINANCE INCOME AND EXPENSE

Finance income is detailed in the table below:

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Interest income	**157**	80	**394**	161
Investment income	**307**	–	**307**	–
Reversal provision for doubtful accounts	**13,439**	–	**13,439**	–
	13,903	80	**14,140**	161

The reversal of the provision for doubtful accounts of $13.4 million relates to the collection of TANESCO arrears which had been previously provided for. The $13.4 million consist of $8.1 million previously carried as deferred revenue and $5.3 million excess receipts over invoiced gas deliveries during the quarter.

In April 2018 the Company invested $70.0 million in short and long-term bonds, of which $7.2 million mature in August 2019 and have been classified as long-term investments. The $0.3 million investment income consists of accrued interest of $0.15 million and $0.15 million amortization of the discount on the acquisition of the bonds. To date the Company has received interest income of $0.13 million. The Company's intention is to hold the bond investment to maturity; however, the bonds are highly liquid by their nature and may readily be transferred to cash when necessary.

Finance expense is detailed in the table below:

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Base interest expense	**1,517**	1,585	**3,055**	3,103
Participatory interest expense	**607**	725	**3,745**	1,456
Interest expense	**2,124**	2,310	**6,800**	4,559
Net foreign exchange loss	**214**	(104)	**597**	(34)
Indirect tax	**2,799**	2,354	**3,063**	2,559
Finance expense	**5,137**	4,560	**10,460**	7,084

Base and participatory interest expense relate to the long-term loan with the International Finance Corporation ("IFC"). The amount of base interest expense during the quarter was $1.5 million (Q2 2017: $1.6 million) and $3.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $3.1 million). The participatory interest expense during the quarter was $0.6 million (Q2 2017: $0.7 million) and $3.7 million for the six months ended June 30, 2018 (six month ended June 30, 2017: $1.4 million). The increase is related to an additional payment of $2.6 million associated with the sale of the 7.933% interest in PAEM in January 2018 (see sections on long-term loan and non-controlling interest).

The indirect tax of $2.8 million for the quarter (Q2 2017: $2.4 million) and $3.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $2.6 million) is for VAT associated with invoices to TANESCO for interest on late payments and invoices under the take or pay provisions within the PGSA; these amounts are not recognized in the financial statements due to not meeting the revenue recognition criteria with respect to assurance of collectability.

TANESCO

At June 30, 2018 the current receivable from TANESCO was $ nil (December 31, 2017: $ nil). During the quarter the amounts received from TANESCO continued to be in excess of the revenue recognized for gas sales to TANESCO. As a consequence, $13.4 million of cumulative excess receipts over sales invoiced since Q3 2017, of which $5.4 million was in the current quarter, has been allocated to the long-term arrears together with the associated reversal of the provision for doubtful accounts.

The TANESCO long-term trade receivable at June 30, 2018 was $60.9 million with a provision of $60.9 million compared to $74.4 million (with a provision of $74.4 million) at December 31, 2017. Subsequent to June 30, 2018, the Company has invoiced TANESCO $2.7 million for 2018 gas deliveries and TANESCO has paid the Company $5.8 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:

	AS AT	
$'000	**JUNE 30, 2018**	DECEMBER 31, 2017
Total TANESCO receivable	**119,716**	108,833
Unrecognized amounts for not meeting revenue recognition criteria [(i)]	**(58,794)**	(38,710)
Invoiced amounts reduced based on TANESCO's payment history for the previous three years	**–**	(4,172)
Provision for doubtful accounts	**(60,922)**	(74,361)
TANESCO deferred revenue balance per consolidated financial statements	**–**	(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. During the quarter the Company invoiced TANESCO for $16.6 million relating to take or pay arrangements under the PGSA for the year ending June 30, 2018 (year ended June 30, 2017: $13.4 million). These amounts have not been recognized in the financial statements, however, the VAT associated with the invoice of $2.5 million (Q2 2017: $2.0 million) has been written off to finance expense in the quarter.*

TAXATION

Income Tax

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

As at June 30, 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 $11.9 million (Q4 2017: $11.8 million). During the quarter there was a deferred tax charge of $0.4 million compared to a deferred tax charge of $0.3 million in Q2 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 19.3% (Q2 2017: 19.4%) has been applied to Profit Gas of $2.0 million (Q2 2017: $1.2 million) and $6.0 million for the six months ended June 30, 2018 ($2.6 million for the six months ended June 30, 2017). Accordingly, $0.4 million for the quarter ended June 30, 2018 (Q2 2017: $0.2million) and $1.2 million for the six months ended June 30, 2018 ($0.5 million for the six months ended June 30, 2017) of APT has been recorded as other income tax.

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Additional Profits Tax	**383**	238	**1,157**	512

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 $1.8 million for the quarter (Q2 2017: $2.1 million) and $3.8 million for the six months ended June 30, 2018 ($4.3 million six months ended June 30, 2017) has been recorded in the accounts at an average depletion rate to $0.60/mcf (2017: $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 ended June 30, 2018 the Company incurred $1.0 million (Q2 2017: $0.4 million) in capital expenditures relating to the completion of the SS-12 well flow line and long lead items for the refrigeration project at Songo Songo Island.

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Geological and geophysical and well drilling	**–**	3	**–**	30
Pipelines and infrastructure	**1,019**	250	**1,811**	343
Other equipment	**23**	97	**50**	97
	1,042	350	**1,861**	470
Other (1)	**–**	–	**–**	7,352
	1,042	350	**1,861**	7,822

(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 $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

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Operating activities				
Net income (loss)	**12,487**	(622)	**7,849**	2,218
Non-cash adjustments	**(8,089)**	5,232	**(10,505)**	8,318
Base interest paid	**1,517**	1,585	**3,055**	3,103
Participatory interest	**607**	725	**3,745**	1,456
Changes in non-cash working capital (1)	**6,135**	5,118	**10,040**	5,730
Net cash flows from operating activities	**12,657**	12,038	**14,184**	20,825
Net cash used in investing activities	**(890)**	(326)	**(1,701)**	(542)
Net cash used in financing activities	**(75,451)**	(1,585)	**(80,742)**	(3,103)
(Decrease) increase in cash	**(63,684)**	10,127	**(68,259)**	17,180
Effect of change in foreign exchange on cash	**53**	337	**119**	210
Net (decrease) increase in cash	**(63,631)**	10,464	**(68,140)**	17,390

(1) See Consolidated Interim Statements of Cash Flows

The Company's net cash flows from operating activities for the quarter ended June 30, 2018 increased by 5% to $12.7 million (Q2 2017: $12.0 million) and fell by 32% to U$14.2 million for the six months ended June 30, 2018 ($20.8 million for the six months ended June 30, 2017). The increase in the quarter is primarily a consequence of increased collections from TANESCO. The decrease for the six months ended June 30, 2018 is primarily a consequence of the exercise of Stock Appreciation Rights and Restrictive Stock Units in Q1 2018. The increase in cash used in financing activities during the quarter is a consequence of investment in bonds of $70.0 million net of and the payment of $3.6 million in participatory interest for the year ended December 31, 2017. The increase of cash used in investing activities for the six months ended June 30, 2018 is the combined result of a dividend payment of $16.9 million and the payment of participatory interest of $6.1 million offset by the proceeds from the sale of a minority interest in a subsidiary of $15.4 million.

WORKING CAPITAL

Working capital as at June 30, 2018 was $72.1 million (December 31, 2017: $69.6 million) and is detailed in the table below:

$'000		AS AT JUNE 30, 2018		AS AT DECEMBER 31 2017
Cash		**54,182**		122,322
Investment in short term bonds		**62,870**		–
Trade and other receivables		**15,234**		12,273
Songas	2,129		2,378	
Industrial customers	10,307		6,915	
Songas gas plant operations	6,648		5,827	
Other receivables	1,518		2,521	
Provision for doubtful accounts	(5,368)		(5,368)	
Prepayments		**807**		866
		133,093		135,461
Trade and other payables		**60,814**		56,758
TPDC share of Profit Gas (1)	41,737		33,422	
Songas	1,515		1,670	
Other trade payables	3,443		1,961	
Accrued liabilities	14,119		19,705	
Deferred revenue		–		8,410
Tax payable		**150**		718
		60,964		65,886
Working capital (2)		**72,129**		69,575

(1) *The balance of $41.7 million payable to TPDC is the accrued liability for their share of profit gas delivered to TANESCO which has not been paid for. The majority of the settlement of this liability is dependent on receipt of payment from TANESCO for arrears.*

(2) *As at June 30, 2018 TANESCO deferred revenue is nil (December 31, 2017: $8.4 million). The deferred revenue is a consequence of the cumulative cash collected from TANESCO during the year ending December 31, 2017 being in excess of the invoiced amounts recognized as revenue during the same period. Correspondingly, as at June 30, 2018 and December 31, 2017 there is no current receivable for TANESCO. During the quarter the cumulative excess receipts over recognized revenue of $13.4 million have been offset against the long term TANESCO receivable consequently there is no deferred revenue in working capital at June 30, 2018. The total of short and long-term TANESCO receivables as at June 30, 2018, including unrecorded invoices not meeting revenue recognition criteria, was $119.7 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 $10.3 million receivable relating to industrial customers $6.8 million had been received as at the date of this report.

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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 $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 $5 million starting April 15, 2022 and one final payment of $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 was initially guaranteed by the Company to a maximum of $30 million. The initial 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. Pursuant to the sale of the non-controlling interest in PAEM, the Company agreed with the IFC to reduce the outstanding amount of the loan by the percentage interest sold in PAEM of 7.933% ($4.8 million) on the fourth anniversary of the first drawdown. The Company has provided an additional guarantee to the IFC that if PAET is unable to pay down the loan on or before December 14, 2019, the Company will make the payment. This guarantee is in addition to the Company's initial guarantee.

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 $1.5 million (Q2 2017: $1.5 million) and $3.1 million for the six months ended June 30, 2018 (six months ending June 30, 2017: $3.1 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 $0.6 million (Q2 2017: $0.7 million) and $3.7 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $1.5 million). The year to date charge includes an additional payment of $2.6 million (six months ended June 30, 2017: $ 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 from 7% to 6.4%. At June 30, 2018 the participatory interest included in accrued liabilities is $1.2 million (December 31, 2017: $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 June 30, 2018 as detailed in the table below:

	AS AT	
Number of shares ('000)	**JUNE 30, 2018**	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 the Company incurred costs of $0.1 million (Q2 2017: $0.1 million) and $0.2 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $0.2 million) with this firm for services provided.

As at June 30, 2018 the Company has a total of $0.1 million (Q4 2017: $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 ($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 (182.8 Bcf as at June 30, 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 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, and future gas demand.

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 $0.30/mcf for sales between 70 MMcfd and 90 MMcfd and $0.40/mcf for volumes above 90 MMcfd by issuing credit notes to TANESCO. This was in addition to the tariff of $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 $2.98/mcf increased to $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 $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 $13.3 million.

At the date of this report, the Company has no significant outstanding contractual commitments. 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 $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 $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 $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

		Tax dispute	Disputed amounts $' million		
Area	**Period**	**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.	1.0	0.7	1.7 (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).	29.2	9.9	39.1 (3)
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.7	5.4 (4)
			33.2	13.3	46.5

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 $46.5 million (December 31, 2017: $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 the Tanzanian Revenue Authority ("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 ($1.6 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 for their application, under the certificate of urgency, for CAT leave to review its judgement. During Q1 2018 CAT ruled in favour of PAET's preliminary objection. TRA still has the right to amend and re-file its application;*

(b) *2010 ($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) *2008 ($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 $1.8 million (with tax impact of $0.6 million). PAET has objected to the assessment for being time-barred, incorrect and arbitrary;*

(b) *2009 ($2.5 million): In 2015 TRAB ruled against PAET with respect to timing of deductibility of capital expenditures and other expenses ($1.7 million). In Q2 2017 PAET lost an appeal at TRAT and in July 2018 lost an appeal at CAT. Management intends to file an application for the CAT to review its judgement and has 60 days from the day of judgement to file the application. In July 2017 TRA sent PAET an amended assessment claiming additional taxes, interest and penalties ($0.8 million). PAET has objected to the assessment for being time-barred and arbitrary and is awaiting a TRA response;*

(c) *2010 ($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;*

(d) *2011 ($1.9 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 ($1.7 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 ($0.2 million) raised for the year;*

(e) *2012 ($15.7 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;*

(f) *2013 ($6.5 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 ($0.9 million) which disallowed certain operating costs included in the tax returns and tax on repatriated income ($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;*

(g) *2014 ($9.1 million): In 2016 TRA issued an assessment of $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 $3.0 million and tax on repatriated income $2.8 million. PAET has objected the assessments and is awaiting TRA response;*

(h) *2015 ($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 ($5.3 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 ($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.*

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 retro-spectively. 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 $15.7 million cash (net of closing adjustments) and $4.0 million of Swala convertible preferred shares. The preferred shares were issued to the Company on June 18, 2018 and entitle the holder to a 10% per annum distribution payable 15 days after each quarter end commencing from the closing date, January 16, 2018. Payment of the quarterly distributions is at the discretion of Swala based on funds available, however, the liability accrues if any amount is unpaid when due. If any distributable amount remains unpaid at December 31, 2021, the Company may demand settlement and Swala is obligated to comply by transferring and returning shares of PAEM sold to Swala; the aggregate value of these shares will equal to the amount of the outstanding distributions.

Swala is obligated to redeem 20% the preference shares for cash annually starting December 31, 2021 until all shares are redeemed. If at any time Swala does not redeem in cash the required amount of shares, Swala shall be obligated to redeem the preferred shares by transferring and returning shares of PAEM sold to Swala; the aggregate value of these shares will equal the amount of any outstanding redemption.

Following the issue of the preference shares a further price adjustment of $0.3 million was recorded, reducing the total cash consideration for tranche I of the transaction to $15.4 million.

The agreement provides Swala with the right to acquire up to a maximum of 40% of PAEM based on the same terms and conditions (an additional 32.067%). The Company has indefinitely extended the right to acquire the additional interest to Swala but retains the right to terminate the extension at any time.

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

	AS AT	
$'000	**JUNE 30, 2018**	DECEMBER 31, 2017
Balance, beginning of period	**–**	–
Recorded at the date of disposition	**178**	–
Share of post-acquisition loss	**(33)**	–
Balance, end of period	**145**	–

SUMMARY QUARTERLY RESULTS

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

	2018		2017				2016	
Figures in $'000 except where otherwise stated	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Financial								
Revenue	**14,959**	14,223	10,609	15,287	16,810	18,126	19,267	20,619
Net income (loss)	**12,487**	(4,638)	(4,684)	(34)	(622)	2,840	1,048	5,302
(Loss) earnings per share - basic and diluted *($)*	**0.35**	(0.13)	(0.13)	0.00	(0.02)	0.08	0.03	0.15
Funds flow from (used in) operations [(1)]	**4,398**	(7,054)	63	4,241	4,610	5,926	6,211	10,024
Funds flow from (used in) operations per share - basic and diluted *($)*	**0.12**	(0.20)	0.01	0.12	0.13	0.17	0.18	0.29
Net cash flows from operating activities	**12,657**	1,527	12,882	14,447	12,038	8,787	8,345	6,540
Net cash flows per share - basic and diluted *($)*	**0.36**	0.04	0.37	0.41	0.35	0.25	0.24	0.19
Operating netback *($/mcf)*	**3.17**	2.23	2.26	2.94	3.44	3.34	3.35	3.31
Working capital	**72,129**	65,201	69,575	71,129	73,854	68,112	71,989	67,635
Long-term loan	**58,596**	58,557	58,518	58,501	58,468	58,399	58,399	58,398
Shareholders' equity	**89,018**	76,636	78,731	82,426	82,407	82,982	80,023	79,152
Capital expenditures								
Geological and geophysical and well drilling	**–**	–	–	–	3	27	32	26
Pipeline and infrastructure	**1,019**	792	442	477	250	93	99	(71)
Other equipment	**23**	27	30	126	97	–	–	–
Other	**–**	–	–	–	–	7,352	–	–
Total	**1,042**	819	472	603	350	7,472	131	(45)
Operating								
Additional Gas sold *(MMcf)*								
– industrial	**1,294**	1,251	1,110	1,285	1,158	1,041	1,226	1,238
– power	**1,774**	2,114	2,428	2,867	2,437	2,873	2,895	3,047
Total	**3,068**	3,365	3,538	4,152	3,595	3,914	4,121	4,285
Additional Gas sold *(MMcfd)*								
– industrial	**14.2**	13.9	12.1	14.0	12.7	11.6	13.3	13.5
– power	**19.5**	23.5	26.4	31.1	26.8	31.9	31.5	33.1
Total	**33.7**	37.4	38.5	45.1	39.5	43.5	44.8	46.6
Average price per mcf *(US$)*								
– industrial	**7.80**	7.79	7.78	7.65	7.69	7.75	7.52	7.60
– power	**3.62**	3.60	3.63	3.63	3.57	3.57	3.57	3.57
Weighted Average	**5.39**	5.16	4.93	4.87	4.90	4.68	4.75	4.73

(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 and Q2 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.

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 $3.5 million and $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 $1.9 million in both Q4 2016 and Q1 2017, a reduction of $0.8 million in Q2 2017, a net revenue increase of $1.8 million in Q3 2017, a net revenue increase of $1.0 million in Q4 2017, and a net revenue increase of $1.6 million in Q1 2018 (see "Company Operating Revenue"). The increase in Q2 2018 is a result of the reversal of the provision of doubtful accounts for TANESCO resulting in an increase in finance income of $13.4 million.
- The Company recorded an interest expense of $1.6 million in Q3 2016 to Q4 2016, $2.3 million in Q1 2017 and Q2 2017, $2.9 million in Q3 2017, $2.6 million in Q4 2017 and $4.7 million in Q1 2018 and $2.1 million in Q2 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.
    - Q3 2016: Credit of $0.1 million, share price closed at CDN$3.41.
    - Q4 2016: Charge of $0.6 million, share price closed at CDN$3.82.
    - Q1 2017: Charge of $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 $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 $2.1 million, share price closed at CDN$4.60.
    - Q4 2017: Charge of $2.1 million, share price closed at CDN$5.00.
    - Q1 2018: Charge of $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.
    - Q2 2018: Charge of $0.4 million, share price closed at CDN$5.28

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 $10.0 million in Q3 2016 from $6.7 million in Q2 2016 is primarily the result of the $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 $2.5 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 difference in funds flow between Q2 2018 and Q2 2017 is a consequence of the decline in revenue offset to an extent by the fall in stock- based compensation between the quarters. 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 costs. The decrease between Q4 2017 and Q3 2017 is the consequence of the fall in revenue, the increase in stock based compensation costs 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 net cash flow for Q2 2018 and Q2 2017 were the same as a consequence of the lower sales in Q2 2018 compared to Q2 2017 being offset by an increase in collections from TANESCO, with the current TANESCO receivable being $5.7 million at the end of Q2 2017 compared to $ nil at the end of Q2 2018.

The level of working capital between Q4 2016 and Q3 2017 has remained fairly consistent at an average of $71.3 million. The fall in working capital to $69.6 million in Q4 2017 from $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 $69.6 to $65.2 million is primarily due to the increase in stock based compensation payments between periods. The increase in working capital between Q1 2018 and Q2 2018 is a consequence of the improved collections from TANESCO resulting in zero deferred revenue being carried in current liabilities. Capital expenditure for the last four quarters amounted to $2.9 million compared to $0.6 million from Q3 2016 to Q2 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 Q2 2018 averaged of 1,235 MMcf (four quarters ending Q2 2017: 1,166 MMcf) with total Industrial sales volumes for the four quarters ending Q2 2018 increasing to 4,940 MMcf (13.5 MMcfd) compared to 4,663 MMcf (12.8 MMcfd) in the four quarters ending Q2 2017. The increase is a primarily a result of new customers coming on line.

The level of Power sales volumes decreased by 18% in the four quarters ending Q2 2018 to an average of 2,295 MMcf (four quarters ending Q2 2017: 2,813 MMcf) with total Power sector sales volumes for the four quarters ending Q2 2018 decreasing to 9,183 MMcf (25.1 MMcfd) compared to 11,252 MMcf (30.8 MMcfd) in the four quarters ending Q2 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 and January 1, 2018 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. Since July 1, 2017 the Company has invoiced TANESCO $28.2 million (excluding the $16.6 million Take or Pay invoice for the twelve months ending June 30, 2018) and has received $42.9 million. As a consequence, the percentage estimate used to record revenue was revised during the quarter, with all the invoiced revenue for the period being recorded as revenue.

At June 30, 2018 the current receivable from TANESCO was $ nil (December 31, 2017: $ nil). During the quarter, the amounts received from TANESCO continued to be in excess of the revenue for gas sales to TANESCO. As a consequence, $13.4 million of cumulative excess receipts over sales invoiced since Q3 2017, of which $5.4 million was in the current quarter has now been allocated to the long-term arrears together with the associated write-back of the provision for doubtful accounts.

The TANESCO long-term trade receivable at June 30, 2018 was $60.9 million (with a provision of $60.9 million) (December 31, 2017 was $74.4 million (with a provision of $74.4 million)). Subsequent to June 30, 2018, the Company has invoiced TANESCO $2.7 million for 2018 gas deliveries and TANESCO has paid the Company $5.8 million.

As at June 30, 2018 Songas owed the Company $8.8 million (December 31, 2017: $8.2 million) while the Company owed Songas $1.9 million (December 31, 2017: $2.0 million). The amounts due to the Company are mainly for sales of gas of $2.1 million (December 31, 2017: $2.4 million) and for the operation of the gas plant of $6.6 million (December 31, 2017: $5.8 million) against which the Company has made a provision for doubtful accounts of $4.9 million (December 31, 2017: $4.9 million), whereas the amounts due to Songas primarily relate to pipeline tariff charges of $1.5 million (December 31, 2017: $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 on TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in petroleum operations as well as mid and downstream natural gas activities. The 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 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 Amended and Restated Gas Agreement ("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 initialed 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.

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Net cash flow from operating activities	**12,657**	12,038	**14,184**	20,825
Base interest expense	**(1,517)**	(1,585)	**(3,055)**	(3,103)
Participatory interest expense	**(607)**	(725)	**(3,745)**	(1,456)
Changes in non-cash working capital	**(6,135)**	(5,118)	**(10,040)**	(5,730)
Funds flow from (used in) operations	**4,398**	4,610	**(2,656)**	10,536

The Company's funds flow from operations for the quarter ended June 30, 2018 was $4.4 million (Q2 2017: $4.6 million). The difference in funds flow between Q2 2018 and Q2 2017 is a consequence of the decline in revenue offset to an extent by the fall in stock based compensation between the quarters. For the six month period ending June 30, 2018 there was an outflow of $2.7 million (six month period ending June 30, 2017: funds inflow of $10.5 million). The decrease in funds flow from operations for the first six months of the year is due to lower net cash flow from operating activities combined with an increase in interest expense and non-cash working capital.

- 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.

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. Currently, given the consistent payment pattern from TANESCO over the past 18 months, 100% of invoices for gas deliveries was recognized as revenue in Q2 2018.

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.

FORWARD LOOKING STATEMENTS

This 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 TPDC future back-in rights on the economic terms of the PSA; ability to meet all conditions under the 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 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 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 ARGA will continue to conduct themselves in accordance with the ARGA until a new Gas Sales and Purchase Agreement is signed; the Company's expectation that, despite the Re-Rating Agreement of the gas processing plant owned by Songas having expired, the Songas gas processing plant production volumes will not be restricted; the anticipated effect of the AGP2 signed in 2017 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 TRAT 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 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 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 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 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 future changes to the PSA on the Company as a result of the implementation of new government policies for the oil and gas industry; 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 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 successfully negotiate agreements; receipt of required regulatory approvals; the ability of the Company to increase production as required to meet demand; 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 appeals 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.

ORCA EXPLORATION GROUP INC.

Q2 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 and six-month periods ended June 30, 2018.

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

ORCA EXPLORATION GROUP INC.		THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	Note	**2018**	2017	**2018**	2017
Revenue	*6, 7*	**14,959**	16,810	**29,182**	34,936
Production, distribution and transportation		**(3,097)**	(2,986)	**(5,886)**	(6,144)
Net production revenue		**11,862**	13,824	**23,296**	28,792
Expenses					
General and administrative		**(3,091)**	(3,159)	**(6,612)**	(5,834)
Stock based compensation	*13*	**(423)**	(1,560)	**(5,052)**	(2,401)
Depletion		**(1,816)**	(2,066)	**(3,837)**	(4,317)
Finance income	*8*	**13,903**	80	**14,140**	161
Finance expense	*8*	**(5,137)**	(4,560)	**(10,460)**	(7,084)
Income before tax		**15,298**	2,559	**11,475**	9,317
Income tax expense - current		**(1,979)**	(2,833)	**(2,370)**	(6,236)
Income tax expense - deferred		**(449)**	(110)	**(99)**	(351)
Additional Profits Tax		**(383)**	(238)	**(1,157)**	(512)
Net income (loss)		**12,487**	(622)	**7,849**	2,218
Net loss attributable to non-controlling interest		**6**	–	**33**	–
Net income (loss) attributable to shareholders		**12,493**	(622)	**7,882**	2,218
Foreign currency translation (loss) gain from foreign operations		**(105)**	47	**(37)**	166
Comprehensive income (loss)		**12,388**	(575)	**7,845**	2,384
Net income (loss) per share *($)*					
Basic and diluted	*14*	**0.35**	(0.02)	**0.22**	0.06

See accompanying notes to the condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Financial Position (unaudited)

ORCA EXPLORATION GROUP INC.

$'000	Note	AS AT JUNE 30, 2018	DECEMBER 31, 2017
Assets			
Current assets			
Cash and cash equivalents		**54,182**	122,322
Investment in short term bonds	*8*	**62,870**	–
Trade and other receivables	*9*	**15,234**	12,273
Prepayments		**807**	866
		133,093	135,461
Non-current assets			
Investment in bonds		**7,183**	–
Long-term trade receivables	*9*	**2,780**	2,797
Investments	*19*	**3,967**	–
Property, plant and equipment	*10*	**109,226**	111,291
		123,156	114,088
Total Assets		**256,249**	249,549
Equity and liabilities			
Current liabilities			
Trade and other payables	*11*	**60,814**	56,758
Tax payable		**150**	718
Deferred revenue	*7*	**–**	8,410
		60,964	65,886
Non-current liabilities			
Deferred income taxes		**11,910**	11,811
Long-term loan	*12*	**58,597**	58,518
Additional Profits Tax		**35,760**	34,603
		106,267	104,932
Total Liabilities		**167,231**	170,818
Equity			
Capital stock	*13*	**86,508**	86,508
Contributed surplus		**6,319**	6,319
Accumulated other comprehensive loss		**(202)**	(165)
Accumulated loss		**(3,752)**	(13,931)
Non-controlling interest	*19*	**145**	-
		89,018	78,731
Total equity and liabilities		**256,249**	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 JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	Note	**2018**	2017	**2018**	2017
Operating activities					
Net (loss) Income		**12,487**	(622)	**7,849**	2,218
Adjustment for:					
Depletion and depreciation	*10*	**1,856**	2,143	**3,926**	4,483
Reversal of provision for doubtful accounts	*8*	**(13,439)**	–	**(13,439)**	–
Indirect tax	*8*	**2,799**	2,354	**3,063**	2,559
Stock-based compensation	*13*	**69**	790	**(5,331)**	619
Deferred income tax		**449**	110	**99**	351
Additional Profits Tax		**383**	238	**1,157**	512
Unrealized (loss) gain on foreign exchange		**(206)**	(403)	**20**	(206)
Interest expense	*8*	**2,124**	2,310	**6,800**	4,559
Change in non-cash working capital	*18*	**6,135**	5,118	**10,040**	5,730
Net cash from operating activities		**12,657**	12,038	**14,184**	20,825
Investing activities					
Property, plant and equipment expenditures	*10*	**(1,042)**	(350)	**(1,861)**	(470)
Change in non-cash working capital		**152**	24	**160**	(72)
Net cash used in investing activities		**(890)**	(326)	**(1,701)**	(542)
Financing activities					
Investment in bonds	*8*	**(70,053)**	–	**(70,053)**	–
Interest paid	*8*	**(5.081)**	(1,585)	**(9,197)**	(3,103)
Proceeds on sale of interest in a subsidiary	*19*	**(317)**	–	**15,374**	–
Dividends paid to shareholders	*13*	**–**	–	**(16,866)**	–
Net cash used in financing activities		**(75,451)**	(1,585)	**(80,742)**	(3,103)
(Decrease) increase in cash		**(63,684)**	10,127	**(68,259)**	17,180
Cash and cash equivalents at the beginning of the period		**117,813**	87,821	**122,322**	80,895
Effect of change in foreign exchange on cash for the period		**53**	337	**119**	210
Cash and cash equivalents at the end of the period		**54,182**	98,285	**54,182**	98,285

See accompanying notes to the condensed consolidated interim financial statements.

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

ORCA EXPLORATION GROUP INC. *$'000*	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated loss	Non-controlling interest	Total
Note	*13*			*13*	*19*	
Balance as at December 31, 2017	86,508	6,319	(165)	(13,931)	–	78,731
Dividend declared	–	–	–	(16,866)	–	(16,866)
Foreign currency translation adjustment on foreign operations	–	–	(37)	–	–	(37)
Net income (loss)	–	–	–	7,882	(33)	7,849
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 June 30, 2018	**86,508**	**6,319**	**(202)**	**(3,752)**	**145**	**89,018**

$'000	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated loss	Total
Note	*13*				
Balance as at December 31, 2016	85,488	6,347	(381)	(11,431)	80,023
Foreign currency translation adjustment on foreign operations	–	–	166	–	166
Net income	–	–	–	2,218	2,218
Balance as at June 30, 2017	85,488	6,347	(215)	(9,213)	82,407

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, and 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 June 30, 2018 and for the three and six months ended June 30, 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 August 14, 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 ("$") unless otherwise stated.

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 and six-month periods ended June 30, 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, investments, 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 June 30, 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 $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 48% of the Company's gross field revenue operating revenue for the six months ending June 30, 2018 and $2.1 million of the short and long-term receivables at June 30, 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 $60.8 million of financial liabilities with regards to trade and other payables of which $37.4 million is due within one to three months, nil is due within three to six months, and $23.4 million is due within six to twelve months (see Note 11).

At the end of the quarter approximately 70% 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 payments to TPDC are made when cash is received for the arrears (see Note 9).

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..

					THREE MONTHS ENDED JUNE 30	
			2018			2017
$'000	**Italy**	**Tanzania**	**Total**	Italy	Tanzania	Total
External revenue	**–**	**14,959**	**14,959**	–	16,810	16,810
Segment (loss) income [(1)]	**(69)**	**12,556**	**12,487**	(96)	(526)	(622)
Finance income [(2)]	**–**	**13,903**	**13,903**	–	80	80
Indirect tax [(2)]	**–**	**2,799**	**2,799**	–	2,354	2,354
Interest expense [(2)]	**–**	**2,124**	**2,124**	–	2,310	2,310
Depletion & depreciation	**–**	**1,856**	**1,856**	–	2,143	2,143

					SIX MONTHS ENDED JUNE 30	
			2018			2017
$'000	**Italy**	**Tanzania**	**Total**	Italy	Tanzania	Total
External revenue	**–**	**29,182**	**29,182**	–	34,936	34,936
Segment (loss) income [(1)]	**(3)**	**7,852**	**7,849**	(131)	2,349	2,218
Finance income [(2)]	**–**	**14,140**	**14,140**	–	161	161
Indirect tax [(2)]	**–**	**3,063**	**3,063**	–	2,559	2,559
Interest expense [(2))]	**–**	**6,800**	**6,800**	–	4,559	4,559
Depletion & depreciation	**–**	**3,926**	**3,926**	–	4,483	4,483

			AS AT JUNE 30, 2018			AS AT DECEMBER 31, 2017
$'000	**Italy**	**Tanzania**	**Total**	Italy	Tanzania	Total
Capital additions [(3)]	**–**	**1,861**	**1,861**	–	8,897	8,897
Total assets	**528**	**255,721**	**256,249**	2,041	247,508	249,549
Total liabilities	**9**	**167,222**	**167,231**	493	170,325	170,818

(1) *The income in Italy relates to foreign exchange gains (losses) on the euro cash balances held in country.*
(2) *See Note 8.*
(3) *In Q1 2017 $7.4 million was transferred from accounts receivable to property, plant and equipment (see Note 9).*

7 REVENUE

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Industrial sector	**10,099**	8,906	**19,846**	16,974
Power sector	**6,431**	7,163	**18,213**	15,517
Gross field revenue	**16,530**	16,069	**38,059**	32,491
TPDC share of revenue	**(3,689)**	(2,266)	**(10,727)**	(4,383)
Company operating revenue	**12,841**	13,803	**27,332**	28,108
Current income tax adjustment	**2,118**	3,007	**1,850**	6,828
Revenue	**14,959**	16,810	**29,182**	34,936

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 continued to collect 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 invoiced amount for gas deliveries during the same period. As a result the Company: (i) recognized all amounts invoiced in Q2 2018 for gas deliveries as revenue; (ii) recognized $8.1 million of previously deferred revenue (which represented excess cash received over invoiced amounts for gas deliveries which was not offset against long term TANESCO arrears previously provided for at the end of Q1 2018) and (ii) recognized a further $5.3 million of long term TANESCO arrears previously provided for as finance income (see Notes 8 and 9). For the six months ended June 30, 2018 the Company recorded an increase of $4.2 million in gross field revenue and reallocated $2.6 million of TPDC Profit share entitlement (following the release of $4.2 million of deferred revenue) which resulted in an overall increase of $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:

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Increase (decrease) in gross field revenue and accounts receivable	**–**	(797)	**4,172**	(2,379)
Increase (decrease) in revenue	**–**	(1,543)	**1,603**	(3,448)
Increase (decrease) in net income	**–**	(797)	**1,292**	(2,379)
Increase (decrease) in liabilities	**–**	(746)	**2,880**	(1,069)

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 INCOME AND EXPENSE

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Interest income	**157**	80	**394**	161
Investment income	**307**	–	**307**	–
Reversal of provision for doubtful accounts	**13,439**	–	**13,439**	–
	13,903	80	**14,140**	161

The reversal of the provision for doubtful accounts of $13.4 million relates to the collection of TANESCO arrears which had been previously provided for. The $13.4 million consist of $8.1 million previously carried as deferred revenue and $5.3 million excess receipts over invoiced gas deliveries during the quarter (see Notes 7 and 9).

In April 2018, the Company invested $70.0 million in bonds. The $0.3 million investment income consists of accrued interest of $0.15 million and $0.15 million amortization of the discount on the acquisition of the bonds. To date the Company has received interest income of $0.13 million. The Company's intention is to hold the bond investment to maturity; however, the bonds are highly liquid by their nature and may readily be transferred to cash when necessary.

Finance expense

$'000	THREE MONTHS ENDED JUNE 30 2018	2017	SIX MONTHS ENDED JUNE 30 2018	2017
Base interest expense	**1,517**	1,585	**3,055**	3,103
Participatory interest expense	**607**	725	**3,745**	1,456
Interest expense	**2,124**	2,310	**6,800**	4,559
Net foreign exchange loss (gain)	**214**	(104)	**597**	(34)
Indirect tax	**2,799**	2,354	**3,063**	2,559
Finance expense	**5,137**	4,560	**10,460**	7,084

Base and participatory interest expense relate to the long-term loan with the International Finance Corporation ("IFC"). The amount of base interest expense during the quarter was $1.5 million (Q2 2017: $1.6 million) and $3.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $3.1 million). The participatory interest expense during the quarter was $0.6 million (Q2 2017: $0.7 million) and $3.7 million for the six months ended June 30, 2018 (six month ended June 30, 2017: $1.4 million); the increase is related to an additional payment of $2.6 million associated with the sale of the 7.933% interest in PAEM in January 2018 (see Notes 12 and 19).

The indirect tax of $2.8 million for the quarter (Q2 2017: $2.4 million) and $3.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $2.6 million) is for VAT associated with invoices to TANESCO for interest on late payments and invoices under the take or pay provisions within the PGSA; these amounts are not recognized in the financial statements due to not meeting the revenue recognition criteria with respect to assurance of collectability (see Note 9).

9 TRADE AND OTHER RECEIVABLES

Current receivables

$'000	AS AT JUNE 30, 2018	DECEMBER 31, 2017
Trade receivables		
Songas	**2,129**	2,378
Industrial customers	**10,307**	6,915
Less provision for doubtful accounts	**(452)**	(452)
	11,984	8,841
Other receivables		
Songas gas plant operations	**6,648**	5,827
Other	**1,518**	2,521
Less provision for doubtful accounts	**(4,916)**	(4,916)
	3,250	3,432
	15,234	12,273

Long-term trade receivables and other

$'000	AS AT JUNE 30, 2018	DECEMBER 31, 2017
TANESCO receivable	**60,922**	74,361
Provision for doubtful accounts	**(60,922)**	(74,361)
Net TANESCO receivable	**–**	–
VAT Songas workovers	**2,205**	2,205
VAT bond	**352**	363
Lease deposit	**223**	229
Long-term trade receivables and other	**2,780**	2,797

TANESCO

At June 30, 2018 the current receivable from TANESCO was $ nil (December 31, 2017: $ nil). During the quarter, the amounts received from TANESCO continued to be in excess of the revenue for gas sales to TANESCO. As a consequence, $13.4 million of cumulative excess receipts over sales invoiced since Q3 2017, of which $5.4 million was in the current quarter, has been recorded to the long-term arrears together with the associated recovery of the provision for doubtful accounts.

The TANESCO long-term trade receivable at June 30, 2018 was $60.9 million with a provision of $60.9 million (December 31, 2017: $74.4 million with a provision of $74.4 million). Subsequent to June 30, 2018 the Company has invoiced TANESCO $2.7 million for 2018 gas deliveries and TANESCO has paid the Company $5.8 million.

Songas

As at June 30, 2018 Songas owed the Company $8.8 million (December 31, 2017: $8.2 million) while the Company owed Songas $1.9 million (December 31, 2017: $2.0 million). The amounts due to the Company are mainly for sales of gas of $2.1 million (December 31, 2017: $2.4 million) and for the operation of the gas plant of $6.6 million (December 31, 2017: $5.8 million) against which the Company has made a provision for doubtful accounts of $4.9 million (December 31, 2017: $4.9 million), whereas the amounts due to Songas primarily relate to pipeline tariff charges of $1.5 million (December 31, 2017: $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 $14.5 million was transferred to the cost pool to recover the costs via the PSA cost recovery mechanism. This resulted in:

i) $7.4 million of the Songas receivable being reclassified to plant, property and equipment equal to the proportion not previously provided against. This represents the value which will be recovered via the PSA revenue sharing mechanism;

ii) the write-off of the $4.9 million portion of the Songas receivable that had been previously provided for; and

iii) $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 $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:

$'000	December 31, 2017	Year to date transactions	**June 30, 2018**	Post quarter-end payments and receipts	Outstanding as at the date of this report
Pipeline tariff - payable	(1,670)	(155)	**(1,515)**	1,515	–
Gas sales - receivable	2,378	(249)	**2,129**	(1,155)	974
Gas plant operation receivable	5,827	821	**6,648**	(632)	6,016
Provision for gas plant operation receivable	(4,916)	–	**(4,916)**	–	(4,916)
Other payable	(378)	–	**(378)**	–	(378)
Net balances	1,241	727	**1,968**	(272)	1,696

10

PROPERTY, PLANT AND EQUIPMENT

$'000	Oil and natural gas interests	Leasehold improvements	Computer equipment	Vehicles	Fixtures & fittings	Total
Costs						
As at December 31, 2017	204,266	699	1,487	449	1,126	208,027
Additions	1,811	–	50	–	–	1,861
As at June 30, 2018	**206,077**	**699**	**1,537**	**449**	**1,126**	**209,888**
Accumulated depletion and depreciation						
As at December 31, 2017	93,258	694	1,315	346	1,123	96,736
Depletion and depreciation	3,837	5	43	38	3	3,926
As at June 30, 2018	**97,095**	**699**	**1,358**	**384**	**1,126**	**100,662**
Net book values						
As at December 31, 2017	111,008	5	172	103	3	111,291
As at June 30, 2018	**108,982**	**–**	**179**	**65**	**–**	**109,226**

In determining the depletion charge, it is estimated that future development costs of $79.6 million (December 31, 2017: $80.4 million) will be required to bring the total proved reserves to production. The Company recorded depreciation of $0.05 million in Q2 2018 (Q2 2017: $0.1 million) and $0.1 million in the six months ended June 30, 2018 (six months ended June 30, 2017: $0.2 million) in general and administrative expenses.

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TRADE AND OTHER PAYABLES

$'000	AS AT JUNE 30, 2018	DECEMBER 31, 2017
Songas	**1,515**	1,670
Other trade payables	**3,443**	1,961
Trade payables	**4,958**	3,631
TPDC share of Profit Gas, net	**41,737**	33,422
Accrued liabilities	**14,118**	19,705
	60,814	56,758

TPDC share of Profit Gas

$'000	AS AT JUNE 30, 2018	DECEMBER 31, 2017
TPDC share of Profit Gas	**43,102**	35,876
Less "Adjustment Factor"	**(1,365)**	(2,454)
TPDC share of Profit Gas payable	**41,737**	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 $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 $5 million starting April 15, 2022 and one final payment of $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 was initially guaranteed by the Company to a maximum of $30 million. The initial 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. Pursuant to the sale of the non-controlling interest in PAEM, the Company agreed with the IFC to reduce the outstanding amount of the loan by the percentage interest sold in PAEM of 7.933% ($4.8 million) on the fourth anniversary of the first drawdown. The Company has provided an additional guarantee to the IFC that if PAET is unable to pay down the loan on or before December 14, 2019, the Company will make the payment. This guarantee is in addition to the Company's initial guarantee.

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 $1.5 million (Q2 2017: $1.5 million) and $3.1 million for the six months ended June 30, 2018 (six months ending June 30, 2017: $3.1 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 $0.6 million (Q2 2017: $0.7 million) and $3.7 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $1.5 million). The year to date charge includes an additional payment of $2.6 million (six months ended June 30, 2017: $ 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 from 7% to 6.4%. At June 30, 2018 the participatory interest included in accrued liabilities is $1.2 million (December 31, 2017: $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.

	AS AT	
$'000	**JUNE 30, 2018**	DECEMBER 31, 2017
Loan principal	**60,000**	60,000
Financing costs	**(1,403)**	(1,482)
	58,597	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:

	2018		
Number of shares	Authorised *(000)*	Issued *(000)*	Amount *($'000)*
Class A			
As at December 31, 2017 and June 30, 2018	**50,000**	**1,750**	**983**
Class B			
As at December 31, 2017 and June 30, 2018	**100,000**	**33,506**	**85,525**
First preference			
As at December 31, 2017 and June 30, 2018	**100,000**	**–**	**–**
Total Class A, Class B and first preference	**250,000**	**35,256**	**86,508**

All of the issued capital stock is fully paid.

Stock Appreciation Rights ("SARs")	SARs *(000)*	Exercise Price *(CDN$)*
Outstanding as at December 31, 2017	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 June 30, 2018	**855**	**2.30 to 3.87**

The number outstanding, the weighted average remaining life and weighted average exercise prices of SARs at June 30, 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	0.54	34	2.30
3.02 to 3.25	235	2.29	–	3.04
3.84 to 3.87	230	2.86	–	3.86
2.30 to 3.87	**855**	**1.67**	**34**	**2.92**

Restricted Stock Units ("RSUs")	RSUs *(000)*	Exercise Price *(CDN$)*
Outstanding as at December 31, 2017	1,148	0.001
Exercised	(910)	0.001
Outstanding as at June 30, 2018	**238**	**0.001**

The number outstanding, the weighted average remaining life and weighted average exercise prices of RSUs at June 30, 2018 were as follows:

Exercise Price *(CDN$)*	Number outstanding *(000)*	Number exercisable *(000)*	Weighted average remaining contractual life *(years)*
0.001	**238**	**238**	**3.78**

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 46.4% to 51.4%; 0% dividend yield; 5% forfeiture; a closing stock price of CDN$5.28 per share.

	AS AT	
$'000	**JUNE 30, 2018**	DECEMBER 31, 2017
SARs	**940**	4,339
RSUs	**1,623**	3,555
	2,563	7,894

As at June 30, 2018 a total accrued liability of $2.6 million (December 31, 2017: $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 $0.4 million (Q2 2017: $1.6 million) and $5.1 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $2.4 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

('000)	AS AT JUNE 30 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 income for the quarter of $12.5 million (Q2 2017: $0.6 million net loss) and a weighted average number of Class A and Class B shares outstanding during the quarter of 35,256,432 (Q2 2017: 34,856,432). The calculation of earnings per share for the six months ended June 30, 2018 is based on a net income of $7.9 million (six months ended June 30; 2017: $2.2 million) and a weighted average number of Class A and Class B shares outstanding for the six months ended June 30, 2018 of 35,256,432 (six months ended June 30, 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. During the quarter $0.1 million (Q2 2017: $0.1 million) and $0.2 million for the six months ended June 30, 2018 (six months ended June 30, 2017: $0.2 million) was incurred with this firm for services provided.

As at June 30, 2018 the Company has a total of $0.1 million (Q4 2017: $0.5 million) recorded in trade and other payables in relation to the related party.

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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 ($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 (182.8 Bcf as at June 30, 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 $0.30/mcf for sales between 70 MMcfd and 90 MMcfd and $0.40/mcf for volumes above 90 MMcfd by issuing credit notes to TANESCO. This was in addition to the tariff of $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 $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 $2.98/mcf increased to $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. Under an amendment to the PGSA (effective January 20, 2018) the maximum daily quantity under the PGSA was reduced from 36MMcfd to 26 MMcfd.

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 $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 $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 commitments 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 $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 $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 $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

		Tax dispute	Disputed amount $' million		
Area	**Period**	**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.	1.0	0.7	1.7 (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).	29.2	9.9	39.1 (3)
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.7	5.4 (4)
			33.2	13.3	46.5

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 $46.5 million (December 31, 2017: $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 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 ($1.6 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 for their application, under the certificate of urgency, for CAT leave to review its judgement. During Q1 2018 CAT ruled in favour of PAET's preliminary objection. TRA still has the right to amend and re-file its application;

(b) 2010 ($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) 2008 ($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 $1.8 million (with tax impact of $0.6 million). PAET has objected to the assessment for being time-barred, incorrect and arbitrary;

(b) 2009 ($2.5 million): In 2015 TRAB ruled against PAET with respect to timing of deductibility of capital expenditures and other expenses ($1.7 million). In Q2 2017 PAET lost an appeal at TRAT and in July 2018 lost an appeal at CAT. Management intends to file an application for the CAT to review its judgement and has 60 days from the day of judgement to file the application. In July 2017 TRA sent PAET an amended assessment claiming additional taxes, interest and penalties ($0.8 million). PAET has objected to the assessment for being time-barred and arbitrary and is awaiting a TRA response;

(c) 2010 ($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;

(d) 2011 ($1.9 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 ($1.7 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 ($0.2 million) raised for the year;

(e) 2012 ($15.7 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;

(f) 2013 ($6.5 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 ($0.9 million) which disallowed certain operating costs included in the tax returns and tax on repatriated income ($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;

(g) 2014 ($9.1 million): In 2016 TRA issued an assessment of $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 $3.0 million and tax on repatriated income $2.8 million. PAET has objected the assessments and is awaiting TRA response;

(h) 2015 ($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 ($5.3 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 ($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.

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CHANGE IN NON-CASH OPERATING WORKING CAPITAL

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
$'000	**2018**	2017	**2018**	2017
Decrease in trade and other receivables	**8,340**	14	**7,231**	6,033
Decrease in tax receivable	**889**	–	**–**	–
Decrease (increase) in long term receivables	**4**	40	**17**	(2,179)
Decrease in prepayments	**137**	156	**59**	(138)
(Decrease) increase in trade and other payables	**(3,385)**	5,233	**3,301**	1,770
Increase (decrease) in tax payable	**150**	(326)	**(568)**	244
	6,135	5,117	**10,040**	5,730

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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 $15.7 million cash (net of closing adjustments) and $4.0 million of Swala convertible preference shares. The preference shares were issued to the Company on June 18, 2018 and entitle the holder to a 10% per annum distribution payable 15 days after each quarter end commencing from the closing date, January 16, 2018. Payment of the quarterly distributions is at the discretion of Swala based on funds available, however, the liability accrues if any amount is unpaid when due. If any distributable amount remains unpaid at December 31, 2021, the Company may demand settlement and Swala is obligated to comply by transferring and returning shares of PAEM sold to Swala; the aggregate value of these shares will equal to the amount of the outstanding distributions.

Swala is obligated to redeem 20% the preference shares for cash annually starting December 31, 2021 until all shares are redeemed. If at any time Swala does not redeem in cash the required amount of shares, Swala shall be obligated to redeem the preferred shares by transferring and returning shares of PAEM sold to Swala; the aggregate value of these shares will equal the amount of any outstanding redemption.

Following the issue of the preference shares a further price adjustment of $0.3 million was recorded, reducing the total cash consideration for tranche I of the transaction to $15.4 million.

The agreement provides Swala with the right to acquire up to a maximum of 40% of PAEM based on the same terms and conditions (an additional 32.067%). The Company has indefinitely extended the right to acquire the additional interest to Swala but retains the right to terminate the extension at any time.

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

	AS AT	
$'000	**JUNE 30, 2018**	DECEMBER 31, 2017
Balance, beginning of period	**–**	–
Recorded at the date of disposition	**178**	–
Share of post-acquisition loss	**(33)**	–
Balance, end of period	**145**	–

Corporate Information

Board of Directors

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Chairman

Queensway
Gibraltar

David W. Ross
Non-Executive Director

Calgary, Alberta
Canada

William H. Smith
Non-Executive Director

Calgary, Alberta
Canada

Glenn D. Gradeen
Non-Executive Director

Calgary, Alberta
Canada

Officers

E. Alan Knowles
Interim Chief Executive Officer

Calgary, Alberta
Canada

Blaine Karst
Chief Financial Officer

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