Q3 2020 INTERIM FINANCIAL STATEMENTS AND NOTES

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

		Three months ended September 30		Nine months ended September 30	
$'000	Note	2020	2019	2020	2019
Revenue	6, 7	**20,859**	21,453	**55,894**	62,383
Production, distribution and transportation		**3,034**	2,894	**8,384**	8,385
Net production revenue		**17,825**	18,559	**47,510**	53,998
Operating expenses					
General and administrative		**3,778**	3,777	**10,465**	10,839
Stock based compensation (recovery) expense	14	**(82)**	814	**247**	1,741
Depletion	10	**3,931**	3,688	**10,752**	10,439
Finance income	8	**(1,752)**	(779)	**(18,498)**	(5,710)
Finance expense	8	**6,540**	2,697	**12,028**	7,933
Income before tax		**5,410**	8,362	**32,516**	28,756
Income tax expense – current		**1,589**	3,118	**6,568**	8,910
Income tax expense – deferred		**859**	178	**1,060**	1,103
Additional Profits Tax		**937**	2,116	**3,465**	5,283
Net income		**2,025**	2,950	**21,423**	13,460
Net income attributable to non-controlling interest		**538**	367	**1,037**	1,105
Net income attributable to shareholders		**1,487**	2,583	**20,386**	12,355
Foreign currency translation (gain) loss from foreign operations		**(11)**	25	**11**	30
Comprehensive income		**1,498**	2,558	**20,375**	12,325
Net income attributable to shareholders per share ($)					
Basic and diluted	15	**0.06**	0.07	**0.72**	0.35

See accompanying notes to the condensed consolidated interim financial statements.

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 nine month periods ended September 30, 2020.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

$'000	Note	As at September 30, 2020	As at December 31, 2019
ASSETS			
Current assets			
Cash and cash equivalents		**98,534**	93,899
Investment in short-term bonds	8	**–**	44,756
Trade and other receivables	9	**21,751**	22,167
Prepayments		**4,728**	6,752
		125,013	167,574
Non-current assets			
Long-term receivables	12	**2,214**	2,250
Investments	20	**3,967**	3,967
Capital assets	10	**97,435**	97,981
		103,616	104,198
Total assets		**228,629**	271,772
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	11	**34,188**	48,161
Tax payable		**1,930**	501
Current portion of Additional Profits Tax		**9,659**	11,940
		45,777	60,602
Non-current liabilities			
Deferred income taxes		**16,214**	15,153
Lease liabilities	10	**614**	1,129
Long-term loan	13	**54,191**	54,057
Additional Profits Tax		**26,072**	32,264
		97,091	102,603
Total liabilities		**142,868**	163,205
SHAREHOLDERS' EQUITY			
Capital stock	14	**63,243**	84,099
Contributed surplus		**–**	4,181
Accumulated other comprehensive loss		**(221)**	(210)
Accumulated income		**21,539**	20,334
Non-controlling interest	20	**1,200**	163
		85,761	108,567
Total equity and liabilities		**228,629**	271,772

See accompanying notes to the condensed consolidated interim financial statements.

Nature of operations (Note 1); Contractual obligations and committed capital investments (Note 17); Contingencies (Note 18).

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS (UNAUDITED)

		Three months ended September 30		Nine months ended September 30	
$'000	Note	2020	2019	2020	2019
OPERATING ACTIVITIES					
Net income		**2,025**	2,950	**21,423**	13,460
Adjustment for:					
Depletion and depreciation	10	**4,068**	3,757	**11,159**	10,649
Loss on disposal of lease		**293**	–	**293**	–
Indirect tax	8	**201**	323	**1,670**	995
Stock based compensation (recovery) expense	14	**(82)**	814	**247**	1,741
Deferred income taxes		**859**	178	**1,060**	1,103
Additional Profits Tax		**937**	2,116	**3,465**	5,283
Finance expense	8	**5,337**	–	**5,337**	–
Unrealized (gain) loss on foreign exchange		**(224)**	42	**(385)**	1
Interest expense	8	**1,361**	2,279	**5,517**	6,658
Change in non-cash working capital	19	**(1,982)**	(4,856)	**(22,650)**	(10,068)
Net cash flows from operating activities		**12,793**	7,603	**27,136**	29,822
INVESTING ACTIVITIES					
Capital expenditures	10	**(9,412)**	(652)	**(10,906)**	(3,157)
Change in non-cash working capital	19	**(202)**	(328)	**(7)**	(71)
Net cash used in investing activities		**(9,614)**	(980)	**(10,913)**	(3,228)
FINANCING ACTIVITIES					
Lease payments		**(396)**	(35)	**(621)**	(105)
Substantial issuer bid	14	**–**	–	**(38,170)**	–
Normal course issuer bid	14	**(302)**	(4,413)	**(2,149)**	(4,413)
Investment in short-term bonds, net	8	**4,963**	20,116	**44,756**	(9,692)
Interest paid	8	**(3,738)**	(1,579)	**(6,632)**	(6,950)
Finance expense	8	**(5,337)**	–	**(5,337)**	–
Dividends paid to shareholders	14	**(1,158)**	(1,611)	**(3,869)**	(2,924)
Dividends paid to non-controlling interest		**–**	–	**–**	(952)
Net cash (used in) from financing activities		**(5,968)**	12,478	**(12,022)**	(25,036)
(Decrease) increase in cash and cash equivalents		**(2,789)**	19,101	**4,201**	1,558
Cash and cash equivalents at the beginning of the period		**101,113**	47,100	**93,899**	64,660
Effect of change in foreign exchange on cash for the period		**210**	(3)	**434**	(20)
Cash and cash equivalents at the end of the period		**98,534**	66,198	**98,534**	66,198

See accompanying notes to the condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

$'000	Capital stock	Contributed surplus	Accumulated other comprehensive loss	Accumulated income	Non-controlling interest	Total
Note	*14*			*14*	*20*	
Balance as at December 31, 2019	84,099	4,181	(210)	20,334	163	108,567
Share repurchase	(20,856)	(4,181)	–	(14,460)	–	(39,497)
Share repurchase costs	–	–	–	(822)	–	(822)
Dividends declared	–	–	–	(3,899)	–	(3,899)
Foreign currency translation adjustment on foreign operations	–	–	(11)	–	–	(11)
Net income	–	–	–	20,386	1,037	21,423
Balance as at September 30, 2020	**63,243**	**–**	**(221)**	**21,539**	**1,200**	**85,761**

$'000	Capital stock	Contributed surplus	Accumulated other comprehensive loss	Accumulated income	Non-controlling interest	Total
Note	*14*			*14*	*20*	
Balance as at December 31, 2018	86,508	6,319	(248)	652	471	93,702
Share repurchase	(2,314)	(2,099)	–	–	–	(4,413)
Dividends declared	–	–	–	(4,476)	–	(4,476)
Foreign currency translation adjustment on foreign operations	–	–	(30)	–	–	(30)
Net income	–	–	–	12,379	1,105	13,484
Non-controlling interest dividend declared and paid	–	–	–	–	(952)	(952)
Balance as at September 30, 2019	84,194	4,220	(278)	8,555	624	97,315

See accompanying notes to the condensed consolidated interim financial statements.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

General Information

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

The condensed consolidated interim financial statements of the Company as at September 30, 2020 and for the three and nine months ended September 30, 2020 comprise the accounts of the Company and its subsidiaries (collectively, the "Company") and were authorized for issue in accordance with a resolution of the directors on November 18, 2020.

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 ("Songas Infrastructure"). 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 Electric Supply Company Limited ("TANESCO") is a parastatal organization which is wholly-owned by the GoT, with oversight by the Ministry of Energy ("MoE"). TANESCO is responsible for the majority of electricity generation, transmission and distribution 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 and Additional Gas to TPDC who in turn generate and sell power to TANESCO.

The Company delivers gas to TPDC through a long-term gas sales agreement ("LTGSA") signed in 2019 to the TPDC operated National Natural Gas Infrastructure ("NNGI") on Songo Songo Island where the natural gas is processed before being transported to Dar es Salaam for power and industrial use.

In addition to gas supplied to TPDC, Songas and TANESCO, the Company has developed and supplies an industrial gas market in the Dar es Salaam area.

2. Basis of Preparation

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, 2019.

Basis of Measurement

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 United States dollars ("$") unless otherwise stated.

COVID-19

In the nine-month period ended September 30, 2020 global oil prices declined significantly as a result of reduced demand driven by the recent coronavirus pandemic ("COVID-19") and concerns of excess supply resulting from failed negotiations between OPEC and other countries. As of now, there remains a considerable uncertainty regarding the duration and extent of oil demand destruction from the COVID-19 pandemic. Although the Company's production and reserves are entirely comprised of gas, the current challenging economic climate has the potential to have significant adverse impacts on the Company, including, but not limited to:

- potential material declines in revenue and cash flows due to reduced commodity prices,
- potential declines in future revenue, which could result in increased impairment charges on long-term assets,
- potential increased risk of non-performance by the Company's customers which could materially increase collection risk of accounts receivable and customer defaults on contracts, and
- potential prolonged demand reduction which could negatively impact the Company's ability to maintain liquidity.

There has been a small decrease in Industrial sales but no significant impact on Company operations to date due to COVID-19 however the current situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company are not known at this time. Estimates and judgments made by management in the preparation of these consolidated financial statements are subject to a higher degree of measurement uncertainty during this volatile period.

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, 2019. There have been no changes in accounting policies for the three and nine month periods ended September 30, 2020 and the policies have been applied consistently to all periods presented in the condensed consolidated interim financial statements except as described below.

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 "Business Combinations". The amendments are intended to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. IFRS 3 continues to adopt a market participant's perspective to determine whether an acquired set of activities and assets is a business. The amendments clarify the minimum requirements for a business; remove the assessment of whether market participants are capable of replacing any missing elements; add guidance to help entities assess whether an acquired process is substantive; narrow the definitions of a business and of outputs; and introduce an optional fair value concentration test. The concentration test is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The amendments to IFRS 3 are effective for annual reporting periods beginning on or after January 1, 2020 and apply prospectively and have had no impact on the Company.

4. Use of Estimates and Judgments

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 judgments 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, 2019.

See Note 4 of the audited consolidated financial statements for the year ended December 31, 2019 for a full discussion.

5. Risk Management

The Company, by virtue of 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, Songas and TPDC. The carrying amount of accounts receivable and the long-term receivable represents the maximum credit exposure. As at September 30, 2020 and December 31, 2019, provisions exist against all of the long-term TANESCO receivable, gas plant operations and capital expenditure receivables from Songas and a receivable of $0.5 million from one industrial customer. No write-off of any customer receivables occurred in Q3 2020 (see Note 9).

The Company manages the credit exposure related to cash and cash equivalents by selecting counterparties based on credit ratings, monitoring all investments to ensure a stable return and by 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. At September 30, 2020 the Company has working capital of $79.2 million which is net of $45.8 million of financial liabilities with regards to trade and other payables of which $20.8 million is due within one to three months, $ nil is due within three to six months, and $25.0 million is due within six to twelve months (see current liabilities on the Consolidated Interim Statements of Financial Position).

As at September 30, 2020 approximately 45% of the current liabilities relate to TPDC. 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 substantial 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.

COVID 19 has reduced travel throughout the world in 2020. Tourism is a major source of revenue and foreign currency for Tanzania and the decrease in travel has resulted in a reduction of foreign currency flowing into the country. It has been more difficult for the Company in 2020 to convert Tanzanian shillings to United States dollars compared to prior years, however, as at the date of this report, this has not significantly impacted the PAET's ability to meet its United States dollar obligations. There is a risk that in the future the Company may not be able to convert Tanzanian shillings to United States dollars as and when required.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

6. Segment Information

The Company has one reportable industry segment which is international exploration, development and production of petroleum and natural gas. During 2020 and 2019 the Company's producing and exploration assets were entirely located in Tanzania. In 2019 the Company relinquished exploration and appraisal interests in Italy and the companies used for the Italian operations were wound up in Q2 2020.

7. Revenue

	Three months ended September 30		Nine months ended September 30	
$'000	2020	2019	2020	2019
Industrial sector	**9,145**	10,848	**25,896**	29,156
Power sector	**15,143**	15,490	**40,920**	44,084
Gross field revenue	**24,288**	26,338	**66,816**	73,240
TPDC share of revenue	**(4,559)**	(8,807)	**(16,863)**	(21,987)
Company operating revenue	**19,729**	17,531	**49,953**	51,253
Current income tax adjustment	**1,130**	3,922	**5,941**	11,130
	20,859	21,453	**55,894**	62,383

The Company recognized 100% of amounts invoiced for deliveries to TANESCO as revenue during the first nine months of 2019 and 2020. During Q3 2020 the Company invoiced TANESCO $5.9 million (Q3 2019: $12.9 million) for gas deliveries and received $7.5 million (Q3 2019: $13.7 million) in payments. Based on the consistent payments from TANESCO, the Company: (i) recognized all amounts invoiced for gas deliveries in Q3 2020 as revenue; and (ii) recognized $1.6 million during the quarter (Q3 2019: $ nil) as finance income relating to the amounts collected during the quarter that were applied towards the long-term TANESCO receivables previously provided for (see Note 8).

8. Finance Income and Expense

Finance Income

	Three months ended September 30		Nine months ended September 30	
$'000	2020	2019	2020	2019
Interest income	**185**	214	**720**	429
Investment income	**–**	565	**305**	1,783
Reversal of provision for doubtful accounts	**1,567**	–	**17,473**	3,498
	1,752	779	**18,498**	5,710

The reversal of the provision for doubtful accounts of $1.6 million (Q3 2019: $ nil) follows collection of TANESCO long-term arrears which had been previously provided for and represents the excess of receipts over invoices for gas delivered during Q3 2020 (see Notes 7 and 9).

At September 30, 2020 the Company did not have investments in short-term bonds (December 31, 2019: $44.8 million invested with maturity dates from February 2020 to July 2020 and a range of interest rates from 1.375% to 2.75%). The $0.3 million investment income for the nine months ended September 30, 2020 (nine months ended September 30, 2019: $1.8 million) includes interest earned of $0.3 million (nine months ended September 30, 2019: $1.1 million) and amortization of the discount on the acquisition of the bonds of $ nil (nine months ended September 30, 2019: $0.7 million).

Finance Expense

	Three months ended September 30		Nine months ended September 30	
$'000	2020	2019	2020	2019
Base interest expense	**1,469**	1,579	**4,363**	4,683
Participation interest (recovery) expense	**(132)**	692	**1,082**	1,951
Lease interest expense	**24**	8	**72**	24
Interest expense	**1,361**	2,279	**5,517**	6,658
Net foreign exchange (gain) loss	**(359)**	95	**(496)**	280
Indirect tax	**201**	323	**1,670**	995
Impairment of receivable	**5,337**	–	**5,337**	–
	6,540	2,697	**12,028**	7,933

8. Finance Income and Expense continued

Base interest expense and participation interest expense relate to the long-term loan (the "Loan") with the International Finance Corporation ("IFC"). Base interest on the Loan is payable quarterly in arrears 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 participation interest expense is paid annually in arrears and equates to 6.4% of PAET's net cash flows from operating activities net of net cash flows used in investing activities for the year. The participation interest will continue until October 15, 2026 regardless of whether the Loan is repaid prior to its contractual maturity date.

The indirect tax is for VAT associated with invoices to TANESCO under the take or pay provisions within the PGSA and for interest on late payments.

Impairment of receivable is for a receivable from the Tanzanian Revenue Authority ("TRA") who issued an Agency Notice for $5.3 million obligating the Company's bank to release funds in favour of the TRA (see Note 9). The tax dispute related to the Agency Notice is ongoing and based on the opinion of the Company's legal advisors there is better than a 50% chance of the dispute being resolved in favour of the Company (see Note 18). The Company recorded the $5.3 million as other receivables and fully provided for the amount in dispute as the timing and likelihood for collection is uncertain.

9. Current Trade and Other Receivables

	As at	
$'000	September 30, 2020	December 31, 2019
Trade receivables		
Songas	**2,562**	2,332
TPDC	**4,887**	7,284
Industrial customers	**10,425**	9,121
Provision for doubtful accounts	**(452)**	(452)
	17,422	18,285
Other receivables		
Songas gas plant operations	**5,350**	6,431
Other	**6,985**	1,166
Impairment of receivables	**(8,006)**	(3,715)
	4,329	3,882
	21,751	22,167

Songas

As at September 30, 2020 Songas owed the Company $7.9 million (December 31, 2019: $8.8 million), while the Company owed Songas $1.9 million (December 31, 2019: $2.4 million). The amounts due to the Company are for sales of gas of $2.6 million (December 31, 2019: $2.4 million) and for the operation of the gas plant of $5.3 million (December 31, 2019: $6.4 million) against which the Company has made a provision for doubtful accounts of $2.7 million (December 31, 2019: $3.7 million). The Company is pursuing the collection of the arrears and as part of the contractual process, the Company has entered into arbitration to resolve the dispute for the amounts previously provided for. The results of the arbitration are uncertain at this time. The amounts due to Songas primarily relate to pipeline tariff charges of $1.5 million (December 31, 2019: $1.8 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis.

TPDC

The current receivable from TPDC is for gas deliveries through the NNGI pursuant to the signing of the LTGSA. In accordance with the LTGSA, any unpaid, overdue amounts are offset against TPDC profit share.

Other

The increase in other receivables and the impairment of receivables relate to the TRA (see Note 8).

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

10. Capital Assets

$'000	Natural gas interests	Office and other	Right-of-use	Total
Costs				
As at December 31, 2019	214,163	2,870	1,665	218,698
Additions	10,807	19	80	10,906
Disposals	–	–	(536)	(536)
As at September 30, 2020	**224,970**	**2,889**	**1,209**	**229,068**
Accumulated depletion and depreciation				
As at December 31, 2019	117,758	2,770	189	120,717
Additions	10,752	83	324	11,159
Disposals	–	–	(243)	(243)
As at September 30, 2020	**128,510**	**2,853**	**270**	**131,633**
Net book values				
As at September 30, 2020	**96,460**	**36**	**939**	**97,435**

In determining the depletion charge, it is estimated that as at September 30, 2020 the future development costs of $57.1 million (December 31, 2019: $67.9 million) will be required to bring the total proved reserves to production. The future development cost is an estimate of the capital expenditure required to ensure the Company can produce the required gas volumes to meet its contractual obligations for the remaining life of the licence. During the nine months ended September 30, 2020 the Company recorded depreciation of $0.1 million (nine months ended September 30, 2019: $0.1 million) in general and administrative expenses.

Right-of-use assets

$'000	
As at December 31, 2019	1,476
Additions	80
Disposals	(293)
Depreciation	(324)
As at September 30, 2020	**939**

Lease liabilities

$'000	
As at December 31, 2019	1,411
Additions	80
Lease interest expense	72
Lease foreign currency translation difference	2
Lease payments	(621)
As at September 30, 2020	**944**

Right-of-use assets is presented as part of capital assets on the Company's balance sheet. Of the total lease liability of $0.9 million, $0.3 million is current and is presented in trade and other payables.

Disposals relate to the surrender of the Winchester office lease. Lease payments includes the final lease payment including costs for returning the Winchester office premises to their original condition along with regular lease payments on two lease agreements in Tanzania.

11. Trade and Other Payables

$'000	As at September 30, 2020	As at December 31, 2019
Songas	**1,875**	2,354
Other trade payables	**4,194**	1,310
Trade payables	**6,069**	3,664
TPDC Profit Gas entitlement, net	**20,787**	33,134
Accrued liabilities	**7,332**	11,363
	34,188	48,161

TPDC share of Profit Gas

$'000	As at September 30, 2020	As at December 31, 2019
TPDC share of Profit Gas	**26,534**	38,077
Less "Adjustment Factor"	**(5,747)**	(4,943)
	20,787	33,134

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. A significant percentage of the settlement of the $20.8 million liability to TPDC is dependent on receipt of payment from TANESCO for long-term arrears that have been fully provided for.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

12. Long-term Receivables

$'000	As at September 30, 2020	As at December 31, 2019
Amounts invoiced to TANESCO	**113,382**	118,861
Unrecognized amounts not meeting revenue recognition criteria[1]	**(82,355)**	(71,407)
Provision for doubtful accounts	**(31,027)**	(47,454)
Net TANESCO receivable	**–**	–
VAT Songas workovers	**2,205**	2,205
Lease deposit	**9**	45
	2,214	2,250

[1] The amount includes invoices for interest on late payments and invoices relating to differences between gas contracted for delivery versus gas taken by TANESCO.

During the quarter the amounts received from TANESCO were in excess of the revenue recognized for gas sales to TANESCO and $1.6 million (Q3 2019: $ nil) of cumulative excess cash receipts over sales invoiced in Q3 2020 were recorded to reduce the long-term arrears along with the associated reversal of the provision for doubtful accounts. In Q2 2020 the Company invoiced TANESCO $6.5 million (Q2 2019: $ nil) under the take or pay provision within the PGSA; this invoice has not been recognized as it does not meet revenue recognition criteria with respect to assurance of collectability.

In 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 $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 consider options to collect the workover costs through the mechanisms provided in the agreements with Songas.

13. Long-term Loan

In 2015 PAET took out the Loan with the IFC, a member of the World Bank Group, for $60 million. The Loan was fully drawn down in 2016.

The Loan is to be repaid through six semi-annual payments of $5 million starting April 15, 2022 and one final payment of $25.2 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. The Loan is an unsecured subordinated obligation of PAET and is guaranteed by the Company to a maximum of $30 million. The guarantee may only be called upon by IFC at maturity in 2025 and, subject to IFC approval and receipt of all required regulatory approvals, the Company, at its discretion, may issue shares in fulfillment of all or part of the guarantee obligation in 2025. Pursuant to the sale of the non-controlling interest in PAE PanAfrican Energy Corporation ("PAEM"), the parent company of PAET, the Company agreed with the IFC to reduce the outstanding amount of the Loan by the percentage interest sold of 7.9% ($4.8 million) before the fourth anniversary of the first drawdown. PAET made this payment on October 16, 2019.

Dividends and distributions from PAET to the Company are restricted, if at any time amounts of interest, principal or participating interest are due and outstanding. All amounts due under the Loan have been paid when due.

$'000	As at September 30, 2020	As at December 31, 2019
Loan principal	**55,240**	55,240
Financing costs	**(1,049)**	(1,183)
	54,191	54,057

14. Capital Stock

Authorised

50,000,000	Class A common shares ("Class A Shares")	No par value
100,000,000	Class B subordinate voting shares ("Class B 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 (1) 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

	As at					
	September 30, 2020			December 31, 2019		
Number of shares	Authorised (000)	Issued (000)	Amount ($'000)	Authorised (000)	Issued (000)	Amount ($'000)
Class A Shares	**50,000**	**1,750**	**983**	50,000	1,750	983
Class B Shares	**100,000**	**24,388**	**62,260**	100,000	32,557	83,116
First preference shares	**100,000**	**–**	**–**	100,000	–	–
	250,000	**26,138**	**63,243**	250,000	34,307	84,099

During Q3 2020 there were no changes in capital stock.

During Q2 2020 the Company repurchased and cancelled 477,500 Class B Shares at a weighted average price of CDN$5.32 per Class B Share under the normal course issuer bid ("NCIB"). This resulted in an aggregate purchase of CDN$2.5 million of Class B Shares. Total cash payments of $2.1 million were applied to the capital stock, contributed surplus and accumulated income accounts.

During Q1 2020 the Company repurchased and cancelled 7,692,297 Class B Shares at a weighted average price of CDN$6.50 per Class B Share under a substantial issuer bid. This resulted in an aggregate purchase of CDN$50.0 million of Class B Shares representing 23.6% of the Company's issued and outstanding Class B Shares and 22.4% of the total number of the Company's issued and outstanding shares. Total cash payments of $38.2 million were applied to the capital stock, contributed surplus and accumulated income accounts.

All issued capital stock is fully paid.

Changes in Stock Appreciation Rights ("SARs")

$'000	SARs (000)	Exercise price (CDN$)
Outstanding as at December 31, 2019	2,322	2.30 to 6.65
Issued	160	5.02
Exercised	(495)	5.00
Exercised	(60)	3.02
Exercised	(30)	3.87
Forfeited	(317)	5.00
Forfeited	(118)	5.02
Forfeited	(72)	6.65
Outstanding as at September 30, 2020	**1,390**	**2.30 to 6.65**

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

14. Capital Stock continued

The number outstanding, the weighted average remaining life, the number exercisable and the weighted average exercise prices of SARs at September 30, 2020 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	30	–	30	2.30
3.02	60	0.25	–	3.02
3.87	60	2.50	–	3.87
5.00 to 6.65	1,240	2.29	227	5.15
2.30 to 6.65	**1,390**	**2.15**	**257**	**4.94**

Changes in Restrictive Stock Units (“RSUs”)

$’000	RSUs (000)	Exercise price (CDN$)
Outstanding as at December 31, 2019	235	0.01
Issued	21	0.01
Exercised	(49)	0.01
Forfeited	(44)	0.01
Outstanding as at September 30, 2020	**163**	**0.01**

The number outstanding, the number exercisable and the weighted average remaining life of RSUs at September 30, 2020 were as follows:

Exercise price (CDN$)	Number outstanding (000)	Number exercisable (000)	Weighted average remaining contractual life (years)
0.01	**163**	**49**	**2.02**

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 as at September 30, 2020, the following assumptions have been made: a risk free rate of interest of 1.0%, stock volatility of 34.08% to 42.86%, 0% dividend yield, 5% forfeiture and a closing stock price of CDN$5.80 per share.

14. Capital Stock continued

$'000	As at September 30, 2020	As at December 31, 2019
SARs	**1,427**	1,996
RSUs	**523**	536
	1,950	2,532

Dividend Summary

Declaration date	Record date	Payment date	Amount per share (CDN$)
September 17, 2020	September 30, 2020	October 15, 2020	0.08
June 22, 2020	June 30, 2020	July 15, 2020	0.06
February 25, 2020	March 31, 2020	April 30, 2020	0.06
November 28, 2019	December 31, 2019	January 31, 2020	0.06
September 17, 2019	September 30, 2019	October 31, 2019	0.06
May 29, 2019	June 30, 2019	July 31, 2019	0.06
January 22, 2019	March 31, 2019	April 30, 2019	0.05

15. Earnings Per Share

	Three months ended September 30		Nine months ended September 30	
(000)	2020	2019	2020	2019
Outstanding shares				
Weighted average number of Class A and Class B Shares, basic	**26,138**	34,914	**28,381**	35,141
Weighted average number of Class A and Class B Shares, diluted	**26,138**	34,914	**28,381**	35,141

The calculation of earnings per share is based on a net income attributable to shareholders for the quarter of $1.5 million (Q3 2019: $2.6 million) and a weighted average number of Class A and Class B Shares outstanding during the quarter ended September 30, 2020 of 26,137,955 (Q3 2019: 34,914,403). The calculation of earnings per share for the nine months ended September 30, 2020 is based on a net income of $20.4 million (nine months ended September 30, 2019: $12.4 million) and a weighted average number of Class A and Class B shares outstanding for the nine months ended September 30, 2020 of 28,381,477 (nine months ended September 30, 2019: 35,140,832).

16. Related Party Transactions

The Chairman of the Company's Board of Directors is counsel to a law firm that provides legal advice to the Company and its subsidiaries. Fees for services provided by this firm totalled $0.1 million during the quarter ended September 30, 2020 (Q3 2019: $0.1 million) and $0.8 million for the nine months ended September 30, 2020 (nine months ended September 30, 2019: $0.2 million).

As at September 30, 2020 the Company had a total of $0.1 million (December 31, 2019: $0.2 million) recorded in trade and other payables in relation to related parties.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

17. Contractual Obligations and 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 which was 229 Bcf as at September 30, 2020 (December 31, 2019: 214 Bcf). 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 the end of July 2024.

Terms of the Gas Agreement were modified by the Amended and Restated Gas Agreement (“ARGA”) which was initialled by all parties but remains unsigned. In certain respects, the parties thereto are conducting themselves as though the ARGA is in effect. Management does not foresee a material risk with the conduct of the Company’s business with an unsigned ARGA at this time.

Capital Commitments

The Company is adapting to the recent outbreak of COVID-19 and the related economic and social disruption, volatility in financial markets, potential disruption to global supply chains, and the ability to directly and indirectly staff the Company’s day to day operations. The current challenging economic climate may lead to further adverse changes in cash flows, working capital levels and/or debt balances, which may also have a direct impact on the Company’s operating results and financial position. These and other factors may adversely affect the Company’s liquidity and ability to generate income and cash flows in the future. The current volatility in commodity prices and uncertainty regarding the timing for recovery creates inherent challenges with the preparation of financial forecasts.

Tanzania

At the date of this report, the Company’s only significant outstanding contractual commitment is in relation to the $38 million fixed price turnkey compression contract; $13.3 million has been paid to date. The remaining forecasted capital expenditures under this contract are $11.4 million in Q4 2020, $9.5 million in 2021 and $3.8 million in 2022.

Italy

The Company relinquished its rights to farm-in on the Central Adriatic permit in 2019 and has no further capital obligations relating to Italian operations. The subsidiary companies previously used for the Company’s Italian operations were wound up in Q2 2020.

18. 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 historical costs (the "Cost Pool") and in 2011 disputed approximately $34.0 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, parties are to agree the appointment of 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. From 2010 to 2015 TPDC rejected a further $18.0 million of costs. In 2016 the Tanzanian Petroleum Upstream Regulatory Authority (“PURA”) assumed the role of auditing the PSA cost pool from TPDC and for 2016 and 2017 have rejected all costs pertaining to downstream development amounting to $5.9 million and a further $0.8 million of other costs. To date there remains a total of $45.1 million of costs that have been queried or rejected by TPDC or PURA through the cost pool audit process.

During 2019 discussions on the disputed amounts briefly resumed with TPDC. At the time of writing this report no independent specialist has been appointed and neither TPDC nor PURA have issued a formal dispute regarding cost recovery. 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 pursuant to the terms of the PSA. The Company’s view is that all costs have been correctly included in the Cost Pool however should any of the costs be rejected as not being cost recoverable, the Company would be required to retroactively adjust its share of revenue for the period under dispute.

18. Contingencies continued

Tax

Amounts in $' millions					As at September 30, 2020	As at December 31, 2019
Area	Period	Reason for dispute	Principal	Interest	Total	Total
Pay-As-You-Earn ("PAYE") tax	2008-16	PAYE tax on grossed-up amounts in staff salaries which are contractually stated as net.	0.9	0.4	**1.3**	1.5
Withholding tax ("WHT")	2005-16	WHT on services performed outside of Tanzania by non-resident persons, on deemed dividend, on loan interest and on other services.	5.7	2.6	**8.3**	8.3
Income Tax	2008-16	Deductibility of capital expenditures and expenses (2009, 2012 and 2016), 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).	35.1	16.4	**51.5**	50.9
VAT	2008-16	Output VAT on imported services and SSI Operatorship services.	2.8	2.8	**5.6**	5.7
			44.5	22.2	**66.7**	66.4

There were no new assessments issued during the quarter ended September 30, 2020 with regards to corporation tax, WHT, VAT, excise duty or payroll tax. Management, with advice from its legal counsels, has reviewed the Company's position on the objections and appeals related to the disputed amounts and has concluded that no provision is required with regard to these matters and that the maximum potential exposure is $61.4 million (December 31, 2019: $66.4 million). See Note 21 of the audited consolidated financial statements for the year ended December 31, 2019 for a full discussion of contingent tax issues.

During the quarter ended September 30, 2020, acting under instructions from the TRA, PAET's commercial bank transferred to the TRA the full principal tax amount of $2.6 million and the interest of $2.7 million with regards to the 2008-10 output VAT which is currently under dispute. Subsequently, the Company filed an appeal for review with the Tanzanian Court of Appeal (the "CAT"). The amounts have been recorded in trade and other receivables and fully provided for pending the resolution of the dispute.

During the quarter ended June 30, 2020, the Company filed an application for judicial review at the CAT with regards to the 2008-10 PAYE case ($0.3 million). During the quarter ended September 30, 2020, acting under instructions from the TRA, PAET's commercial bank transferred the full principal tax amount in dispute ($0.3 million) to the TRA. The Company has filed an appeal for review with the CAT.

The process of appealing assessments issued by the TRA starts by initially filing an appeal with the TRA. If this is not successful, claims can be taken to higher authorities starting with the Tax Revenue Appeals Board, followed by an appeal to the Tax Revenue Appeals Tribunal and finally to the CAT.

In 2016 theTRA introduced significant changes in relation to the income tax treatment of the extractive sector with separate new chapters in Part V of the Income Tax Act 2004 ("ITA, 2004") for mining and for petroleum to be effective commencing in 2018. Further changes were subsequently made by the Written Laws (Miscellaneous Amendments) Act, 2017 ("WLMAA, 2017") and in particular section 36(a)(ii) of the WLMAA, 2017. The WLMAA, 2017 amended section 65M and 65N of the ITA 2004 to exclude cost oil/cost gas from inclusion in both income and expenditure. The Company is still evaluating the tax effects of the changes as there are a number of uncertainties and ambiguities as to the interpretation and application of certain provisions of the WLMAA, 2017. In the absence of guidance on these matters, the Company has used what it believes are reasonable interpretations and assumptions in applying the WLMAA, 2017 for purposes of determining its tax liabilities and the results of operations, which may change as it receives additional clarification and implementation guidance. The Company does not expect a significant impact from the changes as it is able to recover taxes payable from the TPDC Profit Gas entitlement under the terms of the PSA.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

19. Change in Non-Cash Operating Working Capital

	Three months ended September 30		Nine months ended September 30	
$'000	2020	2019	2020	2019
Decrease (increase) in trade and other receivables	**1,214**	(1,684)	**(1,326)**	(3,571)
Decrease in prepayments	**2,751**	309	**2,024**	744
Decrease in trade and other payables	**(6,277)**	(3,921)	**(12,881)**	(10,035)
Decrease in APT	**–**	–	**(11,938)**	–
Increase in tax payable	**90**	110	**1,428**	2,754
Decrease (increase) in long-term receivable	**38**	2	**36**	(31)
	(2,184)	(5,184)	**(22,657)**	(10,139)
Changes in non-cash operating working capital	**(1,982)**	(4,856)	**(22,650)**	(10,068)
Changes in non-cash investing working capital	**(202)**	(328)	**(7)**	(71)
	(2,184)	(5,184)	**(22,657)**	(10,139)

20. Non-Controlling Interest

The Company sold 7.9% (7,933 Class A common shares) of PAEM to a wholly owned subsidiary of Swala Oil & Gas (Tanzania) plc. ("Swala") in 2018 for $15.4 million cash and $4.0 million of Swala convertible preference shares ("Preference Shares") pursuant to a share purchase agreement. The Preference Shares entitle the Company 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 the Class A common shares of PAEM sold to Swala. The aggregate value of these shares will equal the amount of the outstanding distributions. As at September 30, 2020 the Company has not received any distributions or recorded any amount receivable related to the Preference Shares.

Swala is obligated to redeem 20% of the Preference Shares for cash annually starting from December 31, 2021 until all shares are redeemed. If at any time Swala does not redeem in cash the required number of Preference Shares, Swala is obligated to redeem the Preference Shares by transferring and returning the Class A common shares of PAEM sold to Swala. The aggregate value of these Class A common shares will equal the amount of any outstanding redemption.

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

	As at	
$'000	September 30, 2020	December 31, 2019
Balance, beginning of period	**163**	(513)
Share of income	**1,037**	1,628
Dividends paid	**–**	(952)
Balance, end of period	**1,200**	163

CORPORATE INFORMATION

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Jay Lyons
Executive Director and
Interim Chief Executive Officer
Vancouver, Canada

David W. Ross
Chairman and Non-Executive Director
Calgary, Canada

Dr Frannie Léautier
Non-Executive Director
Washington DC, United States

Linda Beal
Non-Executive Director
London, United Kingdom

Officers

Jay Lyons
Interim Chief Executive Officer
Vancouver, Canada

Blaine Karst
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