

ORCA EXPLORATION GROUP INC.

MANAGEMENT'S  
DISCUSSION  
& ANALYSIS

# Financial and Operating Highlights

	THREE MONTHS ENDED OR AS AT 30 SEPTEMBER		NINE MONTHS ENDED OR AS AT 30 SEPTEMBER	
	2016	2015	2016	2015
<i>(Expressed in US\$'000 unless indicated otherwise)</i>				
<b>OPERATING</b>				
<b>Daily average gas delivered and sold (MMcfd)</b>				
<b>Additional Gas</b>	<b>46.6</b>	46.4	<b>44.4</b>	46.7
Industrial	<b>13.5</b>	11.9	<b>12.3</b>	11.1
Power	<b>33.1</b>	34.5	<b>32.1</b>	35.6
<b>Average price (US\$/mcf)</b>				
Industrial	<b>7.60</b>	7.67	<b>7.77</b>	7.57
Power	<b>3.57</b>	3.62	<b>3.56</b>	3.53
Weighted average	<b>4.73</b>	4.66	<b>4.72</b>	4.48
<b>Operating netback (US\$/mcf)</b>	<b>3.31</b>	2.67	<b>3.23</b>	2.40
<b>FINANCIAL</b>				
<b>Revenue</b>	<b>17,744</b>	15,943	<b>48,126</b>	38,216
<b>Funds flow from operating activities</b>	<b>11,572</b>	9,462	<b>29,745</b>	18,063
per share - basic and diluted (US\$)	<b>0.33</b>	0.27	<b>0.85</b>	0.52
<b>Net cash flows from (used in) operating activities</b>	<b>6,540</b>	(2,963)	<b>11,623</b>	1,568
per share - basic and diluted (US\$)	<b>0.19</b>	(0.08)	<b>0.85</b>	0.04
<b>Net income</b>	<b>5,302</b>	6,112	<b>1,116</b>	8,001
per share - basic and diluted (US\$)	<b>0.15</b>	0.18	<b>0.03</b>	0.23
<b>Working capital (including cash)</b>	<b>67,635</b>	39,660	<b>67,735</b>	39,660
<b>Cash</b>	<b>74,079</b>	49,540	<b>74,079</b>	49,540
<b>Capital expenditures</b>	<b>(45)</b>	8,275	<b>16,793</b>	13,871
<b>Long-term loan</b>	<b>58,398</b>	–	<b>58,398</b>	–
<b>Outstanding shares ('000)</b>				
Class A	<b>1,751</b>	1,751	<b>1,751</b>	1,751
Class B	<b>33,106</b>	33,106	<b>33,106</b>	33,106
<b>Total shares outstanding</b>	<b>34,857</b>	34,857	<b>34,857</b>	34,857
<b>Weighted average diluted Class A and Class B shares</b>	<b>34,857</b>	34,889	<b>34,857</b>	34,889

The above table includes non-GAAP measures which may not be comparable to other companies including funds flow from operations and operating netback. Further, the above financial and operational highlights contain forward-looking information, which is subject to certain assumptions and risks. Please refer to the Management Discussion and Analysis ("MD&A") for information on non-GAAP measures and for our advisory on forward looking statements.

## Q3 2016 Operating Highlights

- Revenue for quarter increased 11% to US\$17.7 million from US\$15.9 million in Q3 2015 and increased 26% to US\$48.1 million over the nine months ended 30 September 2016 compared to US\$38.2 million for the comparable prior year period. The increase is primarily due to the level of capital expenditure associated with the Offshore Program and the positive impact this had on the Company's share of net revenue. The Offshore Program which included workovers on wells SS-5, SS-7 and SS-9 and the drilling of one new well, SS-12, commenced in the third quarter of 2015 and was completed at the end of the first quarter of 2016 with the demobilization of the rig and services occurring during Q2 2016. The expenditures substantially increased the cost pool entitling the Company to 75% of net revenue for both the current quarter (Q3 2015: 58%) and the nine months ended 30 September 2016 (nine months ended 30 September 2015: 51%) with the corresponding reduction in Profit Gas attributable to TPDC by 42% and 49% respectively. The Additional Gas Sales for the quarter increased to 46.6 MMcfd from 46.4 MMcfd in Q3 2016 and decreased by 5% to 44.4 MMcfd from 46.7 MMcfd over the nine months ended 30 September 2016. The fall in sales volumes for the nine months ended 30 September 2016 has been substantially offset by a 5% increase in the weighted average gas price to US\$4.72/Mcf from US\$4.48/Mcf for the comparable prior year period.
- Funds flow from operating activities in Q3 2016 was US\$11.6 million, or US\$0.33 per share diluted, a 22% increase compared to US\$9.5 million or US\$0.27 per share in Q3 2015, primarily the result of a higher revenue driven by a higher Cost Gas entitlement during the period. Funds flow for the nine months ended 30 September 2016 was up 65% to US\$29.7 million, or US\$0.85 per share, compared to US\$18.1 million or US\$0.52 per share for the comparable prior year period. The increases were primarily the result of higher revenues during the respective periods.
- Net income for Q3 2016 was US\$5.3 million, or US\$0.15 per share basic and diluted, as compared to income of US\$6.1 million, or US\$0.18 per share basic and diluted, in Q3 2015. Net income for the nine months ended 30 September 2016 was US\$1.1 million, or US\$0.03 per share, as compared to net income of US\$8.0 million, or US\$0.23 per share, for the comparable prior year period. The relative decrease in net income for the periods is a consequence of the increased provision against the TANESCO receivable of US\$12.4 million (US\$1.0 million in Q3 2016, US\$3.4 million in Q2 2016, and US\$8.0 million in Q1 2016) and the increase in the level of stock based compensation having been offset by the increase in revenue associated with the decrease in TPDC Profit Gas.
- Total capital expenditures for the quarter were US\$ nil compared to US\$8.3 million in Q3 2015. The capital expenditure in Q3 2015 related to workovers of SS-5, SS-7 and SS-9 for the Offshore Program. The total capital expenditures for the nine months ended 30 September 2016 were US\$16.8 million compared to US\$13.9 million for the comparable prior year period. The capital expenditures for the nine months ended 30 September 2016 included the drilling of well SS-12 which was started in 2015 and completed in February 2016.

- Working capital as at 30 September 2016 increased 70% to US\$67.6 million compared to US\$39.7 million as at 30 September 2015. The increase is primarily a result of the increase in long-term debt of US\$58.4million offset by capital expenditures primarily related to the recently completed Offshore Program. The increase in the cash to US\$74.1 million as at 30 September 2016 from US\$49.5 million as at 30 September 2015 accounting for 88% of the total increase in working capital over the twelve month period.
- At 30 September 2016, TANESCO owed the Company US\$81.2 million excluding interest (of which arrears were US\$74.4 million) compared to US\$69.7 million (including arrears of US\$61.9 million) as at 31 December 2015. During the quarter, the Company received a total of US\$8.6 million (Q3 2015: US\$4.0 million) from TANESCO against sales invoices totaling US\$10.2 million (Q3 2015: US\$10.4 million). Current TANESCO receivables as at 30 September 2016 amounted to US\$6.9 million (Q4 2015: US\$7.8 million). Since the quarter end, TANESCO has paid the Company US\$3.7 million, and as at the date of this report the total TANESCO receivable is US\$80.8 million (of which US\$74.2 million has been provided for). The amounts owed do not include interest billed to TANESCO.
- The Company is aware that the Government of Tanzania ("GoT") and the MEM continue to be engaged in ongoing discussions with the World Bank with the primary purpose to address the GoT debts and specifically the TANESCO arrears to the Company and other gas suppliers. Although the Company believes progress is being made with TANESCO to resolve the arrears and to keep payments current, there is no certainty as to the timing for the settlement of the arrears. The Company has filed a notice of dispute with TANESCO to enforce its contractual rights to collect all amounts owed.

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## Management's Discussion & Analysis

THIS MD&A OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED 30 SEPTEMBER 2016 SHOULD BE READ IN CONJUNCTION WITH THE CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE AND NINE MONTHS ENDED 30 SEPTEMBER 2016 AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES TOGETHER WITH THE MD&A FOR THE YEAR ENDED 31 DECEMBER 2015. THIS MD&A IS BASED ON THE INFORMATION AVAILABLE ON 15 NOVEMBER 2016.

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### FORWARD LOOKING STATEMENTS

This management's discussion and analysis ("MD&A") contains forward-looking statements or information (collectively, "forward-looking statements") within the meaning of applicable securities legislation. More particularly, this MD&A contains, without limitation, forward-looking statements pertaining to the following: the Company's expectations regarding supply and demand of natural gas; anticipated power sector revenues; potential impact of Tanzanian Production Development Corporation ("TPDC") future back-in rights on the economic terms of the Production Sharing Agreement ("PSA"); ability to meet all conditions under the International Finance Corporation ("IFC") financing agreement signed on 29 October 2015; the Company's estimated spending for the planned Development Program for 2016 and 2017, which includes construction of the production platform for well SS-12, tie-in of well SS-12 to the production facilities and implementation of a refrigeration unit to enable production into the National Natural Gas Infrastructure Project ("NNGIP") which includes two gas processing facilities and pipelines supplying gas from the Mtwara Region of Tanzania and Songo Songo Island to Dar es Salaam; the potential impact of the Petroleum Act, 2015 ("Act") and the Finance Act, 2016 on the Company's business in Tanzania; the Company's belief that the parties to the unsigned Amended and Restated Gas Agreement ("ARGA") will continue to conduct themselves in accordance with the ARGA until the new Gas Sales Agreement ("NGSA") is signed; the Company's expectation that, despite the Re-Rating Agreement of the gas processing plant owned by Songas Limited ("Songas") having expired, the Songas gas processing plant will not be de-rated and the risk that Songas and the Company will not agree on appropriate terms and sign the NGSA in a timely manner; the Company's expectation that it can expand and maintain the deliverability of gas volumes in excess of the existing Songas infrastructure; the Company's expectation that the SS-4 well may need to be suspended in the future; the forward-looking statements under "Contractual Obligations and Committed Capital Investment"; the Company's expectation that it will not have a shortfall during the term of the Protected Gas delivery obligation to July 2024; and the Company's expectations in respect of its appeal on the decision of the Tax Revenue Appeals Tribunal and other statements under "Contingencies – Taxation". In addition, statements relating to "reserves" are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. The recovery and reserve estimates of the Company's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Although management believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, operational, competitive, political and social uncertainties and contingencies.

These forward-looking statements involve substantial known and unknown risks and uncertainties, certain of which are beyond the Company's control, and many factors could cause the Company's actual results to differ materially from those expressed or implied in any forward-looking statements made by the Company, including, but not limited to: failure to receive payments from the Tanzanian Electrical Supply Company ("TANESCO"); risk that financing solutions are not implemented by the Tanzanian government and the World Bank; risk that any financing provided by the World Bank will not be allocated to resolving TANESCO arrears; risk that TPDC, the Ministry of Energy and Minerals ("MEM") and the Company are unable to agree on commercial terms for future incremental gas sales and consequently the Company cannot expand the Songo Songo development beyond the existing Songas infrastructure and supply gas to the NNGIP; risk that additional gas volumes available to the NNGIP from third parties will replace all or a portion of the volumes currently nominated by TANESCO under the Portfolio Gas Sales Agreement ("PGSA") until additional gas-fired power generation is brought on-stream to consume all of the Company's available gas production; risk that the Development Program is not completed as planned and the actual cost to complete the Development Program exceeds the Company's estimates; risk that the remaining well workovers under the Development Program are unsuccessful or determined to be infeasible; risk that the contingencies related to the development work for the full field development plan for Songo Songo are not satisfied; potential negative effect on the Company's rights under the PSA and other agreements relating to its business in Tanzania as a result of the recently approved Act, as well as the risk that such legislation will create additional costs and time connected with the Company's business in Tanzania; risk that, without extending or replacing the Re-Rating Agreement, the gas processing plant may be de-rated back to its original capacity, resulting in a material reduction in the Company's sales volumes of Additional Gas; risk that the Company will not fully recover Songas' share of capital expenditures associated with the workovers of wells SS-5 and SS-9; risk that the Company will 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 and changes in how they are interpreted and enforced; increased competition; the lack of availability of qualified personnel or management; fluctuations in commodity prices, foreign exchange or interest rates; stock market volatility; competition for, among other things, capital, drilling equipment and skilled personnel; failure to obtain required equipment for drilling; delays in drilling plans; failure to obtain expected results from drilling of wells; effect of changes to the PSA on the Company; changes in laws; imprecision in reserve estimates; the production and growth potential of the Company's assets; obtaining required approvals of regulatory authorities; risks associated with negotiating with foreign governments; inability to satisfy debt obligations and conditions; failure to successfully negotiate agreements; and risk that the Company will not be able to fulfil its contractual obligations. In addition, there are risks and uncertainties associated with oil and gas operations, therefore the Company's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurances can be given that any of the events anticipated by these forward-looking statements will transpire or occur, or if any of them do so, what benefits the Company will derive therefrom. Readers are cautioned that the foregoing list of factors is not exhaustive.

Such forward-looking statements are based on certain assumptions made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors the Company believes are appropriate in the circumstances, including, but not limited to, the TPDC, the MEM and the Company are able to agree on commercial terms for future incremental gas sales and the Company can expand Songo Songo development beyond the existing Songas infrastructure and supply gas to the NNGIP; the Development Program will be completed within the timing anticipated; the actual costs to complete the Development Program are in line with estimates; that there will continue to be no restrictions on the movement of cash from Mauritius or Tanzania; that the Company will have sufficient cash flow, debt or equity sources or other financial resources required to fund its capital and operating expenditures and requirements as needed; that the Company will have adequate funding to continue operations; that the Company will successfully negotiate agreements; receipt of required regulatory approvals; the ability of the Company to increase production at a consistent rate; infrastructure capacity; commodity prices will not further deteriorate significantly; the ability of the Company to obtain equipment and services in a timely manner to carry out exploration, development and exploitation activities; future capital expenditures; availability of skilled labour; timing and amount of capital expenditures; uninterrupted access to infrastructure; the impact of increasing competition; conditions in general economic and financial markets; effects of regulation by governmental agencies; that the Company's appeal of various tax assessments will be successful; that the enactment of the Act 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.

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## NON-GAAP MEASURES

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

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

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

## NATURE OF OPERATIONS

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

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

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

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

TANESCO is a parastatal organization which is wholly-owned by the Government of Tanzania, with oversight by the MEM. TANESCO is responsible for the generation, transmission and distribution of electricity throughout Tanzania. Natural gas has become an integral component of TANESCO's power generation fuel mix as a more reliable source of supply over seasonal hydro power and a more cost effective alternative to liquid fuels. The Company currently supplies gas directly to TANESCO by way of a Portfolio Gas Supply Agreement ("PGSA") and indirectly through the supply of Protected Gas and Additional Gas to Songas which in turn generates and sells power to TANESCO. TANESCO is the Company's largest customer and the gas supplied by the Company to Songas and TANESCO today fires approximately 35% of the electrical power generated in Tanzania and 47% of the gas utilized for power generation in the country.

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

### Consolidation

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

<b>COMPANY</b>	<b>INCORPORATED</b>
Orca Exploration Group Inc.	British Virgin Islands
Orca Exploration Italy Inc.	British Virgin Islands
Orca Exploration Italy Onshore Inc.	British Virgin Islands
Orca Exploration Longastrino SRL	Italy
PAE PanAfrican Energy Corporation	Mauritius
PanAfrican Energy Tanzania Limited ("PAET")	Jersey
Orca Exploration UK Services Limited	United Kingdom

## BUSINESS RISKS

See "Business Risks" in the MD&A for the year ended 31 December 2015 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 if necessary depend in part upon the prevailing capital market conditions as well as the business performance of the Company. There can be no assurance that the Company would be successful in its efforts to 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. Both Songas and the Company have been impacted by TANESCO's inability to pay.

As at 30 September 2016, TANESCO owed the Company US\$81.2 million excluding interest (of which arrears were US\$74.4 million) compared to US\$69.7 million (including arrears of US\$61.9 million) as at 31 December 2015. During the quarter, the Company received a total of US\$8.6 million (Q3 2015: US\$4.0 million) from TANESCO against sales invoices totaling US\$10.2 million (Q3 2015: US\$10.4 million) for the nine months ended 30 September 2016 the Company received a total of US\$18.8 million against sales totaling US\$30.3 million (nine months ending 30 September 2015 received a total of US\$34.1 million against sales totaling US\$45.8 million). Current TANESCO receivables as at 30 September 2016 amounted to US\$6.9 million (Q4 2015: US\$7.8 million). Since the quarter end, TANESCO has paid the Company US\$3.7 million, and as at the date of this report the total TANESCO receivable is US\$80.8 million (of which US\$74.4 million has been provided for). The amounts owed do not include interest billed to TANESCO.

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

Pursuant to the terms of the ARGA, on 25 April 2016 the Company and TPDC issued a joint notice to TANESCO that the company would consider suspending deliveries under this agreement unless suitable arrangements were made by TANESCO to settle arrears and maintain payments for current deliveries (the "Suspension Notice"). Although the Suspension Notice has not been withdrawn, the Company agreed not to act on the Suspension Notice given the commitment by TANESCO to make regular weekly payments to cover current deliveries.

On September 1, 2016 the Company issued a notice of dispute to TANESCO to reinforce that unless the payments are increased to cover current deliveries and efforts taken to reduce arrears, further action will be taken to enforce the Company's contractual rights to collect all amounts owed.

The Company is also aware that the Government of Tanzania ("GoT") and the MEM have engaged in ongoing discussions with the World Bank with the primary purpose to address the GoT debts and specifically, the TANESCO arrears to the Company and other suppliers. The Company is also aware that a tariff increase application has been submitted by TANESCO to the regulatory authority, EWURA to ensure TANESCO can meet its obligations for current and future deliveries.

As at 30 September 2016, Songas owed the Company US\$24.1 million (Q4 2015: US\$19.0 million), while the Company owed Songas US\$1.3 million (Q4 2015: US\$2.6 million); there is no contractual right to offset these amounts. Amounts due to Songas primarily relate to pipeline tariff charges of US\$1.0 million (Q4 2015: US\$1.1 million), whereas the amounts due to the Company are mainly for capital expenditures of US\$14.4 million (Q4 2015: US\$11.2 million), sales of gas of US\$3.4 million (Q4 2015: US\$2.2 million) and for the operation of the gas plant of US\$6.2 million (Q4 2015: US\$5.6 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through "no profit, no loss" basis.

As at 30 September 2016 the net amount owed by Songas to the Company was US\$22.7 million (Q4 2015: US\$16.4 million). The Company considers the doubtful debt provision of US\$9.8 million to be at an appropriate level recognizing the pending settlement of the remaining overdue operatorship charges and the Songas share of the well workover costs. Any significant amounts not agreed to will be pursued through the mechanisms provided in the agreements with Songas.

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

### **Access to Songas processing and transportation**

While the Company operates the Songo Songo gas processing plant, Songas is the owner of plant and pipeline system which transports natural gas from Songo Songo to Dar es Salaam. The Company's ability to deliver gas to its customers in Dar es Salaam is dependent upon it having access to the Songas infrastructure. Although there are agreements with Songas to allow the Company to process and transport gas, there is no assurance that these rights could not be challenged or curtailed by Songas. The inability to access 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 Songo Songo gas 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 a new agreement, there is a risk that Songas could request production be limited to 70 MMcfd (the capacity originally agreed to), which would result in a material reduction in the Company's sales volumes of Additional Gas.

### **The Petroleum Act, 2015**

In July 2015 the Tanzania Parliament passed The Petroleum Act, 2015, which was passed into law by Presidential decree on 4 August 2015. The Act repeals earlier legislation, provides a regulatory framework over mid-stream and downstream gas activity and as well consolidates and puts in place a single, effective and comprehensive legal framework for regulating the oil and gas industry in the country. The Act also provides for the creation of an upstream regulator, the Petroleum Upstream Regulatory Authority ("PURA"). The mid and downstream petroleum as well as gas activities are proposed to be regulated by the current authority, the Energy and Water Utilities Regulatory Authority ("EWURA").

The Act also confers upon on TPDC, the status of the National Oil Company, mandated with the task of managing the country's commercial interest in the petroleum operations as well as mid and downstream natural gas activities. The Act vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of the National Oil Company do not extend to mid and downstream petroleum supply operations.

The Act does provide grandfathering provisions upholding the rights of the Company under the PSA. However, it is still unclear how the provisions of the Act will be interpreted and implemented regarding upstream and downstream activities.

### **Amended and Restated Gas Agreement**

Terms of the original Gas Agreement were modified by the ARGA which was initialed by all parties but not signed. The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and contract terms dealing with the consequences of any insufficiency are dealt with in a new Insufficiency Agreement ("IA"). The IA specifies terms under which Songas may demand cash security in order to keep it whole in the event of a Protected Gas insufficiency. Should the IA be signed, it will govern the basis for determining security. Under the provisional terms of the IA, when it is calculated that funding is required, the Company is required to fund an escrow account at a rate of US\$2.00/MMbtu on all Industrial Additional Gas sales out of its and TPDC's share of revenue, and TANESCO is required to contribute the same amount on Additional Gas sales to the Power sector. The funds provide security for Songas in the event of an insufficiency of Protected Gas. The Company is actively monitoring the reservoir and, supported by the report of its independent engineers, does not anticipate that a liability will occur in this respect. As at the date of this report, the ARGA has only been initialed. Although the ARGA is unsigned, the parties have and continue to conduct themselves, in certain respects, as though the ARGA is in effect. Management does not foresee at this time a material risk with the conduct of the Company's business with an unsigned ARGA.

### **Additional Gas**

The Company has the right under the terms of the PSA to market volumes of Additional Gas subject to satisfying the requirements to deliver Protected Gas to Songas.

There is a risk that Songas could interfere in the Company's ability to produce, transport and sell volumes of Additional Gas if the Company's obligations to Songas under the Gas Agreement are not met. In particular, Songas has the right in specific circumstances to request reasonable security on all Additional Gas sales.

With the passing of the Act, TPDC was given significant rights over upstream and downstream operations in the country and is the sole aggregator of natural gas in the country. Some clauses in the Act conflict with the Company's rights under the PSA to directly market Additional Gas and there is a risk that this prior right will not continue to be recognized and that the Company's ability to maximize revenue on Additional Gas sales may be impaired by the requirement to sell gas to TPDC as aggregator.

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## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of the Company's unaudited condensed consolidated interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ 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 31 December 2015. See "Critical Accounting Estimates and Judgements" in the MDA for the year ended 31 December 2015 for a complete discussion.

### **Collectability of receivables**

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

TANESCO is, and has been, experiencing financial difficulties since 2011. These have been caused by a combination of dependence on high cost liquid fuel power generation following droughts in Tanzania, a government mandate to build additional power stations without appropriate financing and inadequate consumer tariffs to cover operational costs.

Prior to 2016 the Company had reached an understanding with TANESCO that it would only continue to supply gas if TANESCO remained reasonably current with payments for current gas deliveries. Excess payments received over and above the current balances would be applied to the arrears balance. During 2016 TANESCO payments have been irregular and insufficient to cover current gas deliveries. With the resumption of weekly payments in May 2016 together with the current TANESCO application for tariff increases to ensure it can meet its ongoing obligations, the Company has continued gas deliveries with the expectation that TANESCO will stay reasonably current with payments. However there still remains a high level of uncertainty as to the timing of a conclusive arrangement between the GoT and the World Bank and the amount of funds the Company will receive as a result of any arrangements made between the GoT and the World Bank.

Management has reviewed the current position with TANESCO and feels that the current policy to reclassify all amounts receivable from TANESCO in excess of 60 days, and in arrears, as a long-term receivable is still appropriate.

## Results for the three and nine months ended 30 September 2016

### SUMMARY

During the nine months ended 30 September 2016 the Company successfully completed the drilling of well SS-12. This completed all work-over and drilling activities planned under the Offshore Program. Based on preliminary evaluation, the Company anticipates that production capabilities will increase by approximately 35 MMcfd once the SS-12 production platform is completed and the well is tied into the NNGIP infrastructure. Total capital expenditures for the nine months ended 30 September 2016 were US\$16.8 million (nine months ending 30 September 2015: US\$13.9 million).

The Company's revenue increased by 11% to US\$17.7 million in the third quarter of 2016 (Q3 2015: US\$15.9 million) and increased 26% to US\$48.1 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015: US\$38.2 million). The increase is primarily a result of the capital expenditures from the Offshore Program which commenced in Q3 2015 and was completed in Q1 2016 increasing the pool of recoverable costs which entitled the Company to a greater share of net revenue.

The Company recorded a net income for the quarter of US\$5.3 million (Q3 2015: US\$6.1 million) and a net income for the nine months ended 30 September 2016 of US\$1.1 million (nine months ended 30 September 2015: US\$8.0 million). The decrease quarter over quarter and year to date over year to date is primarily a result of the increase in the provision for doubtful accounts on the TANESCO long-term receivable to US\$12.4 million as at 30 September 2016 from US\$11.5 million at 30 June 2016 (Q3 2015 and nine months ending 30 September 2015: US\$ nil), although TANESCO weekly payments were more consistent in the quarter compared to Q2 2016 and Q3 2015. The increase in revenue as a consequence of the Offshore Program is offset to a large extent by the increase in associated corporation tax and the cost of servicing the IFC financing facility.

The Company finished the quarter in a stable financial position with US\$67.6 million of working capital (Q4 2015: US\$32.5 million). This reflects the final drawdown of US\$40 million on the IFC financing facility bringing total long-term debt at quarter end to US\$58.4 million (Q4 2015: US\$18.6 million), increased receipts from TANESCO (US\$8.6 million in the current quarter compared to US\$6.5 million in Q2 2016) and the overall increase in the net Songas receivable from US\$16.4 million in Q4 2015 to US\$22.7 million at 30 September 2016.

## OPERATING VOLUMES

The total volume of Protected Gas and Additional Gas delivered and sold during Q3 2016 was 8,026 MMcf (Q3 2015: 7,769 MMcf), or average daily volumes of 87.2 MMcfd (Q3 2015: 84.4 MMcfd), net of approximately 0.3 MMcfd (Q3 2015: 0.3 MMcfd) consumed locally for fuel gas.

The Additional Gas sales volumes for the quarter were 4,285 MMcf (Q3 2015: 4,264 MMcf), or average daily volumes of 46.6 MMcfd (Q3 2015: 46.4 MMcfd).

The 5% decrease in Additional Gas volumes from 46.7 MMcfd for the nine months ended 30 September 2015 to 44.4 MMcfd for the nine months ended 30 September 2016 is primarily a result of reduced nominations of natural gas volumes by TANESCO arising from cessation of power generation contract with an independent power producer who was using the Company's Additional Gas; incremental natural gas supply to TANESCO from other gas suppliers; and suspension of power generation by Songas in the early part of Q1 2016 due to issues of non-payment with TANESCO. The decline in natural gas supplied to the power sector was offset by the increase in gas supplied to the industrial customers.

The Company's sales volumes were split between the Industrial and Power sectors as detailed in the table below:

	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
<b>Gross sales volume (MMcf)</b>				
Industrial sector	1,238	1,091	3,361	3,031
Power sector	3,047	3,173	8,809	9,708
<b>Total volumes</b>	<b>4,285</b>	4,264	<b>12,170</b>	12,739
<b>Gross average daily sales volume (MMcfd)</b>				
Industrial sector	13.5	11.9	12.3	11.1
Power sector	33.1	34.5	32.1	35.6
<b>Total daily sales volume</b>	<b>46.6</b>	46.4	<b>44.4</b>	46.7

### Industrial sector

Industrial sales volume increased by 13% to 1,238 MMcf (13.5 MMcfd) in Q3 2016 from 1,091 MMcf (11.9 MMcfd) in Q3 2015 and increased by 11% to 3,361 MMcf (12.3 MMcfd) for the nine months ended 30 September 2016 from 3,031 MMcf (11.1 MMcfd) for the nine months ended 30 September 2015. The increased volumes are primarily the result of fewer days of unscheduled maintenance work by cement, textile and edible oil companies and consumption by new customers connected during the first half of 2016.

### Power sector

Power sector sales volumes decreased by 4% to 3,047 MMcf (33.1 MMcfd) in Q3 2016 compared to 3,173 MMcf (34.5 MMcfd) in Q3 2015 and decreased by 9% to 8,809 MMcf (32.1 MMcfd) for the nine months ended 30 September 2016 from 9,708 MMcf (35.6 MMcfd) for the nine months ended 30 September 2015. The decrease in volumes on a year to date basis is primarily a result of reduced nominations of natural gas volumes by TANESCO arising from cessation of power generation contract with an independent power producer who was using the Company's Additional Gas; incremental natural gas supply to TANESCO from other gas suppliers; and suspension of power generation by Songas in the early part of Q1 2016 due to issues of non-payment with TANESCO.

## SONGO SONGO DELIVERABILITY

As at 30 September 2016, the Company had a field productive capacity of approximately 155 MMcfd, with the expansion of production volumes limited to 102 MMcfd by the available Songas pipeline infrastructure. The increase in field productive capacity was due to successful workovers on wells SS-5, SS-7 and SS-9 completed during the second half of 2015. Well SS-3 is currently suspended; it is the Company's intention to undertake workovers on SS-3 and SS-4 wells in the future. During Q1 2016, the Company completed drilling well SS-12 adding a further potential of 35 MMcfd to the field productive capacity. The SS-12 well cannot be produced until the construction of a production platform and a flowline to tie the well into the NNGIP infrastructure.

## COMMODITY PRICES

The commodity prices achieved in the different sectors during the quarter and the nine months ended 30 September are detailed in the table below:

US\$/mcf	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
<b>Average sales price</b>				
Industrial sector	7.60	7.67	7.77	7.56
Power sector	3.57	3.62	3.56	3.53
<b>Weighted average price</b>	<b>4.73</b>	4.66	<b>4.72</b>	4.48

### Industrial sector

The average gas price during the quarter was US\$7.60/mcf, a decrease of 1% from US\$7.67/mcf in Q3 2015. This is a consequence of: (i) the impact of lowering the floor prices for some industrial customers that came into effect in September 2016; (ii) a contractual step change in the gas prices to a cement company with effect from 1 January 2016 and (iii) a change in the sales mix.

The average price for the nine months ended 30 September 2016 was US\$7.77/mcf up 3% from US\$7.56/mcf for the nine months ended 30 September 2015.

### Power sector

The average gas price during the quarter was US\$3.57/mcf, a decrease of 1% from US\$3.62/mcf in Q3 2015. The decrease is the result of a reduction in the volumes subjected to premium price in accordance with the terms of the gas sales contracts offsetting the contractual annual indexation price rise of 2% in July.

The average price for the nine months ended 30 September 2016 was US\$3.56/mcf up 1% compared with US\$3.53/mcf for the nine months ended 30 September 2015.

## OPERATING REVENUE

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

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

The Additional Gas sales volumes for both the quarter and Q3 2015 were below 50 MMcfd and, as a consequence, the Company was only entitled to a 40% share of Profit Gas revenue for the year as opposed to a 55% share when production is above 50 MMcfd (net of Cost Gas recoveries from revenue). See "Principal Terms of the Tanzanian PSA and Related Agreements."

The Company was allocated a total of 85% of the Songo Songo field net revenue in the quarter (Q3 2015: 75%). The increase in the allocation of net revenue is a consequence of the Offshore Development Program which enabled the Company to be entitled to the maximum cost gas allocation due to the increase in the cost pool.

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Gross sales revenue	20,284	21,315	57,457	58,597
Gross tariff for processing plant and pipeline infrastructure	(2,545)	(2,930)	(7,624)	(9,053)
Gross revenue after tariff ("field net revenue")	<b>17,739</b>	18,385	<b>49,833</b>	49,544
<i>Analysed as to:</i>				
Company Cost Gas	13,304	10,748	37,375	25,145
Company Profit Gas	1,774	3,055	4,983	9,760
Company operating revenue	15,078	13,803	42,358	34,905
TPDC share of revenue	2,661	4,582	7,475	14,639
	<b>17,739</b>	18,385	<b>49,833</b>	49,544

The Company's total revenues for the quarter and the nine months ended 30 September 2016, amounted to US\$17.7 million and US\$48.1 million, respectively, after adjusting the Company's operating revenues of US\$15.1 million and US\$42.4 million by:

- i) Adding US\$3.0 million and US\$6.7 million for income tax for the quarter and for the nine months ended 30 September 2016. The Company is liable for income tax in Tanzania, but the income tax is recoverable out of TPDC's Profit Gas when the tax is payable. To account for this, revenue is grossed up to include the current income tax charge of 30%; and,
- ii) Subtracting US\$0.3 million and US\$0.9 million for deferred Additional Profits Tax charged in the quarter and for the nine months ended 30 September 2016, respectively. This tax is considered a royalty and is presented as a reduction in revenue.

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

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Industrial sector	9,405	9,845	26,120	24,370
Power sector	10,879	11,470	31,337	34,227
<b>Gross sales revenue</b>	<b>20,284</b>	21,315	<b>57,457</b>	58,597
Processing and transportation tariff	(2,545)	(2,930)	(7,624)	(9,053)
Field net revenue	17,739	18,385	49,833	49,544
TPDC share of revenue	(2,661)	(4,582)	(7,475)	(14,639)
<b>Company operating revenue</b>	<b>15,078</b>	13,803	<b>42,358</b>	34,905
Additional Profits Tax charge	(329)	(593)	(925)	(2,020)
Current income tax adjustment	2,995	2,733	6,693	5,331
<b>Revenue</b>	<b>17,744</b>	15,943	<b>48,126</b>	38,216

The Company's gross sales revenue decreased by 5% to US\$20.3 million over the prior year quarter (Q3 2015: US\$21.3 million) resulting from a combination of a 1% increase in the weighted average sales price and a 13% reduction in sales volumes.

The Company's operating revenue increased 9% to US\$15.1 million compared with US\$13.8 million in Q3 2015. The increase is primarily due to the capital expenditures related to the Offshore Program which commenced in Q3 2015 and completed in Q1 2016. This entitled the Company to 75% of net revenue as Cost Gas in the quarter and the corresponding reduction in Profit Gas and a corresponding decrease in Profit Gas attributable to TPDC by 42%.

A recovery in the APT charge of US\$0.3 million, or 45%, for the quarter and US\$0.9 million, or 54%, for the nine months is a result of the fall in the effective rate from 20.7% to 18.6%.

The APT charge is based on the Company's share of Profit Gas which decreased to US\$1.8 million for Q3 2016 (Q3 2015: US\$3.1 million) and to US\$5.0 million for the nine months ending 30 September 2016 (nine months ending 30 September 2015: US\$9.8 million). The drop in Profit Gas is a direct result of the capital expenditure increasing Cost Gas.

## PROCESSING AND TRANSPORTATION TARIFF

Under the Re-Rating Agreement the Company effectively pays a tariff of US\$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US\$0.40/mcf for volumes above 90 MMcfd in addition to the regulated tariff of US\$0.59/mcf payable to Songas. The Re-Rating Agreement formally expired in 2013; without a new agreement there is a risk that Songas may choose not to operate the gas processing plant above 70 MMcfd. The tariff charge for the quarter was US\$2.5 million (Q3 2015: US\$2.9 million). The reduction in the tariff for the quarter and for the first nine months of the year is the result of lower volumes during the respective periods.

## PRODUCTION AND DISTRIBUTION EXPENSES

Well maintenance costs are allocated between Protected Gas and Additional Gas in proportion to their respective sales during the period. The total cost of maintenance for the quarter was US\$0.1 million (Q3 2015: US\$0.1 million). Amounts allocated for Additional Gas for the quarter were US\$0.1 million (Q3 2015: US\$0.1 million).

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

Distribution costs represent the direct cost of maintaining the ring main distribution pipeline and pressure reduction station (security, insurance and personnel). Ring main distribution costs were US\$0.7 million for the quarter (Q3 2015: US\$0.5 million). The production and distribution costs are detailed in the table below:

<i>US\$'000</i>	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Share of well maintenance	65	43	239	186
Other field and operating costs	112	440	714	1,343
	177	483	953	1,529
Ringmain distribution costs	724	459	2,051	1,412
<b>Production and distribution expenses</b>	<b>901</b>	942	<b>3,004</b>	2,941

## OPERATING NETBACKS

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

<i>US\$/mcf</i>	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Gas price – Industrial	7.60	7.67	7.77	7.57
Gas price – Power	3.57	3.62	3.56	3.53
<b>Weighted average price for gas</b>	<b>4.73</b>	4.66	<b>4.72</b>	4.49
Tariff	(0.59)	(0.69)	(0.63)	(0.71)
TPDC share of revenue	(0.62)	(1.08)	(0.61)	(1.15)
<b>Net selling price</b>	<b>3.52</b>	2.89	<b>3.48</b>	2.63
Well maintenance and other operating costs	(0.04)	(0.11)	(0.08)	(0.12)
Ring main distribution costs	(0.17)	(0.11)	(0.17)	(0.11)
<b>Operating netbacks</b>	<b>3.31</b>	2.67	<b>3.23</b>	2.40

The operating netback increased by 24% from US\$2.67/mcf in Q3 2015 to US\$3.31/mcf in Q3 2016. The primary reason for the increase was the 42% decrease in TPDC share of revenue as a consequence of an increase in the Cost Gas recovered, mainly as a result of the workover and drilling program that was completed in Q1 2016. In addition, there was a 2% increase in the weighted average sales from US\$4.66/mcf in Q3 2015 to US\$4.73/mcf in Q3 2016. The overall production and distribution cost averaged US\$0.21/mcf compared to US\$0.22 in Q3 2015.

## GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses are detailed in the table below:

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Employee and related costs	1,934	1,450	5,536	4,205
Stock based compensation	(80)	(1,118)	2,035	(157)
Office costs	738	776	2,301	2,450
Marketing and business development costs	87	67	280	208
Reporting, regulatory and corporate	387	530	1,297	2,204
<b>General and administrative expenses</b>	<b>3,066</b>	1,705	<b>11,449</b>	8,910

General and administrative expenses include the costs of running the natural gas distribution business in Tanzania which is recoverable as Cost Gas and is relatively fixed in nature. Excluding stock based compensation, general and administrative expenses averaged US\$1.0 million per month during the quarter (Q3 2015: US\$0.9 million).

## STOCK-BASED COMPENSATION

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

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Stock appreciation rights ("SARs")	(76)	(1,407)	1,029	(729)
Restricted stock units ("RSUs")	(4)	289	1,006	572
<b>Stock-based compensation</b>	<b>(80)</b>	(1,118)	<b>2,035</b>	(157)

No stock options were outstanding as at 30 September 2016 or 31 December 2015. No options were granted during the quarter (Q3 2015: nil).

As at 30 September 2016, a total of 2,650,000 SARs were outstanding compared to 3,100,000 as at 31 December 2015. A total of 300,000 SARs with an exercise price between CDN\$2.30 and CDN\$2.70 were exercised during Q2 2016, with a further 90,000 SARs with an exercise price of CDN\$2.30 being forfeited during the current quarter. A total of 147,059 RSUs were granted during Q2 2016 and 386,420 RSUs remained outstanding at 30 September 2016 (Q4 2015: nil). The RSUs vested on the date of grant have an exercise price of CDN\$ 0.001 and have a five-year term.

As SARs and RSUs are settled in cash, they are re-valued at each reporting date using the Black-Scholes option pricing model with the resulting liability being recognized in trade and other payables. In the valuation of stock appreciation rights and restricted stock units at the reporting date, the following assumptions have been made: a risk free rate of interest of 0.6%; stock volatility of 47.4% to 52.7%; 0% dividend yield; 5% forfeiture; and a closing price of CDN\$3.41 per Class B share.

As at 30 September 2016, a total accrued liability of US\$3.3 million (Q4 2015: US\$1.6 million) has been recognized in relation to SARs and RSUs. The Company recognized a credit of US\$0.1 million for the quarter (Q3 2015: credit US\$0.2 million).

## NET FINANCE EXPENSE

Net finance expense is detailed in the table below:

<i>US\$'000</i>	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Finance income	60	16	190	23
Interest expense	(1,548)	(266)	(4,101)	(266)
Net foreign exchange gain (loss)	107	(658)	(6)	(2,307)
Provision for doubtful accounts	(981)	(447)	(12,439)	(447)
Write off bad debt	(4)	–	(4)	–
Finance expense	(2,426)	(1,371)	(16,550)	(3,020)
<b>Net finance expense</b>	<b>(2,366)</b>	(1,355)	<b>(16,360)</b>	(2,997)

The Company billed TANESCO interest for late payments amounting to US\$1.1 million in Q3 2016 (Q3 2015: US\$0.6 million) and US\$3.0 million for the nine months ended 30 September 2016 (nine months ending 30 September 2015: US\$1.7 million). The interest income is not recorded in the financial statements because it does not meet the revenue recognition criteria with respect to assurance of collectability. The Company is pursuing collection and amounts will be recognized in earnings when collected. The provision for doubtful accounts for Q3 2016 of US\$1.0 million (Q3 2015: US\$ nil) and for the nine months ended 30 September 2016 of US\$12.4 million (nine months ended 30 September 2015: US\$ nil) relates to overdue TANESCO receivables.

The total amount of interest paid in Q3 2016 was US\$1.5 million (Q3 2015: US\$ nil) and US\$4.1 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015 US\$ nil). The interest relates to the long term loan with the IFC and is payable quarterly in arrears.

The foreign exchange loss reflects the impact of movements in the value of the Tanzanian shilling against the US dollar during the period on outstanding customer/supplier balances and bank accounts in Tanzanian shillings.

## TANESCO

As at 30 September 2016, TANESCO owed the Company US\$81.2 million excluding interest (of which arrears were US\$74.4 million) compared to US\$69.7 million (including arrears of US\$61.9 million) as at 31 December 2015. During the quarter, the Company received a total of US\$8.6 million (Q3 2015: US\$4.0 million) from TANESCO against sales totaling US\$10.2 million (Q3 2015: US\$10.4 million) and for the nine months ended 30 September 2016, the Company received a total of US\$18.8 million against sales totaling US\$30.3 million (nine months ending 30 September 2015 received a total of US\$34.1 million against sales totaling US\$45.8 million). Current TANESCO receivables as at 30 September 2016 amounted to US\$6.9 million (Q4 2015: US\$7.8 million). Since the quarter end, TANESCO has paid the Company US\$3.7 million, and as at the date of this report the total TANESCO receivable is US\$80.8 million (of which US\$74.3 million has been provided for). The amounts owed do not include interest billed to TANESCO.

Management concluded that the continued recognition of TANESCO revenue is appropriate. In arriving at this conclusion management has taken account of:

- Recent discussions with the World Bank, the IMF and IFC during which the Company found strong support for funding to be directed at TANESCO, supported by a recent visit by the World Bank to Tanzania to address the TANESCO debt.
- TANESCO, according to the World Bank, is now making a small profit. With the seasonal increase in available hydro power and new gas to power facilities coming on line later this year, the need for expensive liquid fuel should significantly reduce. Additionally, TANESCO has recently made an application for a tariff increase to ensure it is able to meet its current obligations.
- During the quarter, TANESCO and the GoT have reconfirmed the commitment to the Company to maintain weekly payments to cover current deliveries and to take action to resolve the TANESCO arrears. During the quarter TANESCO made regular weekly payments.
- The Company believes that given the recent statements and commitments made by the MEM, GoT and the World Bank, the TANESCO receivable will be reduced. However there still exists a high degree of uncertainty as to the actual timing of a conclusive arrangement between the GoT and the World Bank to address the TANESCO arrears and the amount of funds the Company will receive as a result of such arrangements.

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## 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 30 September 2016, there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes under the Income Tax Act 2004. Applying the 30% Tanzanian tax rate, the Company has recognized a deferred tax liability of US\$12.2 million (Q4 2015: US\$9.3 million). During the quarter there was a deferred tax charge of US\$1.0 million compared with US\$ nil in Q3 2015. 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 turns depends of the level of expenditure. The Company provides for APT by forecasting annually the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA. The forecast takes into account the timing of future development capital spending.

The Company provides for deferred APT by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA. The effective APT rate of 18.6% (Q3 2015: 20.7%) has been applied to Profit Gas of US\$1.8 million for the quarter (Q3 2015: US\$3.1 million) and US\$5.0 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015: US\$9.8 million). Accordingly, US\$0.3 million has been netted off revenue for the quarter (Q3 2015: US\$0.6 million) and US\$0.9 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015: US\$2.0 million).

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## DEPLETION AND DEPRECIATION

Natural gas properties are depleted using the unit of production method based on the production for the period as a percentage of the total future production from the Songo Songo proven reserves. As at 31 December 2015 the proven reserves estimated to have been produced over the term of the PSA licence, as evaluated by the independent reservoir engineers, McDaniel & Associates Consultants Ltd., were 368 Bcf (2014: 450 Bcf). A depletion expense of US\$2.4 million has been recorded for the quarter (Q3 2015: US\$3.1 million); the reduction compared to Q3 2015 is the result of 23% decrease in the average depletion rate to US\$0.56/mcf (Q3 2015: US\$0.73/mcf). The decrease in the depletion rate is the consequence of the successful completion of the Offshore Program at a lower level of expenditure than planned which in turn reduced expected future development costs from what had been originally forecast at the end of 2014. 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

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## 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 unlikely to be recovered in the future, they are impaired and recorded in earnings.

## FUNDS FLOW FROM OPERATING ACTIVITIES

Funds flow from operating activities before working capital changes were US\$11.6 million for the quarter (Q3 2015: US\$9.5 million) and US\$29.7 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015: US\$18.1 million)::

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
<b>Funds flow from operating activities</b>	<b>11,572</b>	9,462	<b>29,745</b>	18,063
Change in working capital <sup>(1)</sup>	<b>(5,032)</b>	(12,425)	<b>(18,122)</b>	(16,495)
<b>Net cash flows from (used in) operating activities</b>	<b>6,540</b>	(2,963)	<b>11,623</b>	1,568
Net cash used in investing activities	<b>(2,780)</b>	(7,801)	<b>(27,616)</b>	(10,411)
Net cash (used in) from financing activities	<b>(1,518)</b>	(101)	<b>35,698</b>	(158)
Increase (decrease) in cash	<b>2,242</b>	(10,865)	<b>19,705</b>	(9,001)
Effect of change in foreign exchange on cash	<b>31</b>	(123)	<b>577</b>	882
<b>Net increase (decrease) in cash</b>	<b>2,273</b>	(10,988)	<b>20,282</b>	(8,119)

(1) See Condensed Consolidated Interim Statements of Cash Flows (unaudited)

## CAPITAL EXPENDITURES

During the quarter the Company incurred no significant capital expenditures (Q3 2015: US\$8.3 million). The total capital expenditures for the nine months ended 30 September 2016 of US\$16.8 million are net of recharges of US\$1.0 million to Songas for its share of costs on wells SS-5 and SS-9 following the completion of the Offshore Program.

US\$'000	THREE MONTHS ENDED 30 SEPTEMBER		NINE MONTHS ENDED 30 SEPTEMBER	
	2016	2015	2016	2015
Geological and geophysical and well drilling	<b>26</b>	7,578	<b>16,223</b>	12,697
Pipelines and infrastructure	<b>(71)</b>	547	<b>466</b>	977
Other equipment	<b>–</b>	150	<b>104</b>	197
	<b>(45)</b>	8,275	<b>16,793</b>	13,871

## WORKING CAPITAL

Working capital as at 30 September 2016 was US\$67.6 million (Q4 2015: US\$32.5 million) and is detailed in the table below:

US\$'000	AS AT	
	30 SEPTEMBER 2016	31 DECEMBER 2015
Cash	<b>74,079</b>	53,797
Trade and other receivables	<b>29,406</b>	25,391
TANESCO	6,881	7,831
Songas	3,447	2,178
Industrial customers	6,857	6,894
Songas gas plant operations	6,153	5,631
Songas well workover program	14,458	11,209
Other receivables	1,566	1,604
Provision for doubtful accounts	(9,956)	(9,956)
Tax recoverable	<b>4,371</b>	4,519
Prepayments	<b>634</b>	1,118
	<b>108,490</b>	84,825
Trade and other payables	<b>38,482</b>	49,531
TPDC share of Profit Gas <sup>(1)</sup>	28,542	28,208
Songas	969	1,071
Other trade payables	2,535	11,234
Deferred income	667	667
Accrued liabilities	5,769	8,351
Tax payable	<b>2,373</b>	2,773
<b>Working capital <sup>(2)</sup></b>	<b>67,635</b>	32,521

### Notes:

(1) Payable to TPDC for their share of profit gas reflects the total accrued liability based on gas delivered to TANESCO which has not been paid for. Settlement of this liability is dependent on receipt of payment from TANESCO.

(2) Working capital as at 30 September 2016 includes a TANESCO receivable (excluding interest) of US\$6.9 million (31 December 2015: US\$7.8 million). Management has recorded a provision for doubtful accounts against the long-term receivables in excess of 60 days totaling US\$74.4 million (31 December 2015: US\$61.9 million). The total of long and short-term TANESCO receivables, excluding interest, as at 30 September 2016 was US\$81.2 million (31 December 2015: US\$ 69.7 million). The financial statements do not recognize the interest receivable from TANESCO as it does not meet IAS 18 income recognition criteria. The Company is however actively pursuing the collection of all the receivables and the interest that has been charged to TANESCO.

Working capital as at 30 September 2016 increased by 108% over 31 December 2015, primarily as a result of having drawn down the balance of the loan from the IFC and the reclassification of a further US\$12.4 million of TANESCO receivables as long-term. Other significant points are:

- There are no restrictions on the movement of cash from Mauritius or Tanzania, and as at the date of this report, approximately 83% of cash is held outside of Tanzania.
- Since the quarter end the Company has received US\$3.7 million from TANESCO and US\$3.1 million from Songas.
- Of the US\$6.9 million receivable relating to industrial customers, US\$5.4 million had been received as at the date of this report.

The balance of US\$28.5 million payable to TPDC represents the remaining balance of its accrued share of revenue as at 30 September 2016. The settlement of this liability is dependent on receipts of payment from TANESCO.

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## LONG TERM LOAN

On 29 October 2015, the Company entered into an agreement with the IFC, a member of the World Bank Group, to provide financing of up to US\$60 million for the Company's operating subsidiary, PAET. The Company has drawn the US\$60 million Loan facility in full, with an initial drawdown of US\$20 million on 14 December 2015 followed by an additional draw down of US\$40 million on 9 February 2016.

The term of the Loan is 10-years, with no required repayment of principal for the first seven years, followed by a three-year amortization period. The Loan is to be paid out through six semi-annual payments of US\$5 million and one final payment of US\$30 million. The Company may voluntarily prepay all or part of the Loan but must simultaneously pay any accrued base interest costs related to the principal amount being prepaid. If any portion of the Loan is prepaid prior to the fourth anniversary of the first drawdown, the Company would be required to pay the accrued base interest as if the prepaid portion of the Loan had remained outstanding for the full four years. The Loan is an unsecured subordinated obligation of PAET and is guaranteed by the Company to a maximum of US\$30 million. The guarantee may only be called upon by IFC at maturity in 2025. Subject to receipt of IFC and required regulatory approvals, the Company may issue shares in fulfillment of all or part of the guarantee obligation in 2025.

Base interest on the Loan is payable quarterly at 10% per annum on a 'pay-if-you-can-basis' using a formula to calculate the net cash available for such payments as at any given interest payment date. The Company must provide notice to the IFC of the amount of any interest which is not to be paid on any interest payment date the unpaid interest is added to the principal outstanding and may be paid out before or at the time of principal repayment. In addition, an annual variable participatory interest equating to 7% of the cash flow of PAET net of capital expenditures is payable in respect of any given year, commencing with 2016. The participatory interest survives the repayment and/or maturity of the Loan until 15 October 2026. No provision has been made for the three and nine months ended 30 September 2016 as the projection of current cash flow less capital expenditures for 2016 is a negative amount. Dividends and distributions from PAET to the Company are restricted at any time that amounts of unpaid interest, principal or participating interest are outstanding.

## SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

There were 34,856,432 shares outstanding as at 30 September 2016 as detailed in the table below:

<i>Number of shares ('000)</i>	AS AT	
	<b>30 SEPTEMBER 2016</b>	31 DECEMBER 2015
<b>Shares outstanding</b>		
Class A shares	<b>1,751</b>	1,751
Class B shares	<b>33,106</b>	33,106
Class A and Class B shares outstanding	<b>34,857</b>	34,857
<b>Weighted average</b>		
Class A and Class B shares	<b>34,857</b>	34,889
<b>Convertible securities</b>		
Options	–	–
<b>Weighted average diluted Class A and Class B shares</b>	<b>34,857</b>	34,889

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

## RELATED PARTY TRANSACTIONS

One of the non-executive Directors is counsel with a law firm that provides legal advice to the Company and its subsidiaries. During the quarter, the Company incurred US\$0.01 million (Q3 2015: US\$0.2 million) and US\$0.1 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015 US\$0.4 million) to this firm for services provided.

One officer, acting as an Executive Vice-President, provided services to the Company through a consulting agreement with a personnel services company. During the quarter, the Company incurred US\$0.1 million (Q3 2015: US\$0.1 million) and US\$0.2 million for the nine months ended 30 September 2016 (nine months ended 30 September 2015: US\$0.3 million) to this firm for services provided.

As at 30 September 2016, the Company has a total of US\$ nil (30 September 2015: US\$0.2million) recorded in trade and other payables in relation to the related parties.

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## CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

### **Protected Gas**

Under the terms of the original Gas Agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, the Company is liable to pay the difference between the price of Protected Gas (US\$0.55/MMbtu escalated) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (163.5 Bcf as at 30 September 2016). The Company did not have a shortfall during the reporting period and does not anticipate a shortfall arising during the term of the Protected Gas delivery obligation to July 2024.

### **Re-Rating Agreement**

In 2011, the Company signed a re-rating agreement with TANESCO and Songas (the "Re-Rating Agreement") to increase the gas processing capacity to a maximum of 110 MMcfd (the pipeline and pressure requirements at the Ubungu power plant restrict the infrastructure capacity to a maximum of 102 MMcfd). Under the terms of the Re-Rating Agreement, the Company effectively pays an additional tariff of US\$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US\$0.40/mcf for volumes above 90 MMcfd in addition to the tariff of US\$0.59/mcf payable to Songas as set by the energy regulator, EWURA. The Re-Rating agreement expired in 2013. Since the formal expiry of the agreement, production has continued within the higher rated limit and, given the Government's interest in pursuing further development and increasing gas production, the Company expects this to continue. However, there are no certainty that this will occur.

Under the terms of this agreement, the Company agreed to indemnify Songas for damage to its facilities caused by the re-rating, up to a maximum of US\$15 million, but only to the extent that this was not already covered by indemnities from TANESCO's or Songas' insurance policies.

### **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.

Given the completion of the Offshore component of Phase I of the Development Program in February 2016, which has restored field deliverability and provides sufficient natural gas production to fill the Songas plant and pipeline to capacity for the greater portion of the remaining life of the production licence, the Company does not expect to commit to further significant capital expenditures until: (i) agreeing commercial terms with TPDC for the supply of gas to the NNGIP regarding the sale of incremental gas volumes from Songo Songo; and/or (ii) TANESCO arrears have been substantially reduced, guaranteed or other arrangements for payment made which are satisfactory to the Company; and/or (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any new sales contracts with Government entities.

When conditions are deemed appropriate and there is justification to further improve the reliability/capacity of field deliverability, the Company may contemplate undertaking the remaining part or all of the Phase I Development Program which includes the tie-in of well SS12 to the NNGIP, on-shore work-overs of wells SS-3, SS-4 and SS-10 and installation of refrigeration and compression equipment. The additional costs are estimated to be approximately US\$30 million.

### **Italy**

The Company has an agreement to farm in on the Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US\$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US\$0.5 million. Changes in Italian environmental legislation in late 2015 have resulted in the development of this permit being postponed and until the development permit is approved, the Company has no further capital commitments in Italy.

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## CONTINGENCIES

### **The Petroleum Act, 2015**

During the third quarter of 2015, The Petroleum Act, 2015 was passed into law. The 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 Act also provides for the creation of an upstream regulator, the Petroleum Upstream Regulatory (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 bill 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 bill vests TPDC with exclusive rights in the entire petroleum upstream value chain and the natural gas mid and downstream value chain. However, the exclusive rights of TPDC do not extend to mid and downstream petroleum supply operations. The Company is uncertain regarding the potential impact on its business in Tanzania. The Act does provide grandfathering provisions upholding the rights of the Company under their PSA as it was signed prior to passing of the Act. However, it is still unclear how the provisions of the Act will be interpreted and implemented regarding upstream and downstream activities.

### **Cost recovery**

TPDC conducted an audit of the historic Cost Pool and in 2011 disputed approximately US\$34 million of costs that had been recovered from the Cost Pool from 2002 through to 2009. In 2014 TPDC and the Company agreed to remove approximately US\$1.0 million from the Cost Pool and TPDC agreed that US\$9.4 million was no longer in dispute. There have been no further developments during 2015 or the first three quarters of 2016. 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. At the time of writing this report no such specialist has been appointed.

## Taxation

Area	Period	Tax dispute Reason for dispute	Disputed amount US\$' million		
			Principal	Interest	Total
PAYE	2008-10	Pay-As-You-Earn ("PAYE") withholding tax on taxable income of employees on grossed up equivalent of staff salaries, which are contractually stated as net.	0.3	-	0.3 <sup>(1)</sup>
WHT	2005-10	WHT on services by non-resident persons performed outside of Tanzania.	1.1	0.7	1.8 <sup>(2)</sup>
Income Tax	2008-13	Deductibility of capital expenditures and expenses (2009 and 2012), additional income tax (2008, 2010, 2011 and 2012), tax on repatriated income (2012), foreign exchange rate application (2013 and 2015) and underestimation of tax due (2014).	16.8	10.1	26.9 <sup>(3)</sup>
VAT	2008-10	Output VAT on imported services and SSI Operatorship services.	2.7	2.9	5.6 <sup>(4)</sup>
			20.9	13.7	34.6

(1) During 2015, PAET appealed the Tax Revenue Appeals Board ("TRAB") ruling that PAET is liable to pay PAYE on grossed up equivalent of staff salaries. PAET is awaiting appeal date to be set up with the Tax Revenue Appeals Tribunal ("TRAT");

(2) 2005-2009 (US\$1.8 million): During Q2 2016, the Court of Appeal TRAT ruled in favor of PAET. During Q3 2016, TRA has filed an application for review of the case and later filed another application for leave to amend its earlier application. PAET is awaiting a review date to be set up by the Court of Appeal;

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

(3) (a) 2009 (US\$1.8 million): During 2015, TRAB ruled against PAET with respect to the deductibility of capital expenditures and other expenses. PAET appealed to TRAT and is awaiting a hearing date to be scheduled;

(b) 2008, 2010-2011 (US\$4.7 million): During 2015, PAET filed objections against TRA assessments with respect to the deductibility of capital expenditures and other expenses as well as underestimation of interest and is awaiting a response. Subsequent to the end of Q3 2016, PAET received an amended assessment with respect to deductibility of capital allowance for 2010, increasing the total assessment by US\$0.2 million. PAET is preparing to appeal the assessment at TRAB;

(c) 2013 (US\$0.2 million): During 2015, PAET filed objections to TRA assessment with respect to foreign exchange rate application and is awaiting a response;

(d) 2012 (US\$16.3 million): During Q2 2016, TRA issued two assessments with respect to understated revenue, deductibility of capital expenditures and expenses, and tax on repatriated income. During Q3 2016, PAET filed objections to these assessments and is awaiting a response;

(e) 2014 (US\$3.5 million): During Q3 2016, TRA issued an assessment with respect to underestimation of tax due based on the provisional quarterly payments made by PAET, delayed filings of returns and late payments. PAET filed objections to the assessments and is awaiting a response;

(f) 2015 (US\$0.4 million): During Q3 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;

The PSA provides a mechanism by which income tax payable is eligible for recovery through increasing profit share allocations to the Company. The total income tax assessments by the TRA increased by US\$0.6 million from Q2 2016.

(4) In 2014, PAET filed an objection to TRA's claims and is awaiting a response.

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

## SUMMARY QUARTERLY RESULTS OUTSTANDING

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

<i>Figures in US\$'000 except where otherwise stated</i>	2016			2015			2014	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Financial</b>								
Revenue	<b>17,744</b>	14,572	15,810	15,872	15,943	12,553	9,720	9,645
Net income (loss)	<b>5,302</b>	1,452	(5,638)	(6,468)	6,112	3,566	(1,677)	(46,381)
Earnings (loss) per share – basic and diluted (US\$)	<b>0.15</b>	0.04	(0.16)	(0.19)	0.18	0.1	(0.05)	(1.32)
Funds flow from operating activities	<b>11,572</b>	8,320	9,853	8,508	9,462	4,889	3,712	8,733
Funds flow per share – basic and diluted (US\$)	<b>0.33</b>	0.24	0.28	0.24	0.27	0.14	0.11	0.25
Cash flow from (used in) operating activities	<b>6,540</b>	6,237	(1,154)	5,450	(2,963)	(2,844)	7,375	(2,235)
Cash flows (utilized) per share – basic and diluted (US\$)	<b>0.19</b>	0.18	(0.03)	0.16	(0.08)	(0.08)	0.21	(0.06)
Operating netback (US\$/mcf)	<b>3.31</b>	3.32	3.08	3.03	2.65	2.68	1.86	1.69
Working capital	<b>67,635</b>	58,395	56,340	32,521	39,660	38,067	34,870	34,148
Long-term loan	<b>58,398</b>	58,368	58,350	18,599	–	–	–	–
Shareholders' equity	<b>79,153</b>	73,887	72,482	78,154	84,476	78,480	74,944	76,635

### Capital expenditures

Geological and geophysical and well drilling	<b>26</b>	2,558	13,639	23,099	7,578	4,135	984	522
Pipeline and infrastructure	<b>(71)</b>	181	356	1,382	547	275	155	193
Other equipment	<b>–</b>	102	2	59	150	47	–	3

### Operating

Additional Gas sold – industrial (MMcfd)	<b>1,238</b>	1,151	972	1,089	1,137	1,015	925	1,084
– industrial (MMcfd)	<b>13.5</b>	12.6	10.7	11.8	11.9	11.1	10.3	11.8
Additional Gas sold – power (MMcfd)	<b>3,047</b>	2,521	3,241	3,483	3,127	3,041	3,494	3,377
– power (MMcfd)	<b>33.1</b>	27.7	35.6	37.9	34.5	33.4	38.8	36.7
Average price per mcf – industrial (US\$)	<b>7.60</b>	7.64	8.15	7.62	7.67	7.45	7.54	8.24
Average price per mcf – power (US\$)	<b>3.57</b>	3.55	3.55	3.56	3.62	3.47	3.49	3.49

## PRIOR EIGHT QUARTERS

The Company's revenue for the last two years has fluctuated between quarters due to several factors including seasonal issues such as the availability of hydro power, scheduled and unscheduled maintenance by customers resulting in reduced demand, declining well production capacity, a drop in world HFO prices and increased competition for supply of gas within Tanzania.

The drop in sales in Q4 2014 saw the Company's share of Profit Gas drop from 55% to 40% (see "Principal Terms of the Tanzanian PSA and Related Agreements") as the volumes of Additional Gas sold were below 50 MMcfd, where it has remained for the last six quarters. The increase in revenue from Q2 2015 is directly related to the capital expenditure program which has permitted the Company to take a significantly increased share of revenue as Cost Gas, with the underlying sales volumes remaining fairly static from Q2 2015 to Q3 2016.

Changes in net income over the last two years have negatively impacted by the impairment provisions relating to TANESCO. In Q4 2014 the Company recorded a US\$52.2 million doubtful debt provision against TANESCO arrears. In Q4 2015, Q1 2016 and Q2 2016 and Q3 2016 additional doubtful debt provisions of US\$9.8 million, US\$8.0 million, US\$3.5 million and US\$1.0 million respectively were provided against increased TANESCO arrears. Other significant factors affecting the results were:

- The collapse of the Tanzanian Shilling led to a Q4 2014 exchange loss of US\$4.8 million and a further loss of US\$1.8 million in Q1 2015.
- In Q4 2014 the Company wrote off US\$5.1 million relating to site survey costs for an exploration well which it no longer plans to drill.
- In Q1 2016 the Company took a charge of US\$2.8 million for stock based compensation as a consequence of the share price closing at CDN\$4.14 compared to CDN\$2.75 at the end of Q4 2015 together with the issuance of new Restrictive Stock Units.
- In Q2 2016 the Company had a decrease in the stock based compensation charge of US\$0.7 million as the share price closed at CN\$3.40 at the end of the quarter.
- In Q3 2016 the Company recorded a credit of US\$0.1 million for stock based compensation compared to a credit of US\$1.1 million in Q3 2015. The Company recorded an interest expense of US\$1.0 million in Q1 2016 and US\$1.5 million in Q2 and Q3 2016 in relation to the loan from the IFC.

Funds flow from operations for the last four quarters has been fairly steady. Differences between quarters were primarily a result of changes in revenue during the periods. The increase in the funds flow from operations to US\$11.6 million in Q3 2016 from US\$8.3 million in Q2 2016 is primarily the result of the US\$3.3 million increase in revenue over the quarter. In Q2 and Q1 of 2015, funds flow decreased reflecting the drop in revenue during these periods due to declining well production and lower Cost Pool levels reducing the Company's share of revenues. In Q4 2014, there was a large allowance for doubtful accounts taken against the TANESCO receivable which significantly increased funds flow from operations in comparison to the revenue for the period.

Changes in cash flow from (used in) operations between quarters were primarily a result of the timing of receipt of payments from TANESCO.

The decrease in working capital from Q3 2015 to Q4 2015 was a consequence of the increase in creditors associated with the workover and drilling program together with the additional bad debt provision against TANESCO, both of which were offset by the initial draw down of US\$18.6 million from the IFC (net of expenses). The second draw down from the IFC of US\$40 million in Q1 2016 has offset the decrease in working capital associated with the completion of the workover and drilling program from Q4 2015 to Q1 2016.

Capital expenditure for the last four quarters Q4 2015 to Q3 2016 has amounted to US\$41.3 million compared to US\$14.6 million from Q4 2014 to Q3 2015. The 2015 workover and drilling program commenced in Q3 2015 with some preliminary expenditure in Q2 2015.

The level of Industrial volumes increased in the four quarters ending Q3 2016 to an average of 1,113 MMcf from an average of 1,040 MMcf for the four quarters ending Q3 2015. Overall for the past eight quarters, the level of industrial sales has remained static.

The level of Power volumes decreased by 6% in the in the four quarters ending Q3 2016 to an average of 3,073 MMcf from an average of 3,260 MMcf for the four quarters ending Q3 2015, the decline is mainly the consequence of the decision by TANESCO not to renew a contract with an emergency power plant, unscheduled maintenance at the Songo Ubungo Power generation facility and the increased competition for supply of gas within Tanzania.