Orca Exploration Group Inc.

2014 Q1 REPORT FOR THE QUARTER ENDED MARCH 31 2014 AND 2013

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

Glossary

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

Financial and Operating Highlights

Financial *(US$000 except where otherwise stated)*	**31 March 2014**	**31 March 2013**	**Percentage Change**	**31 December 2013**	**Percentage Change**
				Three months ended/As at	
Revenue	**13,698**	13,197	4	14,866	(8)
Profit/(Loss) before tax	**3,246**	4,660	(30)	(3,749)	n/m
Operating netback *(US$/mcf)*	**2.03**	2.15	(6)	2.29	(11)
Cash	**31,058**	13,421	131	32,588	(5)
Working capital [1]	**19,060**	54,757	(65)	27,756	(31)
Shareholders' equity	**121,851**	128,885	(5)	120,252	1
Total comprehensive income/(loss)	**1,573**	2,950	(47)	(3,918)	n/m
per share - basic *(US$)*	**0.05**	0.08	(38)	(0.11)	n/m
per share - diluted *(US$)*	**0.04**	0.08	(50)	(0.11)	n/m
Funds flow from operating activities [2]	**7,104**	8,904	(20)	8,744	(19)
per share from operating activities - basic *(US$)*	**0.20**	0.25	(20)	0.26	(23)
per share from operating activities - diluted *(US$)*	**0.20**	0.25	(20)	0.26	(27)
Net cash flows from operating activities	**660**	(5,748)	n/m	5,566	(88)
per share - basic *(US$)*	**0.02**	(0.17)	n/m	0.16	(88)
per share - diluted *(US$)*	**0.02**	(0.16)	n/m	0.16	(88)
Outstanding Shares *('000)*					
Class A shares	**1,751**	1,751	–	1,751	–
Class B shares	**33,072**	32,892	1	33,072	–
Options	**1,742**	1,922	(9)	1,742	–
Operating					
Additional Gas sold *(MMcf)* - Industrial	**1,164**	1,176	(1)	1,143	2
Additional Gas sold *(MMcf)* - Power	**4,008**	4,363	(8)	4,385	(9)
Additional Gas sold *(MMcfd)* - Industrial	**12.9**	13.1	(2)	12.4	4
Additional Gas sold *(MMcfd)* - Power	**44.5**	48.5	(8)	47.7	(7)
Additional Gas sold *(MMcfd)* - Total	**57.4**	61.6	(7)	60.1	(4)
Average price per mcf *(US$)* - Industrial	**8.11**	7.78	4	8.38	(3)
Average price per mcf *(US$)* - Power	**3.52**	3.55	(1)	3.68	(4)

1. *Working capital as at 31 March 2014 includes a TANESCO receivable of US$9.3million (31 December 2013: US$9.6 million). Given the payment pattern, the TANESCO receivables in excess of 60 days which total US$59.3 million (31 December 2013: US$47.0 million) have been classified as long-term receivables and discounted by US$17.1 million. Total long and short-term TANESCO receivables as at 31 March 2013 were US$68.6 million prior to discounting. Subsequent to the quarter end, TANESCO paid US$10.9 million, and as at 29 May 2014 the TANESCO balance was US$60.9 million of which arrears total US$57.6 million.*
2. *See MD&A – Non-GAAP Measures.*

Highlights

- Orca operated its Tanzania Songo Songo gas field in the first quarter of 2014 near its productive capacity delivering Additional Gas sales volumes averaging 57.4 MMcfd, a decrease of 7% over the same period in 2013 (Q1 2013: 61.6 MMcfd) and a decrease of 4% over Q4 2013 (60.1 MMcfd). Overall production of Protected Gas and Additional Gas was down 2% over Q1 2013 at 94 MMcfd (Q1 2013: 96 MMcfd). Current average production is approximately 94 MMcfd with current volumes down to approximately 82 MMcfd due to seasonally high hydro usage by TANESCO.
- The situation with respect to the outstanding accounts receivable from TANESCO remains urgent. In the event that the Company does not collect from TANESCO the balance of the receivables and TANESCO continues to be unable to pay the Company for subsequent gas deliveries, the Company will need additional funding for its ongoing operations by the end of the 2014 fiscal year.
- Working capital was US$19.1 million at 31 March 2014, down 65% over Q1 2013 (US$54.8 million), a result of reclassifying US$59.3 million (prior to discount) of TANESCO debt as a long-term receivable. As at 31 March 2014, TANESCO owed the Company US$68.6 million of which US$63.9 million was in arrears.
- TANESCO currently owes the Company US$60.9 million, of which US$57.6 million is in arrears. During the quarter, the Company served notice to TANESCO and is actively pursuing legal and contractual options available to collect the arrears and arrest the increase in TANESCO receivables, including but not limited to the suspension of gas deliveries to TANESCO.
- TANESCO has made some effort to arrest the growth of arrears. The Tanzania Ministry of Energy and Minerals ("MEM"), which oversees TANESCO, directed the state utility to seek to establish a regular basis of payments to its creditors given the increased cash flow from higher power tariffs which came into effect in January 2014. TANESCO has stated an intention to pay TZsh 3 billion (US$1.8 million) weekly. Management is currently negotiating a formalized arrangement with TANESCO to repay the arrears and ensure payment for ongoing gas deliveries remains current.
- Q1 earnings were US$1.6 million or US$0.04 per share diluted, down 47% from the prior year period (Q1 2013: US$2.9 million or US$0.08 per share) and compared with a loss of US$3.9 million or US$0.11 per share in Q4 2013, again reflecting the cost of carrying the TANESCO receivable and provisioning a further US$2.6 million (Q4 2013: US$2.2 million) against doubtful debts, primarily Songas.
- Average gas prices were up 2% in Q1 to US$4.55/mcf over the prior year period (Q1 2013: US$4.45/mcf), Industrial gas prices were up 4% in Q1 to US$8.11/mcf (Q1 2013: US$7.78/mcf) and down 3% from Q4 2013 (US$8.38/mcf) from changes in the sales mix. Average Power sector gas prices decreased 1% over the prior year period to US$3.52/mcf (Q1 2013: US$3.55/mcf) and down 4% compared to the Q4 2013 price of US$3.68/mcf, a result of a reduced take at higher marginal prices.
- Gross revenue for the quarter was US$23.9 million, down 3% from the prior year period (Q1 2013: US$24.6 million), with the Company's share of revenue down 5% from US$12.7 million to US$12.1 million. Cost Pool recoveries contributing to operating revenue remained low at US$2.3 million (Q1 2013: US$3.6 million) due to minimal capital spending during the quarter.
- Funds flow from operating activities was down 20% to US$7.1 million or US$0.20 per share diluted (Q1 2013: US$8.9 million or US$0.25 per share), a result of lower net revenues.

- As at 31 March 2014, the Company had US$31.1 million in cash (31 December 2013: US$32.6 million) and no debt, more than double the cash balances of the prior year. Notwithstanding the stronger cash position, the continued TANESCO and Songas non-payment still threatens the Company's viability and the Company has maintained a going concern note in its Q1 2014 Interim Consolidated Financial Statements. The Company currently has US$40 million in cash and no debt.
- During the quarter, Company ended negotiations on potential amendments to the Songo Songo Production Sharing Agreement (the "PSA") and on Government Negotiating Team issues having obtained a full retraction by the Tanzania Petroleum Development Corporation ("TPDC") of the alleged over-recovery of US$21 million in Cost Pools and TPDC having confirmed that the matter was now closed. The claim was the cornerstone of Parliament's 2011 resolution advising the Government that the Company should repay the monies and that the PSA be terminated. The Company continues to use the dispute resolution mechanisms in its agreements to address any and all pertinent issues going forward.
- Establishing commercial terms for future incremental gas sales remains a key condition to the Company's commitment to Songo Songo development – again there were no substantive developments in negotiations during the quarter. In the absence of an agreement in the near future, the Company intends to pursue its rights under the PSA to develop other markets for Songo Songo gas.
- Despite the stalled efforts to reach agreement on commercial terms, the Company continued planning the full development of Songo Songo to reach 190 MMcfd deliverability by mid-2015, and commenced detailed engineering work on potential workovers of two of the more prolific producing wells currently suspended, SS-5 and SS-9. The Company continues to work with the International Finance Corporation of the World Bank Group to finance the development programme. All development work remains contingent upon (i) satisfactory resolution of TANESCO arrears; (ii) acceptable commercial terms for future gas sales to TPDC; and (iii) payment guarantees for future gas deliveries to TPDC.
- The Tanzania National Natural Gas Infrastructure Project ("NNGIP") made significant progress, as reported by TPDC during 2013, with the pipeline currently 72% complete and gas processing facilities 58% complete. Expected onstream date remains mid-2015.

Chairman and CEO's Letter to the Shareholders

Orca operated its Tanzania Songo Songo gas field in the first quarter of 2014 near its productive capacity delivering Additional Gas sales volumes averaging 57.4 MMcfd, a decrease of 7% over the same period in 2013 (Q1 2013: 61.6 MMcfd) and a decrease of 4% over Q4 2013 (60.1 MMcfd). Overall production of Protected Gas and Additional Gas was down 3% over Q1 2013 to average 95 MMcfd (Q1 2013: 98 MMcfd) and current average production is approximately 94 MMcfd.

The situation with respect to the outstanding accounts receivable from TANESCO remains urgent. In the event that the Company does not collect from TANESCO the balance of the receivables and TANESCO continues to be unable to pay the Company for subsequent gas deliveries, the Company will need additional financing to fund its ongoing operations before the end of the 2014 fiscal year.

At the end of Q1, working capital was US$19.1 million, down 65% over Q1 2013 (US$54.8 million), a result of reclassifying US$59.3 million (prior to discount) of TANESCO debt as a long-term receivable. During 2013, the Company reclassified TANESCO receivables in excess of 60-days payable as a long-term receivable to reflect the uncertainty of payment. A discount of US$17.1 million has been applied to this long-term receivable reflecting the estimated cost of delayed payment. As at the date of this report, the Company has US$40 million in cash and no debt.

Again as a result of substantially no capital investment over the quarter, the Company remained in full Profit Gas mode throughout the quarter. Q1 earnings were US$1.6 million or US$0.04 per share diluted, down 47% from the prior year period (Q1 2013: US$2.9 million or US$0.08 per share) and compared with a loss of US$3.9 million or US$0.11 per share in Q4 2013, again reflecting the cost of carrying the TANESCO receivable and provisioning a further US$2.6 million (Q4 2013: US$2.2 million) against doubtful debts, primarily Songas. Funds flow from operating activities was down 20% to US$7.1 million or US$0.20 per share diluted (Q1 2013: US$8.9 million or US$0.25 per share), a result of lower net revenues.

Average gas prices were up 2% in Q1 to US$4.55/Mcf over the prior year period (Q1 2013: US$4.45 /Mcf), Industrial gas prices were up 4% in Q1 to US$8.11/Mcf (Q1 2013: US$7.78/Mcf) and down 3% from Q4 2013 (US$8.38/mcf) from changes in the sales mix. Average Power sector gas prices decreased 1% over the prior year period to US$3.52/Mcf (Q1 2013: US$3.55/Mcf) and down 4% compared to the Q4 2014 price of US$3.68/mcf, a result of a reduced take at higher marginal prices.

OPERATIONS AND SONGO SONGO DEVELOPMENT

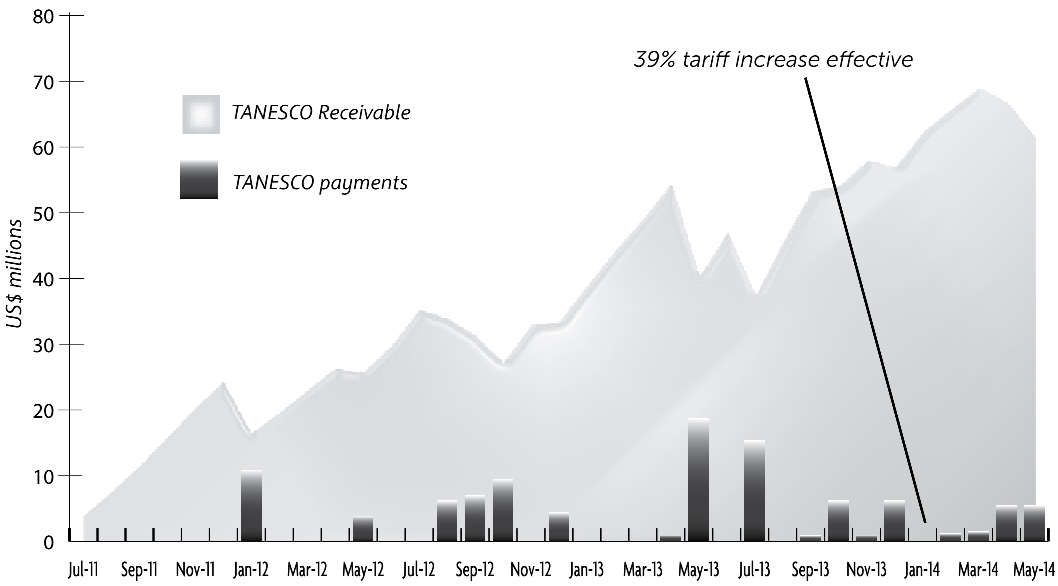
Total production for the quarter averaged 95 MMcfd, down 3% over Q1 2013 (98 MMcfd). The field is experiencing a natural decline and current average production is approximately 94 MMcfd. Total field and plant uptime during the quarter was 99%, allowing for planned maintenance. Planning continued to develop the gas supply necessary to fill the infrastructure expansion contemplated by the National Natural Gas Infrastructure Project ("NNGIP"). With natural declines bringing current productive capacity below existing infrastructure limits of 102 MMcfd, there is the potential currently to sell approximately 8 MMcfd Additional Gas with existing infrastructure.

The focus of Q1 was on work which could be expedited to exploit existing Songas capacity, provide operational redundancy and deliver additional volumes to the NNGIP when commissioned. During the quarter, the Company commenced detailed engineering and front-end logistics work for the workovers of SS-5 and SS-9, two highly productive wells which have been suspended for tubing integrity issues associated with existing well completions reaching the end of their useful life.

TANESCO PAYMENTS AND ARREARS

At the end of Q1 2014, TANESCO owed the Company US$68.6 million. Having received six payments totaling US$10.9 million since the end of the quarter, as of the date of this report TANESCO owed the Company US$60.9 million. Of this amount, approximately US$22 million will be used to settle the liability to TPDC for its share of the revenue.

As we reported with the year-end results, continued non-payment by TANESCO is simply not a sustainable situation for the Company. With unabated growth in arrears over the first quarter, in March the Company served TANESCO with a Notice of Dispute to set in motion the contractually agreed mechanism which would result in either an acceptable settlement or arbitration for collection. Since we reported our annual results to shareholders on 24th April 2014, TANESCO has made some effort to arrest the growth of arrears. The Tanzania Ministry of Energy and Minerals ("MEM"), which oversees TANESCO, directed the state utility to seek to establish a regular basis of payments to its creditors given the increased cash flow from higher power tariffs which came into effect in January 2014. TANESCO has stated an intention to pay TZsh 3 billion (US$1.8 million) weekly. Management is currently negotiating a formalized arrangement with TANESCO to repay the arrears and ensure payment for ongoing gas deliveries remains current.



On 26 March 2014, the World Bank approved a Second Power and Gas Development Policy Operation of US$100 million. Disbursement by the bank to Government treasury is expected by the end of Q2, and as we reported with our annual results, the Company remains to be informed as to the quantum of payments if any which may be made as a result of the second DPO.

MOVING THE GAS SALES AGREEMENT AHEAD

As we reported at year-end, little progress has been made in over a year of discussions with Government concerning gas prices for a long term gas sales agreement ("GSA") with TPDC as gas aggregator. The Company has been advised recently that the Government intends to take on outside economic advisors in the near future to assist in the understanding of wellhead economics and arrive at a mutually agreeable gas price with the Company.

CONTRACTUAL DISPUTE RESOLUTION PROCESSES ARE WORKING

As we reported at year-end, tangible progress has been made returning to the contractual dispute settlement mechanisms within the Company's agreements. During the quarter, following a Notice of Dispute issued to TPDC, the US$21 million claim was formally withdrawn and TPDC confirmed the matter was now closed. This allegation was the key foundation of the November 2011 Parliamentary resolution that the Company should pay back these monies and that the PSA be terminated. The Company had in fact been wrongly accused and its reputation seriously damaged by this matter. With the claim withdrawn, it proves there was in fact no basis for the accusations and persecution of the Company by the Government.

As there had been no progress in 2013 by the Comptroller Auditor General (CAG) in reviewing the alleged US$34 million claim of Cost Pool over-recoveries from 2001 to 2009, so in November 2013, the Company initiated a Notice of Dispute with TPDC to end the matter. CAG then appointed an independent auditor from a leading firm to audit the exceptions report on its behalf, which audit has recently concluded. In accordance with the dispute resolution process, following the audit senior Company management and senior TPDC officials will meet to seek a resolution of the matter. If a mutual agreement is not reached, the Company intends to refer the matter to ICSID arbitration.

NATIONAL NATURAL GAS INFRASTRUCTURE PROJECT ON SCHEDULE

The NNGIP continued to make progress during the quarter. According to project manager TPDC, substantially all the pipe is in country, with 363 km welded and 168 km backfilled. The pipeline construction is 56% complete and 72% weighted average overall pipeline completion prior to commissioning processes. Gas plant construction is 37% complete and weighted average overall gas plant completion is 58% prior to commissioning processes. The current expectation of TPDC is for construction completion by February 2015 and commissioning in June 2015.

NEXT STEPS

Our immediate objective is to crystallize a settlement with TANESCO concerning arrears and payments going forward. If we cannot, we will seek a decision in arbitration to collect. We believe that there is considerable pressure to secure gas supply, and now that the Government is coming to terms with wellhead economics, we are cautiously optimistic that terms can be reached.

W. David Lyons
Chairman & CEO

29 May 2014

FORWARD LOOKING STATEMENTS

This management's discussion and analysis ("MD&A") contains forward-looking statements. More particularly, this MD&A contains statements concerning, but not limited to: repayment of the TANESCO receivables; the need for additional funding by year end for the Company's ongoing operations if the Company is unable to collect the TANESCO receivables; the actions taken and to be taken by the Company to collect the TANESCO receivables; the Company's viability and its ability to meet its obligations as they come due; the potential taxes and penalties payable by the Company to the TRA and the Company's beliefs regarding the assessments and the steps taken and to be taken by the Company to appeal and object to such assessments; status of negotiations with the TPDC regarding a sales agreement for incremental gas volumes and the Company's plans if an agreement is not reached in the near future; status of execution of a full field development plan for Songo Songo, including the anticipated gas sales volumes, the funding of the development plan, and the contingencies related to the development work; the targeted onstream date for the National Natural Gas Infrastructure Project; anticipated effect of the National Natural Gas Policy on the Company's rights under the PSA; and the Company's strategic plans. 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 Orca'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 Orca's control, and many factors could cause Orca's actual results to differ materially from those expressed or implied in any forward-looking statements made by Orca, including, but not limited to: failure to receive payments from TANESCO; failure to obtain adequate funding to meet the Company's obligations as they come due; failure to reach a sales agreement with TPDC for incremental gas volumes; potential negative effect on the Company's rights under the PSA as a result of the National Natural Gas Policy; risk that the contingencies related to the development work for the full field development plan for Songo Songo are not satisfied; risk that the onstream date for the National Natural Gas Infrastructure Project is delayed; failure to obtain funding for full field development plan for Songo Songo; risk that the Company will be required to pay additional taxes and penalties; the impact of general economic conditions in the areas in which Orca 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 access sufficient capital; failure to successfully negotiate agreements; and risk that the Company will not be able to fulfill its obligations. In addition there are risks and uncertainties associated with oil and gas operations, therefore Orca's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking estimates and, accordingly, no assurances can be given that any of the events anticipated by the forward-looking estimates will transpire or occur, or if any of them do so, what benefits that Orca 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 Orca in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors Orca believes are appropriate in the circumstances, including, but are not limited to: 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 Orca to add production at a consistent rate; infrastructure capacity; commodity prices will not deteriorate significantly; the ability of Orca to obtain equipment 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 will obtain funding for full field development plan for Songo Songo; that the Company's appeal of the tax assessment by the TRA will be successful; 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 Orca undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

NON-GAAP MEASURES

THE COMPANY EVALUATES ITS PERFORMANCE USING A NUMBER OF NON-GAAP (GENERALLY ACCEPTED ACCOUNTING PRINCIPLES) MEASURES. THESE NON-GAAP MEASURES ARE NOT 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 ADJUSTMENTS. 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 PER SHARE FROM OPERATING ACTIVITIES IS CALCUALATED ON THE BASIS OF THE FUNDS FLOW FROM OPERATIONS DIVIDED BY THE WEIGHTED AVERAGE NUMBER OF SHARES.
- NET CASH FLOWS PER SHARE FROM OPERATING ACTIVITIES 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.

BACKGROUND

Tanzania

The Company's principal operating asset is its interest in a Production Sharing Agreement ("PSA") with the Tanzania Petroleum Development Corporation ("TPDC") and the Government of Tanzania in the United Republic of Tanzania. This PSA covers the production and marketing of certain gas from the Songo Songo gas field.

The gas in the Songo Songo field is divided between Protected Gas and Additional Gas. The Protected Gas is owned by TPDC and is sold under a 20-year gas agreement (until July 2024) 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, 232 kilometres of pipeline to Dar es Salaam and a 16 kilometre spur to the Wazo Hill Cement Plant.

Songas utilizes the Protected Gas (maximum 45.1 MMcfd on any given day, non-cumulative) as feedstock for its gas turbine electricity generators at Ubungo, for onward sale to the Wazo Hill cement plant and for electrification of some villages along the pipeline route. The Company receives no revenue for the Protected Gas delivered to Songas and operates the field and gas processing plant on a 'no gain no loss' basis.

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

PRINCIPAL TERMS OF THE TANZANIAN PSA AND RELATED AGREEMENTS

The principal terms of the Songo Songo PSA and related agreements are as follows:

Obligations and restrictions

(a) The Company has the right to conduct petroleum operations, market and sell all Additional Gas produced and share the net revenue with TPDC for a term of 25 years expiring in October 2026.

(b) The PSA covers the two licenses in which the Songo Songo field is located ("Discovery Blocks"). The Proven Section is essentially the area covered by the Songo Songo field within the Discovery Blocks.

(c) No sale of Additional Gas may be made from the Discovery Blocks if in the Company's reasonable judgment such sales would jeopardise the supply of Protected Gas. Any Additional Gas contracts entered into are subject to interruption. Songas has the right to request that the Company and TPDC obtain security reasonably acceptable to Songas prior to making any sales of Additional Gas from the Discovery Block to secure the Company's and TPDC's obligations in respect of Insufficiency (see (d) below).

(d) "Insufficiency" occurs if there is insufficient gas from the Discovery Blocks to supply the Protected Gas requirements or is so expensive to develop that its cost exceeds the market price of alternative fuels at Ubungo.

Where there have been third party sales of Additional Gas by the Company and TPDC from the Discovery Blocks prior to the occurrence of the Insufficiency, the Company and TPDC shall be jointly liable for the Insufficiency and shall satisfy its related liability by either replacing the Indemnified Volume (as defined in (e) below) at the Protected Gas price with natural gas from other sources; or by paying money damages equal to the difference between: (a) the market price for a quantity of alternative fuel that is appropriate for the five gas turbine electricity generators at Ubungo without significant modification together with the costs of any modification; and (b) the sum of the price for such volume of Protected Gas (at US$0.55/MMbtu escalated) and the amount of transportation revenues previously credited by Songas to the state electricity utility, the Tanzania Electric Supply Company ("TANESCO"), for the gas volumes.

(e) The "Indemnified Volume" means the lesser of the total volume of Additional Gas sales supplied from the Discovery Blocks prior to an Insufficiency and the Insufficiency Volume. "Insufficiency Volume" means the volume of natural gas determined by multiplying the average of the annual Protected Gas volumes for the three years prior to the Insufficiency by 110% and multiplied by the number of remaining years (initial term of 20 years) of the power purchase agreement entered into between Songas and TANESCO in relation to the five gas turbine electricity generators at Ubungo from the date of the Insufficiency.

Access and development of infrastructure

(f) The Company is able to utilise the Songas infrastructure including the gas processing plant and main pipeline to Dar es Salaam. Access to the pipeline and gas processing plant is open and can be utilised by any third party who wishes to process or transport gas. Ndovu Resources Limited, a subsidiary of Aminex PLC, with support from TPDC and the Ministry of Energy and Mines, had previously indicated that it wished to tie into the gas processing plant on Songo Songo Island and sell up to 10 MMcfd from its Kiliwani North field. Aminex announced in October 2013 that it has engaged in negotiations with TPDC leading to a gas sales agreement which would provide for gas from Kilwa North to be tied in to the new National Natural Gas Infrastructure Project ("NNGIP") facilities on Songo Songo Island and not be connected into the Songas facilities.

Songas is not required to incur capital costs with respect to additional processing and transportation facilities unless the construction and operation of the facilities are, in the reasonable opinion of Songas, financially viable. If Songas is unable to finance such facilities, Songas shall permit the seller of the gas to construct the facilities at its expense, provided that, the facilities are designed, engineered and constructed in accordance with good pipeline and oilfield practices.

Revenue sharing terms and taxation

(g) 75% of the gross revenues less processing and pipeline tariffs and direct sales taxes in any year ("Net Revenues") can be used to recover past costs incurred. Costs recovered out of Net Revenues are termed "Cost Gas".

The Company pays and recovers costs of exploring, developing and operating the Additional Gas with two exceptions: (i) TPDC may recover reasonable market and market research costs as defined under the PSA; and (ii) TPDC has the right to elect to participate in the drilling of at least one well for Additional Gas in the Discovery Blocks for which there is a development program as detailed in an Additional Gas plan ("Additional Gas Plan") as submitted to the Ministry of Energy and Minerals ("MEM") subject to TPDC being able to elect to participate in a development program only once and TPDC having to pay a proportion of the costs of such development program by committing to pay between 5% and 20% of the total costs ("Specified Proportion"). If TPDC does not notify the Company within 90 days of notice from the Company that the MEM has approved the Additional Gas Plan, then TPDC is deemed not to have elected. If TPDC elects to participate, then it will be entitled to a rateable proportion of the Cost Gas and their profit share percentage increases by the Specified Proportion for that development program.

To date, TPDC has neither elected to back in within the prescribed notice period nor contributed any costs associated with backing in and accordingly the Company has determined that to date there has been no working interest earned by TPDC. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however nothing was agreed between the parties. Until such time as an agreement is reached, the Company will apply the terms of the original PSA. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively. For the purpose of the reserves certification as at 31 December 2013, it was assumed that TPDC will 'back-in' for 20% for all future new drilling activities as determined by the current development plan and this is reflected in the Company's net reserve position.

(h) In 2009, the energy regulator, Energy and Water Utility Regulatory Authority ("EWURA"), issued an order that saw the introduction of a flat rate tariff of US$0.59/mcf from 1 January 2010. The Company's long-term gas price to the Power sector as set out in the initialed Amended and Restated Gas Agreement ("ARGA") and the Portfolio Gas Sales Agreement ("PGSA") is based on the price of gas at the wellhead. As a consequence, the Company is not impacted by the changes to the tariff paid to Songas or other operators in respect of sales to the Power sector.

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 Ubungo 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.

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 or Songas' insurance policies. The Re-rating Agreement expired on 31st December 2012 and in September was extended by Songas to 31 December 2013. There is no need to de-rate the Songas plant. Since then production has continued at 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 assurances that this will occur.

(i) The cost of maintaining the wells and flowlines is split between the Protected Gas and Additional Gas users in proportion to the volume of their respective sales. The cost of operating the gas processing plant and the pipeline to Dar es Salaam is covered through the payment of the pipeline tariff.

(j) Profits on sales from the Proven Section ("Profit Gas") are shared between TPDC and the Company, the proportion of which is dependent on the average daily volumes of Additional Gas sold or cumulative production.

The Company receives a higher share of the net revenues after cost recovery, based on the higher the cumulative production or the average daily sales. The Profit Gas share is a minimum of 25% and a maximum of 55%.

Average daily sales of Additional Gas	Cumulative sales of Additional Gas	TPDC's share of Profit Gas	Company's share of Profit Gas
MMcfd	*Bcf*	*%*	*%*
0 - 20	0 – 125	75	25
> 20 <= 30	> 125 <= 250	70	30
> 30 <= 40	> 250 <= 375	65	35
> 40 <= 50	> 375 <= 500	60	40
> 50	> 500	45	55

For Additional Gas produced outside of the Proven Section, the Company's Profit Gas share is 55%.

Where TPDC elects to participate in a development program, its profit share percentage increases by the Specified Proportion (for that development program) with a corresponding decrease in the Company's percentage share of Profit Gas.

The Company is liable to income tax in Tanzania. Where income tax is payable, the Company pays the tax and there is a corresponding deduction in the amount of the Profit Gas payable to TPDC.

(k) Additional Profits Tax ("APT") is payable where the Company has recovered its costs plus a specified return out of Cost Gas revenues and Profit Gas revenues. As a result: (i) no APT is payable until the Company recovers its costs out of Additional Gas revenues plus an annual operating return under the PSA of 25% plus the percentage change in the United States Industrial Goods Producer Price Index ("PPI"); and (ii) the maximum APT rate is 55% of the Company's Profit Gas when costs have been recovered with an annual return of 35% plus PPI return. The PSA is, therefore, structured to encourage the Company to develop the market and the gas fields in the knowledge that the Profit Gas share can increase with larger daily gas sales and that the costs will be recovered with a 25% plus PPI annual return before APT becomes payable. APT can have a significant negative impact on the project economics if only limited capital expenditure is incurred.

Operatorship

(l) The Company is appointed to develop, produce and process Protected Gas and operate and maintain the Songas gas production facilities and processing plant, including the staffing, procurement, capital improvements, contract maintenance, maintain books and records, prepare reports, maintain permits, handle waste, liaise with the Government of Tanzania and take all necessary safe, health and environmental precautions all in accordance with good oilfield practices. In return, the Company is paid or reimbursed by Songas so that the Company neither benefits nor suffers a loss as a result of its performance.

(m) In the event of loss arising from Songas' failure to perform and the loss is not fully compensated by Songas, the Company, or insurance coverage, then the Company is liable to a performance and operation guarantee of US$2.5 million when (i) the loss is caused by the gross negligence or wilful misconduct of the Company, its subsidiaries or employees, and (ii) Songas has insufficient funds to cure the loss and operate the project.

Consolidation

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

Company	Incorporated
Orca Exploration Group Inc.	British Virgin Islands
Orca Exploration Italy Inc.	British Virgin Islands
Orca Exploration Italy Onshore Inc.	British Virgin Islands
PAE PanAfrican Energy Corporation	Mauritius
PanAfrican Energy Tanzania Limited	Jersey
Orca Exploration UK Services Limited	United Kingdom

Results for the quarter ended 31st March 2014

OPERATING VOLUMES

The total production volume of Protected Gas and Additional Gas for the quarter ended 31 March 2014 was 8,528 MMcf (Q1 2013: 8,818 MMcf) or 94.7 MMcfd (Q1 2013: 98 MMcfd), net of approximately 0.3 MMcfd consumed locally for fuel gas. The Additional Gas sales volumes for the quarter were 5,172 MMcf (Q1 2013: 5,539 MMcf) or average daily volumes of 57.4 MMcfd (Q1 2013: 61.6 MMcfd). This represents a decrease of 7% over the prior year and a decrease of 4% over the prior quarter (Q4 2013: 60.1 MMcfd).

The Company's sales volumes were split between the Industrial and Power sectors as follows:

	Three months ended	
	31 Mar 2014	**31 Mar 2013**
Gross sales volume *(MMcf)*		
Industrial sector	**1,164**	1,176
Power sector	**4,008**	4,363
Total volumes	**5,172**	5,539
Gross daily sales volume *(MMcfd)*		
Industrial sector	**12.9**	13.1
Power sector	**44.5**	48.5
Total daily sales volume	**57.4**	61.6

Industrial sector

Current quarter Industrial sales volume decreased by 1% to 1,164 MMcf (12.9 MMcfd) from 1,176 MMcf (13.1 MMcfd) in Q1 2013. The slight decrease is primarily due to a cyclical decline in consumption resulting from maintenance by textile customers. Industrial gas volumes increased by 2% over Q4 2013 (1,143 MMcf or 12.4 MMcfd) following completion of maintenance work at the major cement producer in the Dar es Salaam area near the end of Q4.

Power sector

Power sector sales volumes decreased by 8% to 4,008 MMcf or 44.5 MMcfd, compared to 4,363 MMcf or 48.5 MMcfd in Q1 2013 as a result of a decrease in production from the Songo Songo fields.
Total gas production has decreased from an average of 98 MMcfd in Q1 2013 to 94 MMcfd in Q1 2014.
In accordance with the PGSA with TANESCO, a decrease in field gas production impacts on the volume supplied to the utility company. Power sales volumes were also down 9% over Q4 2013 (4,385 MMcf or 47.7 MMcfd) principally as a result of reduced nominations by TANESCO owing to seasonal increased hydro availability during the period.

SONGO SONGO DELIVERABILITY

As at 31 March 2014, the Company had a field productive capacity of approximately 95 MMcfd, with expansion of production volumes currently restricted to 102 MMcfd by the available infrastructure. Production wells SS-3, SS-5 and SS-9 remain suspended pending workovers. SS-4 continues to be monitored and it may have to be suspended in the future.

There remains no redundant productive capacity until additional wells can be drilled in the field or existing wells worked over and facilities expanded. A loss or material reduction in the production of any given well will have a material adverse effect on the total production and funds flow from operations of the Company.

Significant additional capital expenditure will be required to enable the Songo Songo field to produce 190 MMcfd in line with the anticipated infrastructure expansion. There are no contractual commitments either in the PSA or otherwise agreed for capital expenditure at Songo Songo. Any significant additional capital expenditure by the Company in Tanzania is discretionary and remains dependent on: (i) agreeing commercial terms with TPDC or other buyers regarding the sale of incremental gas volumes from Songo Songo; (ii) TANESCO receivables being brought up to date, guaranteed or other arrangements for payment satisfactory to the Company, (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any contracts with Government entities; and (iv) the arrangement of finance with the IFC or other lenders.

Whilst the Company continues to refine a full field development plan based on expanded infrastructure submitted to the Ministry of Energy and Minerals ("MEM") during 2013, it is not possible to proceed with the plan until the issues outlined above are resolved.

COMMODITY PRICES

The commodity prices achieved in the different sectors during the quarter are shown in the table below:

	Three months ended	
US$/mcf	**31 Mar 2014**	**31 Mar 2013**
Average sales price		
Industrial sector(1)	**8.11**	7.78
Power sector	**3.52**	3.55
Weighted average price	**4.55**	4.45

(1) In Q1 2014 the Company recognized income of US$0.4 million deferred from 2010 under a take-or-pay provision in an Industrial contract. This has been deducted from revenue in calculating the average sales prices achieved in the quarter.

Industrial sector

The average gas price for the quarter was US$8.11/mcf up 4% from Q1 2013 (US$7.78/mcf) and down 3% from Q4 2013 (US$8.38/mcf). The increase over the same period for the prior year is the result of annual price indexation which is applied in January each year and an increase in the proportion of higher priced sales volumes in the total Industrial sales mix which more than offset the effect of a 4% reduction in Heavy Fuel Oil ("HFO") prices. The reduction in Industrial prices from Q4 2013 to Q1 2014 is a result of a change in sales mix while HFO prices remained flat.

Power sector

The average sales price to the Power sector was US$3.52/mcf for the quarter, down 1% compared with US$3.55/mcf in the prior year period and down 4% compared to the Q4 2013 price of US$3.68/mcf. The decreases are the result of reduced sales to the Power sector which in turn reduced the amount of sales subject to premium pricing in accordance with the PGSA. Higher volumes in both prior comparative periods, Q1 2013 and Q4 2013, resulted in a larger proportion being sold at a higher price, in accordance with the PGSA.

OPERATING REVENUE

Under the terms of the Songo Songo 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 out of 75% of the Net Revenues ("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. TPDC marketing costs are treated as a reduction to the Company's Cost Gas entitlement.

The Additional Gas sales volumes for Q1 2014 and the prior periods were in excess of 50 MMcfd entitling the Company to a 55% share of Profit Gas Revenue (net of Cost Gas recoveries from revenue).

The Company was allocated a total of 60% of Net Revenue in Q1 2014 (Q1 2013: 62%) as follows:

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Gross sales revenue	**23,917**	24,629
Gross tariff for processing plant and pipeline infrastructure	**(3,726)**	(4,076)
Gross revenue after tariff ("Net Revenues")	**20,191**	20,553
Analysed as to:		
Company Cost Gas	**2,272**	3,593
Company Profit Gas	**9,856**	9,113
Company operating revenue	**12,128**	12,706
TPDC share of revenue	**8,063**	7,847
	20,191	20,553

The Company's total revenues for the quarter amounted to US$13,698 after adjusting the Company's operating revenue of US$12,128 by:

i) adding US$3,755 for income tax in the quarter – 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 adjusted to reflect the current year income tax charge, which represents a 30% gross up of the current tax for the year; and

ii) subtracting US$2,185 for Additional Profits Tax – this tax is considered a royalty and is netted against revenue.

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

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Industrial sector	**9,828**	9,124
Power sector	**14,089**	15,504
Gross sales revenue	**23,917**	24,629
Processing and transportation tariff	**(3,726)**	(4,076)
TPDC share of revenue	**(8,063)**	(7,847)
Company operating revenue	**12,128**	12,706
Additional Profits Tax	**(2,185)**	(3,035)
Current income tax adjustment	**3,755**	3,526
Revenue	**13,698**	13,197

The 4% increase in revenue compared to Q1 2013 is the result of several factors. A 7% decrease in sales volumes partially offset by a 2% increase in weighted average gas prices have contributed to an overall 3% decrease in Gross Sales Revenue. At the same time TPDC's share of revenue increased 3% to US$8.1 million (Q1 2013: US$7.8 million) as a consequence reduced Cost Gas recoveries during the current quarter. With the increased scope of investment contemplated in the new development plan, the total APT expected to be paid over the life of the licence was reduced. This resulted in a lower accrual during the current quarter contributing to the Revenue increase.

PROCESSING AND TRANSPORTATION TARIFF

Under the terms of the Re-rating Agreement signed in 2011 between the Company and Songas, 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 regulated tariff of US$0.59/mcf payable to Songas. The Q1 2014 charge for the additional tariff was US$0.7 million (Q1 2013: US$0.8 million).

PRODUCTION AND DISTRIBUTION EXPENSES

The well maintenance costs are allocated between Protected and Additional Gas based on the proportion of their respective sales during the period. The total costs of maintenance for the period was US$200 (Q1 2013: US$134) of which US$125 (Q1 2013: US$84) was allocated for the Additional Gas.

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

Distribution costs represent the direct cost of maintaining the ringmain distribution pipeline and pressure reduction station (security, insurance and personnel).

These production and distribution costs are summarized in the table below:

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Share of well maintenance	**125**	84
Other field and operating costs	**552**	318
	677	402
Ringmain distribution costs	**583**	392
Production and distribution expenses	**1,260**	794

OPERATING NETBACKS

The netback per mcf before general and administrative costs, overhead, tax and APT may be analysed as follows:

	Three months ended	
US$/mcf	**31 Mar 2014**	**31 Mar 2013**
Gas price – Industrial	**8.11**	7.78
Gas price – Power	**3.52**	3.55
Weighted average price for gas	**4.55**	4.45
Tariff	**(0.72)**	(0.74)
TPDC share of revenue	**(1.56)**	(1.42)
Net selling price	**2.27**	2.29
Well maintenance and other operating costs	**(0.13)**	(0.07)
Distribution costs	**(0.11)**	(0.07)
Operating netback	**2.03**	2.15

The operating netback decreased by 6% from US$2.15/mcf in Q1 2013 to US$2.03/mcf in Q1 2014. A 2% increase in the weighted average gas price offset by increases in operating and distribution costs and a 10% increase in the TPDC share of revenue resulted in the decrease in operating netbacks compared with the prior year. Against a 2% decline from the weighted average gas price of US$4.66/mcf in Q4 2013, the operating netback decreased 11% to US$2.03/mcf from US$2.29/mcf, primarily the result of a 10% increase in TPDC Profit Gas share quarter over quarter and the reduction in gas sales volumes.

The 2% increase in the weighted average selling price from US$4.45/mcf in Q1 2013 to US$4.55/mcf in 2014 is a combination of a change in the sales mix resulting in higher average Industrial prices, offset by a 1% reduction in Industrial gas volumes, and an 8% drop in Power sales volumes which led to a reduction in the average Power sales price.

The 67% increase in the well maintenance and other operating costs on a per mcf basis in Q1 over the same period the prior year is primarily the result of lower sales volumes and an increase in some activities during the quarter.

GENERAL AND ADMINISTRATIVE EXPENSES

The general and administrative expenses ("G&A") may be analysed as follows:

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Employee & related costs	**1,823**	1,883
Stock based compensation	**277**	(271)
Office costs	**730**	800
Marketing & business development costs including legal fees	**15**	163
Reporting, regulatory & corporate	**949**	955
General and administrative expenses	**3,794**	3,530

G&A includes the costs of running the natural gas distribution business in Tanzania which is recoverable as Cost Gas and is relatively fixed in nature. G&A averaged approximately US$1.2 million per month during the first quarter of 2014 and 2013. The rate per mcf increased to US$0.73/mcf from US$0.64/mcf in Q1 2013 as a result of the drop in sales volumes.

STOCK-BASED COMPENSATION

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

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Stock appreciation rights	**277**	(271)
Stock-based compensation	**277**	(271)

A total of 1,742,400 stock options were outstanding as at 31 March 2014 compared to 1,922,400 at the end of 2013,

No options were granted during the quarter (Q1 2013: nil).

A total of 2,810,000 stock appreciation rights ("SARs") were outstanding as at 31 March 2014 compared to 1,030,000 as at 31 December 2013. A total of 1,780,000 SARs were granted in January with an exercise price of CDN$2.30, a five-year term and which vest in five equal instalments, the first fifth on the anniversary of the grant date.

As SARs are settled in cash, they are re-valued at each reporting date using the Black-Scholes option pricing model. In the valuation of SARS at the reporting date, the following assumptions have been made: a risk free rate of interest of 1.75% stock volatility of 43% to 53%; 0% dividend yield; 0% forfeiture; and a closing price of CDN$2.35 per Class B share.

As at 31 March 2014, a total accrued liability of US$0.7 million (Q1 2013: US$0.3 million) has been recognised in relation to the SARs in other payables. A charge of US$0.3 million was recognised during the period compared to a credit of US$0.3 million in Q1 2013. The increase in the cost of SARs year over year is due to the granting of an additional 1.8 million SARS in January 2014.

NET FINANCE COSTS

The movement in net financing costs is summarized in the table below:

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Interest charged on overdue trade receivables	**647**	–
Foreign exchange gain	**113**	–
Finance income	**760**	–
Interest expense	**(24)**	205
Net foreign exchange loss	**–**	(1,286)
Provision for doubtful debts	**(2,571)**	–
Finance costs	**(2,595)**	(1,491)
Net finance costs	**1,835**	(1,491)

Interest income of US$0.6 million is due from TANESCO, under the terms of the PGSA, for late payment of gas supplied. This forms part of the TANESCO account receivable balance and has been fully provided against to reflect the uncertainty over the timing of collection.

The decrease in interest expense is the result of repaying the bank loan in full by the end of February 2014.

The foreign exchange gain reflects the impact of a fall in the value of the Tanzanian Shilling against the US Dollar during the period on outstanding customer/supplier balances and bank accounts denominated in Tanzanian Shillings.

As at 31 March 2014, Songas owed the Company US$30.4 million (Q4 2013: US$24.8 million), whilst the Company owed Songas US$20.6 million (Q4 2013: US$16.9 million). There is no contractual right to offset these amounts, although in practice the companies have set off receivables and payables. During 2013 the Company formally offset payable and receivable balances of US$17.5 million. During the quarter the Company has neither received nor paid any amounts in settlement of these balances. Amounts due to Songas primarily relate to pipeline tariff charges of US$19.0 million (Q4 2013: US$15.4 million), whereas the amounts due to the Company are mainly for sales of gas of US$14.7 million (Q4 2013: US$11.6 million) and for the operation of the gas plant for US$15.8 million (Q4 2013: US$13.3 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis without profit margin. Due to the time for which the set off has been outstanding and the lack of evidence of cash payments from Songas, the Company was unable to recognize the net Songas receivable and accordingly a further provision of US$1.9 million (Q4 2013: US$1.8 million) has been recognised against the same. Management continues to negotiate with Songas to reach an offsetting agreement and if, and when, such agreement is reached, the related provision for bad debts will be reversed. The interest income of US$ 0.6 million is due from TANESCO, under the terms of the PGSA, for late payment of gas supplied and this amount has been classified as a bad debt.

Management continues to believe that TANESCO will ultimately settle its debts with the Company. Whilst there has recently begun a series of payments from TANESCO approximately weekly, as at the date of this report, there is no formal set schedule or repayment plan for TANESCO arrears agreed with the Company and payments have been irregular and unpredictable since mid-2011. Based on the actual repayment history as at 31 March 2014 US$9.3 million (Q4 2013: US$9.6 million) of the TANESCO receivable was classified as current and US$59.3 million (Q4 2013: US$47.0 million) was classified as long-term. A discount of US$17.1 million (Q4 2013: US$17.1 million) has been taken against the long-term receivable to reflect the estimated finance cost of delays in collection. The long-term portion of the trade receivable was discounted using a risk adjusted discount rate of 15% to reflect the cost of delayed timing of collections from TANESCO. The discount rate and the expected timing of the collections are reviewed at each period end with any adjustments recorded in the period that the estimates are changed.

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, where income tax is payable, this is recovered from TPDC by deducting an amount from TPDC's share of Profit Gas. This is reflected in the accounts by increasing the Company's revenue by the appropriate amount.

As at 31 March 2014, 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 recognised a deferred tax liability of US$11.2 million (Q1 2013: US$19.8 million) which represents a US$1.0 million reduction in the deferred future income tax charge during the quarter compared with a reduction of US$0.6 million in Q1 2013. The deferred tax has no impact on cash flow until it becomes a current income tax at which point the tax is paid to the Commissioner of Taxes 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 ("APT") is payable.

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

The effective APT rate of 22.2% (Q1 2013: 33.3%) has been applied to Profit Gas of US$4.3 million (Q1 2013: US$9.1 million), and accordingly, US$2.2 million (Q1 2013: US$3.0 million) has been deducted from revenue for the quarter ended 31 March 2014.

	Three months ended	
US$'000	**31 March 2014**	**31 March 2013**
Current APT payable	**2,464**	–
Deferred APT	**(279)**	3,035
	2,185	3,035

The deferred APT credit represents the release of an accumulated provision bringing the APT rate down from 25% to currently projected rate for the life of the PSA.

DEPLETION AND DEPRECIATION

The 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 2013 the proven reserves as evaluated by the independent reservoir engineers, McDaniel & Associates Consultants Ltd., were 476 Bcf, on a life of licence basis. A depletion expense of US$3,563 (Q1 2013: US$2,722) has been charged to the accounts, the increase is the result of a 7% decrease in sales volumes and a 43% increase in the depletion rate to US$0.70/mcf (Q1 2013 US$0.49/mcf).

Non-Natural Gas Properties are depreciated as follows:

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

CARRYING AMOUNTS OF ASSETS

Capitalised costs are periodically assessed to determine whether it is likely that such costs will be recovered in the future. To the extent that these capitalised costs are unlikely to be recovered in the future, they are impaired and recorded in the statement of comprehensive income.

FUNDS GENERATED BY OPERATIONS

Funds from operations before working capital changes were US$7.1 million for Q1 2014 (Q1 2013: US$8.9 million).

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Profit after taxation	**1,586**	2,774
Adjustments [1]	**5,518**	6,130
Funds flow from operating activities	**7,104**	8,904
Working capital adjustments [1]	**(6,444)**	(14,447)
Net cash flows from/(used in) operating activities	**660**	(5,543)
Net cash flows used in investing activities	**(483)**	(270)
Cash flows from/(used in) financing activities	**(1,683)**	3,010
Decrease in cash	**(1,506)**	(2,803)
Effect of change in foreign exchange on cash in hand	**(24)**	177
Net decrease in cash	**(1,530)**	(2,626)

(1) See condensed consolidated interim statement of cash flows

The 20% decrease in funds from operations before working capital changes over Q1 2013 is due to increases in Production and Distribution expenses, increased General and Administrative expenses and APT being current during the quarter as opposed to deferred in the prior year period. APT is reflected in working capital adjustments.

Operating revenues with respect to TANESCO and Songas are not fully reflected in the overall cash position as a consequence of the failure of both TANESCO and Songas to pay their invoices during the period.

CAPITAL EXPENDITURE

Capital expenditures amounted to US$0.5 million during the quarter (Q1 2013: US$0.3 million) and may be analysed as follows:

	Three months ended	
US$'000	**31 Mar 2014**	**31 Mar 2013**
Geological and geophysical and well drilling	**–**	270
Pipelines and infrastructure	**305**	–
Other equipment	**178**	–
	483	270

WORKING CAPITAL

Working capital as at 31 March 2014 was US$19.1 million (31 December 2013: US$27.8 million) and may be analysed as follows:

				As at
US$'000	31 Mar 2014		31 Dec 2013	
Cash		**31,058**		32,588
Trade and other receivables		**35,346**		37,215
TANESCO	**9,320**		9,624	
Songas	**14,653**		11,560	
Other trade debtors	**6,977**		10,874	
Songas gas plant operations	**15,763**		13,280	
Other receivables	**1,735**		2,408	
Provision for doubtful accounts	**(13,102)**		(10,531)	
Tax receivable		**14,364**		14,585
Prepayments		**712**		281
		81,480		84,669
Trade and other payables		**61,681**		53,296
TPDC	**27,300**		20,644	
Songas payables	**19,025**		15,355	
Other trade payables	**2,363**		3,857	
Deferred income	**5,880**		6,271	
Accrued liabilities	**7,069**		7,169	
Related parties	**44**		–	
Bank loan		**–**		1,659
Tax payable		**739**		1,958
Working capital (1)		**19,060**		27,756

Notes:

(1) Working capital as at 31 March 2014 includes a TANESCO receivable of US$9.3 million (31 December 2013: US$9.6 million). Given the payment pattern, the TANESCO receivables in excess of 60 days which total US$59.3 million (31 December 2013: US$47.0 million) have been classified as long-term receivables and discounted by US$17.1 million. Total long- and short-term TANESCO receivables as at 31 March 2013 were US$68.6 million prior to discounting. Subsequent to the quarter end, TANESCO paid US$10.9 million, and as at 29 May 2014 the TANESCO balance was US$60.9 million of which arrears total US$57.6 million.

Working capital as at 31 March 2014 decreased by 31% during the quarter, primarily as a result higher TPDC payables relative to the increase in TANESCO receivables. This is due to the reclassification of TANESCO receivables in excess of 60-days as long-term receivables but leaving the TPDC portion of Profit Gas associated with the additional receivable as current payables. The Company did not incur any major capital expenditure during the quarter. Other significant points are:

- At 31 March 2014 the majority of the Company's cash was held in Mauritius. There are no restrictions on the movement of cash from Mauritius or Tanzania.
- Since the quarter end the Company has received US$10.9 million from TANESCO. Management remains confident that the full amount due from TANESCO will ultimately be received.
- Of the US$6.9 million relating to other trade debtors US$4.5 million had been received as at the date of this report. Management expects to receive the balance during the course of Q2.
- The balance of US$27.3 million payable to TPDC represents the remaining balance of its share of revenue as at 31 March 2014.

BANK LOAN

The loan was fully paid by February 2014. Total payments during the quarter were US$1.7 million.

GOING CONCERN

These financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying amounts of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications.

The ability of the Company to continue as a going concern is dependent on the Company's ability to collect its receivables from Government entities to fund on-going operations and the exploration and development program. The continuing weakness in the financial position of the state utility, TANESCO, has created uncertainty as to whether the Company will be able to collect cash to continue operations and meet its commitments. The immediate need to collect from its debtors may create significant doubt about the Company's ability to continue as a going concern.

In the event that Company does not collect from TANESCO the balance of the outstanding receivables at 31 March 2014 and TANESCO continues to be unable to pay the Company for subsequent 2014 gas deliveries, the Company will need additional funding for its ongoing operations before the end of Q1 2015. There are no guarantees that such additional funding will be available when needed, or will be available on suitable terms. Pursuant to its rights under the PGSA, the Company has served a Notice of Dispute to TANESCO demanding payment in full to collect the arrears, as well as examining the Company's legal and contractual options to mitigate a further increase in arrears including but not limited to suspending gas deliveries to TANESCO.

The material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern are set forth below. The Company generates on average in excess of 65% of its operating revenue from sales to the Power sector companies, Songas and TANESCO. The financial security of Songas is heavily reliant on the payment of capacity and energy charges by TANESCO, which in turn is dependent on the Government of Tanzania to subsidise a significant portion of TANESCO's operating budget.

At 31 March 2014, TANESCO owed the Company US$68.6 million gross prior to discount (including arrears of US$63.9 million) compared to US$56.6 million (including arrears of US$51.5 million) as at 31 December 2013. During the quarter the Company received a total of US$2.8 million (Q1 2013: US$ nil) from TANESCO and, subsequent to the quarter end, TANESCO paid the Company a further US$10.9 million. As of the date of this report, the outstanding balance is US$60.9 million of which US$57.6 million is in arrears.

At the end of Q1 2013, the World Bank approved a Tanzania First Power and Gas Development Policy Operation ("DPO") of US$100 million, the first in a programme of three contemplated operations. The objective of the program is to: (i) strengthen the Tanzania's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources. TANESCO made tangible progress in late 2013 towards sustainability in securing a 39% power tariff increase from the energy regulator, the Energy Water Utilities Regulatory Authority ("EWURA"). This was an important outcome of the World Bank condition to limit Government subsidies of TANESCO and resulted in the advancement of the Second US$100 million Power and Gas DPO, approved by the World Bank on 26 March 2014 and expected to be disbursed in Q2 2014. The Company received significant payments of approximately US$18.7 million in 2013 from TANESCO around the time of the disbursement of the First DPO and as at the date of this report has yet to be advised formally as to the quantum of payments if any which may be made as a result of the Second DPO. The DPO programme contemplates a third tranche which the Company understands is conditional, among other things, upon the Tanzania Gas Act being enacted by Parliament.

Management continues to believe that TANESCO will ultimately settle its debts with the Company and is currently in discussions with TANESCO senior management to agree a payment schedule. Whilst there have been recently a number of payments from TANESCO received approximately weekly, as at the date of this report, there is no set schedule or repayment plan for TANESCO arrears agreed with the Company and payments since mid-2011 have been irregular and unpredictable. Based on the actual repayment history as at 31 March 2014, US$9.3 million (Q4 2013: US$9.6 million) of the TANESCO receivable was classified as current and US$59.3 million (Q4 2013: 47.0 million) was classified as long-term. A discount of US$17.1 million (Q4 2013: US$17.1 million) has been taken against the TANESCO receivable to reflect the estimated finance cost of delay in collections. The trade receivable was discounted using a risk adjusted discount rate of 15% to reflect the cost of delayed timing of collections from TANESCO. The discount rate and the expected timing of the collections are reviewed at each period end with any adjustments recorded in the period that the estimates are changed.

As at 31 March 2014, Songas owed the Company US$30.4 million (Q4 2013: US$24.8 million), whilst the Company owed Songas US$20.6 million (Q4 2013: US$16.9 million). There is no contractual right to offset these amounts, although in practice the companies have set off receivables and payables. During 2013 the Company and Songas formally offset payable and receivable balances of US$17.5 million. During and subsequent to the end of the quarter, the Company has neither received nor paid any amounts in settlement of these balances. Amounts due to Songas primarily relate to pipeline tariff charges of US$19 million (Q4 2013: US$15.4 million), whereas the amounts due to the Company are mainly for sales of gas of US$14.7 million (Q4 2013: US$11.6 million) and for the operation of the gas plant for US$15.8 million (Q4 2013: US$13.3 million).

The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis without profit margin. Due to the time for which the set off has been outstanding and the lack of evidence of cash payments from Songas, the Company was unable to recognize the net Songas receivable and accordingly a further provision of US$1.9 million (Q4 2013: US$1.8 million) has been provided against same (see Note 5). Management continues to negotiate with Songas to reach an offsetting agreement and if, and when, such agreement is reached, the related provision for bad debts will be reversed. Any amounts which are not agreed will be pursued by the Company through the dispute mechanisms provided in its agreements with Songas.

In 2012, to help alleviate the funding gap caused by the delays in TANESCO payments the Company entered into a US$10 million debt facility with a bank in Tanzania. By February 2013, the Company had drawn down the facility. Repayments commenced in March 2013 and the loan was fully repaid in February 2014. A total of US$1.7 million was repaid in the quarter.

SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

There were 34.8 million shares outstanding as at 31st March 2014 which may be analysed as follows:

	As at	
Number of shares ('000)	**31 Mar 2014**	**31 Dec 2013**
Shares outstanding		
Class A shares	**1,751**	1,751
Class B shares	**33,072**	33,072
Class A and Class B shares outstanding	**34,823**	34,823
Convertible securities		
Options	**1,742**	1,742
Fully diluted Class A and Class B shares	**36,565**	36,565
Weighted average		
Class A and Class B shares	**34,823**	34,719
Convertible securities		
Options	**643**	–
Weighted average diluted Class A and Class B shares	**35,466**	34,719

As at 29 May 2014, there were a total of 1,750,517 Class A shares and 33,072,015 Class B shares outstanding.

RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm. During the quarter, the Company incurred US$0.04 million (Q1 2013: US$0.1 million) to this firm for services provided. The transactions with this related party were made at the exchange amount. The Chief Financial Officer provided services to the Company through a consulting agreement with a personal services company, during the quarter the Company incurred US$0.1 million (Q1 2013 US$ nil) to this firm for services provided. As at 31 March 2014 the Company has a total of US$0.04 million (Q1 2013: US$0.2 million) recorded in trade and other payables in relation to the related parties.

CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

CONTRACTUAL OBLIGATIONS

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, then 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 (113.5 Bcf as at 31 March 2014). 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.

The Gas Agreement may be superseded by an initialed Amended and Restated Gas Agreement ("ARGA"). The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and the consequences of any insufficiency to 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 shall 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.

Re-rating Agreement

During Q2 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 Ubungo 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.

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 or Songas' insurance policies. The Re-rating Agreement expired on 31st December 2012 and in September was extended by Songas to 31 December 2013. At this time, the Company knows of no reason to de-rate the Songas plant. Since 31 December 2013 production has continued at 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 assurances that this will occur.

Portfolio Gas Supply Agreement

On 17 June 2011, a long term (to June 2023) PGSA was signed between the Company, TPDC and TANESCO. Under the PGSA, the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 37 MMcfd for use in any of TANESCO's current power plants except those operated by Songas at Ubungo. Under the agreement, the current basic wellhead is approximately US$2.88/mcf on 1 July 2014 this will increase to US$2.94/mcf. Any volumes of gas delivered under the PGSA in excess of 36 MMcfd are subject to a 150% increase in the basic wellhead gas price.

Operating leases

The Company has two office rental agreements, one in Dar es Salaam, Tanzania and one in Winchester, United Kingdom. The agreement in Dar es Salaam was entered into on 1 November 2013 and expires on 31 October 2015 at an annual rent of US$401 thousand. The agreement in Winchester expires on 25 September 2022 and is at an annual rental of GBP35 thousand (US$58 thousand) per annum during 2012 and 2013 and GBP71 thousand (US$115 thousand) per annum thereafter. The costs of these leases are recognised in the General and Administrative expenses.

Capital Commitments

There are no capital commitments at this time.

CONTINGENCIES

Downstream unbundling

The separation or unbundling of the downstream assets currently in the PSA has been an objective of TPDC and MEM for some time. Unbundling was an issue raised by TPDC in the 2012 GNT negotiations and in the recently issued National Natural Gas Policy which contemplates TPDC as a monopoly aggregator and distributor of gas. In the context of the gas policy, TPDC and MEM have indicated that they wish the Company to unbundle the downstream distribution business in Tanzania. The methodology for this has been discussed with TPDC in the course of GNT negotiations. During 2013, the Company tabled a proposal with alternative mechanisms to unbundle the downstream from the PSA which were economically neutral to the parties. TPDC did not respond to the proposal and it was later withdrawn by the Company in connection with the termination of negotiations arising from the GNT and TPDC was advised that the downstream would remain in the PSA until mutually agreed otherwise. The disposition of the downstream business will be addressed at such a time as there is a conflict between new legislation and the Company's rights under the PSA.

TPDC back-in

TPDC has previously indicated a wish to exercise its right under the PSA to 'back in' to the Songo Songo field development and a further wish to convert this into a carried interest in the PSA. The current terms of the PSA require TPDC to provide formal notice in a defined period and contribute a proportion of the costs of any development, sharing in the risks in return for an additional share of the gas. To date, TPDC has not contributed any costs. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however there were no changes to the PSA agreed between the parties. As such the Company continues to stand behind the original terms of the PSA. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively.

For the purpose of the reserves certification as at 31 December 2013, it was assumed that, on the basis of economically rational behavior, TPDC will elect to 'back-in' for 20% for all future new drilling activities with-in the prescribed period as determined by the current development plan and this is reflected in the Company's net reserve position.

Cost recovery

The Company's Cost Pool in Tanzania has been fully recovered resulting in a reduction in the percentage of net revenue attributable to the Company.

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. The Company has contended that the disputed costs were appropriately incurred on the Songo Songo project in accordance with the terms of the PSA. Undertakings to resolve this matter were an outcome of GNT negotiations and the matter was referred to the Controller and Auditor General ("CAG"), head of the National Audit Office of Tanzania. With no progress on resolving the matter, the Company served a Notice of Dispute on TPDC to put the matter to a definitive timeline for resolution, following which the CAG appointed an international independent audit firm to review the disputed costs. The work of the CAG has recently been completed and once TPDC has completed its review of the findings, TPDC and Company senior management will hold discussions to determine whether a settlement is possible. If the matter is not resolved to the Company's satisfaction, it intends to proceed to ICSID arbitration pursuant to the terms of the PSA. This matter has had no impact on the results for the period.

TPDC marketing costs

Under the Songo Songo PSA, all reasonable marketing costs including those incurred by TPDC, with the prior approval by the Company are recoverable. TPDC has to date attempted to claim US$3.6 million in marketing costs from the Company. Management reviewed the claims and can demonstrate that there was no prior approval for such costs, no supporting documentation provided evidencing the expenditure, and further believes the nature of the costs to be unreasonable and not related to marketing the downstream business. Accordingly the Company has rejected the claim by TPDC.

Taxation

During 2013 the Company received a number of assessments for additional tax from the Tanzania Revenue Authority ("TRA"), which together with interest penalties total US$18.4 million at 31 December 2013. Management, together with tax advisors, have reviewed each of the assessments and believe them to be without merit. The Company has appealed against assessments for additional withholding tax and employment related taxes, and has filed formal objections against TRA's claims for additional corporation tax and VAT.

The Tax Revenue Appeals Board (TRAB) considered the Company's appeal against a withholding tax assessment of US$2.4 million in March 2013 and upheld the assessment. The Company then appealed to Tax Revenue Appeals Tribunal whose decision is awaited. Although a similar appeal to the Tribunal has been decided in favour of TRA, management continues to believe this assessment is flawed and, if necessary, will pursue the case in the Court of Appeal where a similar case is currently being heard.

The Company, based on legal counsel's advice, believes it has strong support, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US$7.8 million, including penalties. Subsequent to the quarter end TRA notified the Company that it would not accept the objection relating to 2009 and issued a notice confirming the assessment for US$2.5 million. The Company now intends to appeal to the TRAB in respect of 2009. In the event that the Company's 2008 and 2010 objections are rejected and subsequent appeals are overturned, any additional tax payable will be recoverable from TPDC under the terms the PSA.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US$7.5 million. Again, the Company, based on legal counsel's advice, believes that it has strong grounds for objecting to this assessment and accordingly has made no provision.

The Company has received an assessment of US$0.7 million in respect of employment related taxes which TRA believe to have been underpaid. The Company does not accept TRA's finding and has appealed.

Management continues to review the progress of the above appeals and objections and, as of the date of this report, does not believe any provision is required.

NEW ACCOUNTING POLICIES

On January 1, 2014 the Company adopted new standards with respect to Employee Contributions (Amendments to IAS 19), Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32) and Liability for Levies (IFRIC 21).

The adoption of these amendments and standards had no impact on the amounts recorded in the consolidated financial statements as at January 1, 2014 or on the comparative periods.

Financial instrument classification and measurement

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

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

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

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

The Company's long-term trade receivable is considered Level 3 measurements.

CRITICAL ACCOUNTING POLICES AND ESTIMATES

The preparation of these 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 from these estimates.

In preparing these 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 2013.

SUMMARY QUARTERLY RESULTS

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

US$'000 except where otherwise stated	***2014***				*2013*			*2012*
	Q1	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
FINANCIAL								
Revenue	**13,698**	14,866	14,659	11,996	13,197	20,712	22,425	16,915
Comprehensive income/ (loss) after tax	**1,573**	(3,918)	1,928	(6,817)	2,950	5,504	1,266	5,167
Earnings/(loss) per share - diluted *(US$)*	**0.04**	(0.11)	0.05	(0.19)	0.08	0.15	0.04	0.15
Funds flow from operating activities	**7,104**	8,744	11,851	10,546	8,904	12,015	14,379	9,982
Funds flow per share – diluted *(US$)*	**0.20**	0.26	0.34	0.30	0.25	0.33	0.41	0.28
Operating netback *(US$/mcf)*	**2.03**	2.29	2.26	2.10	2.15	3.01	3.14	2.56
Working capital	**19,060**	27,756	31,585	22,527	54,758	46,820	37,730	38,689
Shareholders' equity	**121,851**	120,252	124,170	122,068	128,885	125,935	120,204	118,938
CAPITAL EXPENDITURES								
Geological and geophysical and well drilling	**–**	(1,370)	391	103	268	2,160	14,749	17,732
Pipeline and infrastructure	**305**	397	296	31	–	(258)	261	563
Power development	**–**	–	–	–	–	(15)	22	84
Other equipment	**178**	1,111	57	4	–	562	1	86
OPERATING								
Additional Gas sold – Industrial *(MMcf)*	**1,164**	1,143	1,092	1,067	1,176	1,127	1,022	829
Additional Gas sold – Power *(MMcf)*	**4,008**	4,385	4,959	4,250	4,363	4,417	4,270	4,172
Average price per mcf – Industrial *(US$)*	**8.11**	8.38	8.43	8.60	7.78	8.56	9.21	10.14
Average price per mcf – Power *(US$)*	**3.52**	3.68	4.10	3.63	3.55	3.61	3.55	2.80

CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

US$'000 except per share amounts	Note	Three months ended 31 Mar 2014	31 Mar 2013
Revenue	*3, 4*	**13,698**	13,197
Cost of sales			
Production and distribution expenses		**(1,260)**	(794)
Depletion expense		**(3,563)**	(2,722)
		8,875	9,681
General and administrative expenses		**(3,794)**	(3,530)
Finance income	*5*	**760**	–
Finance costs	*5*	**(2,595)**	(1,491)
Profit before tax		**3,246**	4,660
Income taxes	*6*	**(1,660)**	(1,886)
Profit after tax		**1,586**	2,774
Foreign currency translation (loss)/gain from foreign operations		**(13)**	176
Total comprehensive income for the period		**1,573**	2,950
Earnings per share			
Basic *(US$)*	*13*	**0.05**	0.09
Diluted *(US$)*	*13*	**0.04**	0.08

See accompanying notes to the condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (UNAUDITED)

US$'000	Note	*As at* 31-Mar 2014	31-Dec 2013
Assets			
Current Assets			
Cash		**31,058**	32,588
Trade and other receivables	*8*	**35,346**	37,215
Tax receivable	*6*	**14,364**	14,585
Prepayments		**712**	281
		81,480	84,669
Non-Current Assets			
Long-term trade receivable	*8*	**42,192**	29,911
Exploration and evaluation assets		**5,564**	5,564
Property, plant and equipment	*9*	**87,600**	90,832
		135,356	126,307
Total Assets		**216,836**	**210,976**
Equity and Liabilities			
Current Liabilities			
Trade and other payables	*10*	**61,681**	53,296
Bank loan	*11*	**–**	1,659
Tax payable		**739**	1,958
		62,420	56,913
Non-Current Liabilities			
Deferred income taxes	*6*	**11,165**	12,132
Deferred additional profits tax	*7*	**21,400**	21,679
		32,565	33,811
Total Liabilities		**94,985**	**90,724**
Equity			
Capital stock	*12*	**85,428**	85,428
Contributed surplus		**6,482**	6,482
Accumulated other comprehensive loss		**(290)**	(303)
Accumulated income		**30,231**	28,645
		121,851	120,252
Total Equity and Liabilities		**216,836**	**210,976**

See accompanying notes to the consolidated consolidated interim financial statements.

Going concern (Note 1)
Contractual obligations and committed capital investment (Note 15)
Contingencies (Note 16)

The consolidated condensed interim financial statements were approved by the Board of Directors on 29 May 2014.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS (UNAUDITED)

US$'000	Note	Three months ended 31 Mar 2014	Three months ended 31 Mar 2013
Cash flows (used in)/from operating activities			
Profit after tax		**1,586**	2,774
Adjustment for:			
Depletion and depreciation	9	**3,715**	2,809
Provision for doubtful debt	5	**2,571**	–
Stock-based compensation		**277**	(271)
Deferred income taxes	6	**(967)**	(582)
Deferred additional profits tax	4,7	**(279)**	3,035
Interest expense	5	**24**	205
Unrealised loss on foreign exchange		**177**	934
Funds flow from operating activities		**7,104**	8,904
Increase in trade and other receivables		**(624)**	(20,928)
Decrease in tax receivable		**221**	320
(Increase)/decrease in prepayments		**(431)**	38
Increase in trade and other payables		**7,890**	7,392
Increase in tax payable		**(1,219)**	(1,269)
Increase in long-term receivable		**(12,281)**	–
Net cash flows from / (used in) operating activities		**660**	(5,543)
Cash flows used in investing activities			
Exploration and evaluation expenditures		**–**	(2)
Property, plant and equipment expenditures	9	**(483)**	(268)
Net cash used in investing activities		**(483)**	(270)
Cash flows (used in)/from financing activities			
Bank loan proceeds	10	**–**	4,000
Bank loan repayments	10	**(1,659)**	(785)
Interest paid	5	**(24)**	(205)
Net cash flow from/ (used in) financing activities		**(1,683)**	3,010
Decrease in cash		**(1,506)**	(2,803)
Cash at the beginning of the period		**32,588**	16,047
Effect of change in foreign exchange on cash in hand		**(24)**	177
Cash at the end of the period		**31,058**	13,421

See accompanying notes to the condensed consolidated interim financial statements.

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

US$'000	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated income	Total
Note	*11*				
Balance as at 1 January 2014	85,428	6,482	(303)	28,645	**120,252**
Foreign currency translation adjustment on foreign operations	–	–	13	–	**13**
Profit after tax for the period	–	–	–	1,586	**1,586**
Balance as at 31 March 2014	85,428	6,482	(290)	30,231	**121,851**

US$'000	Capital stock	Contributed surplus	Cumulative translation adjustment	Accumulated income	Total
Balance as at 1 January 2013	84,983	6,753	89	34,110	**125,935**
Foreign currency translation adjustment on foreign operations	–	–	176	–	**176**
Profit after tax for the period	–	–	–	2,774	**2,774**
Balance as at 31 March 2013	84,983	6,753	265	36,884	**128,885**

See accompanying notes to the condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Interim Financial Statements (Unaudited)

For the three months ended March 31, 2014

General information

Orca Exploration Group Inc. was incorporated on 28 April 2004 under the laws of the British Virgin Islands. The Company produces and sells natural gas to the power and industrial sectors in Tanzania and has gas and oil exploration interests in Italy.

The condensed consolidated interim financial statements of the Company as at and for the three months ended 31 March 2014 comprise accounts of the Company and all its wholly owned subsidiaries (collectively, the "Company" or "Orca Exploration") and were authorised for issue in accordance with a resolution of the directors on 29 May 2014.

1 GOING CONCERN

These financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying amounts of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications.

The ability of the Company to continue as a going concern is dependent on the Company's ability to collect its receivables from Government entities to fund on-going operations and the exploration and development program. The continuing weakness in the financial position of the state utility, TANESCO, has created uncertainty as to whether the Company will be able to collect cash to continue operations and meet its commitments. The immediate need to collect from its debtors may create significant doubt about the Company's ability to continue as a going concern.

In the event that Company does not collect from TANESCO the balance of the outstanding receivables at 31 March 2014 and TANESCO continues to be unable to pay the Company for subsequent 2014 gas deliveries, the Company will need additional funding for its ongoing operations before the end of the current fiscal year. There are no guarantees that such additional funding will be available when needed, or will be available on suitable terms. Pursuant to its rights under the PGSA, the Company has served a Notice of Dispute to TANESCO demanding payment in full to collect the arrears, as well examining the Company's legal and contractual options mitigate a further increase in arrears, including but not limited to suspending gas deliveries to TANESCO.

The material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern are set forth below. The Company generates on average in excess of 65% of its operating revenue from sales to the Power sector companies, Songas and TANESCO. The financial security of Songas is heavily reliant on the payment of capacity and energy charges by TANESCO, which in turn is dependent on the Government of Tanzania to subsidise a significant portion of TANESCO's operating budget.

At 31 March 2014, TANESCO owed the Company US$68.6 million gross prior to discount (including arrears of US$63.9 million) compared to US$56.6 million (including arrears of US$51.5 million) as at 31 December 2013. During the quarter the Company received a total of US$2.8 million (Q1 2013: US$ nil) from TANESCO and, subsequent to the quarter end, TANESCO paid the Company a further US$10.9 million. As of the date of this report, the outstanding balance is US$60.9 million of which US$57.6 million is in arrears.

At the end of Q1 2013, the World Bank approved a Tanzania First Power and Gas Development Policy Operation ("DPO") of US$100 million, the first in a programme of three contemplated operations. The objective of the program is to: (i) strengthen the Tanzania's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources. TANESCO made tangible progress in late 2013 towards sustainability in securing a 39% power tariff increase from the energy regulator, the Energy Water Utilities Regulatory Authority ("EWURA"). This was an important outcome of the World Bank condition to limit Government subsidies of TANESCO and resulted in the advancement of the Second US$100 million Power and Gas DPO, approved by the World Bank on 26 March 2014 and expected to be disbursed in Q2 2014. The Company received significant payments of approximately US$18.7 million in 2013 from TANESCO around the time of the disbursement of the First DPO and as at the date of this report has yet to be advised formally as to the quantum of payments if any which may be made as a result of the Second DPO. The DPO programme contemplates a third tranche which the Company understands is conditional, among other things, upon the Tanzania Gas Act being enacted by Parliament.

Management continues to believe that TANESCO will ultimately settle its debts with the Company and is currently in discussions with TANESCO senior management to agree a payment schedule. Whilst there have been recently a number of payments from TANESCO received approximately weekly, as at the date of this report, however, there is no set schedule or repayment plan for TANESCO arrears agreed with the Company and payments since mid-2011 have been irregular and unpredictable. Based on the actual repayment history as at 31 March 2014, US$9.3 million (Q4 2013: US$9.6 million) of the TANESCO receivable was classified as current and US$59.3 million (Q4 2013: 47.0 million) was classified as long-term. A discount of US$17.1 million (Q4 2013: US$17.1 million) has been taken against the TANESCO receivable to reflect the estimated finance cost of delay in collections. The trade receivable was discounted using a risk adjusted discount rate of 15% to reflect the cost of delayed timing of collections from TANESCO. The discount rate and the expected timing of the collections are reviewed at each period end with any adjustments recorded in the period that the estimates are changed.

As at 31 March 2014, Songas owed the Company US$30.4 million (Q4 2013: US$24.8 million), whilst the Company owed Songas US$20.6 million (Q4 2013: US$16.9 million). There is no contractual right to offset these amounts, although in practice the companies have set off receivables and payables. During 2013 the Company and Songas formally offset payable and receivable balances of US$17.5 million. During and subsequent to the end of the quarter, the Company has neither received nor paid any amounts in settlement of these balances. Amounts due to Songas primarily relate to pipeline tariff charges of US$19 million (Q4 2013: US$15.4 million), whereas the amounts due to the Company are mainly for sales of gas of US$14.7 million (Q4 2013: US$11.6 million) and for the operation of the gas plant for US$15.8 million (Q4 2013: US$13.3 million).

The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis without profit margin. Due to the time for which the set off has been outstanding and the lack of evidence of cash payments from Songas, the Company was unable to recognize the net Songas receivable and accordingly a further provision of US$1.9 million (Q4 2013: US$1.8 million) has been provided against same (see Note 5). Management continues to negotiate with Songas to reach an offsetting agreement and if, and when, such agreement is reached, the related provision for bad debts will be reversed. Any amounts which are not agreed will be pursued by the Company through the dispute mechanisms provided in its agreements with Songas.

2 BASIS OF PREPARATION

A) Statement of compliance

These consolidated interim financial statements have prepared on a historical cost basis using the accrual basis of accounting, and are presented in US dollars. They have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all of the information required for the full annual financial statements prepared in accordance with International Financial Reporting Standards as issued by the IASB. Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the Company and should be read in conjunction with the consolidated financial statements and notes thereto in the Company's 2013 Annual Report.

B) Judgements and estimates

The preparation of these 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 from these estimates.

In preparing these 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 2013.

C) Significant accounting policies

The same accounting policies have been applied in the preparation of these condensed consolidated interim financial statements as those applied by the Company in its consolidated financial statements as at and for the year ended 31 December 2013, except as highlighted below.

On January 1, 2014 the Company adopted new standards with respect to Employee Contributions (Amendments to IAS 19), Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32) and Liability for Levies (IFRIC 21). The adoption of these amendments and standards had no impact on the amounts recorded in the consolidated financial statements as at January 1, 2014 or on the comparative periods.

D) Financial instrument classification and measurement

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

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

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

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

The Company's long-term trade receivable is considered Level 3 measurements.

3 SEGMENT INFORMATION

The Company has one reportable segment which is international exploration, development and production of petroleum and natural gas. The Company currently has producing assets in Tanzania and exploration interests in Italy.

	Three months ended					
	31 March 2014			*31 March 2013*		
US$'000	**Italy**	**Tanzania**	**Total**	**Italy**	**Tanzania**	**Total**
External Revenue	**–**	**13,698**	**13,698**	–	13,197	13,197
Segment Income	**–**	**1,586**	**1,586**	–	2,774	2,774
Non-cash charge[(1)]	**–**	**(2,571)**	**(2,571)**	–	–	–
Total Assets	**226**	**216,610**	**216,836**	834	225,659	226,493
Total Liabilities	**216**	**94,769**	**94,985**	714	96,894	97,608
Capital Additions	**–**	**483**	**483**	–	270	270
Depletion & Depreciation	**–**	**3,715**	**3,715**	–	2,809	2,809

(1) The non-cash charge represents an increase in the doubtful debt provision of US$2.6 million, resulting in a total provision for doubtful debts of US$13.1 million.

4 REVENUE

	Three months ended	
US$'000	**31 March 2014**	**31 March 2013**
Operating revenue	**12,128**	12,706
Current income tax adjustment	**3,755**	3,526
Additional profits tax	**(2,185)**	(3,035)
Revenue	**13,698**	13,197

The Company's total revenues for the quarter amounted to US$13,698 after adjusting the Company's operating revenue of US$12,128 by:

i) adding US$3,755 for income tax for the current period. 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 adjusted to reflect the current income tax charge, which represents a 30% gross up of the current tax for the period (Note 6); and,

ii) subtracting US$2,185 for the deferred effect of Additional Profits Tax – this tax is considered a royalty and is presented as a reduction in revenue.

5 FINANCE INCOME AND FINANCE COSTS

	Three months ended	
US$'000	**31 March 2014**	**31 March 2013**
Interest charged on overdue trade receivables	**647**	–
Foreign exchange gain	**113**	–
Finance income	**760**	–
Interest expense	**(24)**	(205)
Net foreign exchange loss	**–**	(1,286)
Provision for doubtful accounts	**(2,571)**	–
Finance costs	**(2,595)**	(1,491)
Net finance costs	**(1,835)**	(1,491)

Interest income of US$0.6 million is due from TANESCO, under the terms of the PGSA, for late payment of gas supplied. This forms part of the TANESCO account receivable balance and has been fully provided against to reflect the uncertainty over the timing of collection.

6 INCOME TAXES

The tax charge is as follows:

US$'000	Three months ended 31 March 2014	 31 March 2013
Current tax	**2,627**	2,468
Deferred tax	**(967)**	(582)
	1,660	1,886

No tax (Q1 2013: US$3.0 million) was paid during the period in relation to the settlement of the 2013 tax liability. In addition provisional tax payments of US$4.0 million (Q1 2013: US$0.8 million) relating to the current year were made. These are present as a reduction in Tax Payable on the balance sheet.

Tax Rate Reconciliation

US$'000	Three months ended 31 March 2014	 31 March 2013
Profit before taxation	**3,246**	4,660
Provision for income tax calculated at the statutory rate of 30%	**973**	1,398
Add the tax effect of non-deductible income tax items:		
Administrative and operating expenses	**619**	556
Financing charge	**2**	(10)
Stock-based compensation	**83**	(90)
Permanent differences	**(17)**	32
	1,660	1,886

As at 31 March 2014, there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Accordingly a deferred tax liability has been recognized for the quarter ended 31 March 2014.

A deferred tax asset of US$2.2 million (Q1 2013: US$2.2 million) in respect of Longastrino Italy E&E costs has not been recognised because it is not probable that there will be future profits against which this can be utilised.

The deferred income tax liability includes the following temporary differences:

US$'000	As at 31 March 2014	 31 December 2013
Differences between tax base and carrying value of property, plant and equipment	**16,958**	17,081
Income tax recoverable	**10,835**	10,182
Discount on receivable and provision for doubtful debt	**(9,053)**	(8,281)
Deferred Additional Profits Tax	**(7,159)**	(6,509)
Unrealised exchange losses/other provisions	**(416)**	(341)
	11,165	12,132

Tax Receivable

The Company has a tax receivable balance of US$14.4 million (Q4 2013: US$14.6 million).

7 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 ("APT") is payable.

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

The effective APT rate of 22.2% (Q1 2013: 33.3%) has been applied to Profit Gas of US$4.3 million (Q1 2013: US$9.1 million), and accordingly, US$2.2 million (Q1 2013: US$3.0 million) has been netted off revenue for the quarter ended 31 March 2014.

	Three months ended	
US$'000	**31 March 2014**	**31 March 2013**
Current APT payable	**2,464**	–
Deferred APT	**(279)**	3,035
	2,185	3,035

The deferred APT credit represents the release of an accumulated provision bringing the APT rate down from 25% to currently projected rate for the life of the PSA.

8 TRADE AND OTHER RECEIVABLES

Current Receivables

	As at	
US$'000	**31 March 2014**	**31 December 2013**
TANESCO	**9,320**	9,624
Songas	**14,653**	11,560
Other debtors	**6,977**	10,874
Trade receivables	**30,950**	32,058
Songas gas plant operations	**15,763**	13,280
Other receivables	**1,735**	2,408
Less provision for doubtful accounts	**(13,102)**	(10,531)
	35,346	37,215

In addition to the trade receivable from Songas of US$14.7 million, an additional US$15.8 million (Q4 2013: US$13.3 million) is due from Songas with respect to Gas Plant operations. All receivable amounts from Songas have been included in the net Songas balance (see Note 10) of US$9.8 million (Q4 2013: US$7.9 million) and a provision for doubtful debts is recognised for the full net receivable amount of US$9.8 million (see Note 10).

Trade Receivables Age Analysis

As at 31 March, 2014 (US$'000)	**Current**	**>30 <60**	**>60 <90**	**>90**	**Total**
TANESCO	4,669	4,651	–	–	**9,320**
Songas	1,119	964	1,010	11,560	**14,653**
Other debtors	3,720	2,315	784	158	**6,977**
Trade receivables	9,508	7,930	1,794	11,718	**30,950**

As at 31 December, 2013 (US$'000)	**Current**	**>30 <60**	**>60 <90**	**>90**	**Total**
TANESCO	5,071	4,553	–	–	**9,624**
Songas	1,076	1,016	927	8,541	**11,560**
Other debtors	3,663	2,822	1,661	2,728	**10,874**
Trade receivables	9,810	8,391	2,588	11,269	**32,058**

Subsequent to 31 March 2014, US$10.9 million has been received from TANESCO, and US$4.5 million from other debtors. As a result of irregular and unpredictable payments by TANESCO, management has reclassified the TANESCO balance more than 60 days as a long-term receivable and has discounted the value of the TANESCO receivable (see Note 1). The Songas trade receivable is less than equivalent trade payable and no contractual right of set off exists.

Long-Term Receivables

	As at	
US$'000	**31 March 2014**	**31 Dec 2013**
TANESCO receivable > 60 days	59,265	46,984
Discount on long-term receivable	(17,073)	(17,073)
Net long-term receivable	42,192	29,911

9 PROPERTY, PLANT AND EQUIPMENT

US$'000	**Oil & natural gas interests**	**Leasehold improvements**	**Computer equipment**	**Vehicles**	**Fixtures & Fittings**	**Total**
Costs						
As at 1 January 2014	139,072	885	1,072	137	1,168	**142,334**
Additions	305	70	63	–	45	**483**
Disposals	–	(258)	–	–	–	**(258)**
As at 31 March 2014	**139,377**	**697**	**1,135**	**137**	**1,213**	**142,559**
Depletion and depreciation						
As at 1 January 2014	49,967	245	761	137	392	**51,502**
Charge for period	3,563	36	49	–	67	**3,715**
Depreciation on disposals	–	(258)	–	–	–	**(258)**
As at 31 March 2014	**53,530**	**23**	**810**	**137**	**459**	**54,959**
Net Book Values						
As at 31 March 2014	**85,847**	**674**	**325**	**–**	**754**	**87,600**
As at 31 December 2013	89,105	640	311	–	776	**90,832**

In determining the depletion charge, it is estimated that future development costs of US$238 million (31 December 2013: US$239 million) will be required to bring the total proved reserves to production. During the quarter the Company recognized depreciation of US$0.2 million (Q1 2013: US$0.1 million) in General and Administrative expenses.

10 TRADE AND OTHER PAYABLES

US$'000	As at 31 March 2014	31 Dec 2013
Songas	**19,025**	15,355
Other trade payables	**2,363**	3,857
Trade payables	**21,388**	19,212
TPDC	**27,300**	20,644
Deferred income	**5,880**	6,271
Accrued liabilities	**7,069**	7,169
Related party *(Note 14)*	**44**	–
	61,681	53,296

The balances payable to Songas are net of amounts receivable from Songas that have been agreed as fully settled. The following table shows the amounts considered to have been settled by offsetting during the period.

US$'000	1 January 2014	Transactions during the quarter	Gross balance	Set off	31 March 2014
Pipeline tariff - payable	(15,354)	(3,671)	(19,025)	–	**(19,025)**
Gas sales - receivable	11,561	3,092	14,653	–	**14,653**
Gas plant operation - receivable	13,280	2,483	15,763	–	**15,763**
Miscellaneous payable	(1,546)	(29)	(1,575)	–	**(1,575)**
Net balances	7,941	1,875	9,816	–	**9,816**

11 BANK LOAN

The loan was fully paid by February 2014. Total payments during the quarter were US$1.7 million.

12 CAPITAL STOCK

Authorised and Issued Share Capital

Number of shares (000s)	Authorised	Issued	Amount (US$'000)
Class A			
As at 1 January 2014 and 31 March 2014	50,000	1,751	983
Class B			
As at 1 January 2014 and 31 March 2014	100,000	33,072	84,445
First preference			
As at 1 January 2014 and 31 March 2014	100,000	–	–
Total Class A, Class B and First Preference shares	250,000	34,823	85,428

All of the issued capital stock is fully paid.

Stock options

Thousands of options or CDN$	Options	Exercise Price
Outstanding as at 1 January 2014 and 31 March 2014	1,742	1.00 to 3.60

The weighted average remaining life and weighted average exercise prices of options at 31 March 2014 were as follows:

Exercise Price (CDN$)	Number Outstanding as at 31 March 2014	Weighted Average Remaining Contractual Life (years)	Number Exercisable as at 31 March 2014	Weighted Average Exercise Price (CDN$)
1.00	**1,092**	0.42	1,092	1.00
3.18	**400**	3.75	400	3.18
3.60	**250**	2.5	250	3.60
	1,742		1,742	

Stock Appreciation Rights

Thousands of stock appreciation rights or CDN$	SAR	Exercise Price
Outstanding as at 1 January 2014	1,030	2.12 to 4.20
Granted	1,780	2.30
Outstanding as at 31 March 2014	**2,810**	**2.12 to 4.20**

The Company records a charge to the income statement using the Black-Scholes fair value option pricing model every reporting period with a resulting liability being recognised in trade and other payables. In the valuation of stock options and stock appreciation rights at the reporting date, the following assumptions have been made: a risk free rate of interest of 1.75% stock volatility of 43% to 53%; 0% dividend yield; 0% forfeiture; a closing stock price of CDN$2.35 per share.

As at 31 March 2014, a total accrued liability of US$0.7 million (Q1 2013: US$0.3 million) has been recognised in relation to the stock appreciation rights. A charge of US$0.3 million was recognised during the period compared to a credit of US$0.3 million in Q1 2013. The increase in the cost of SARs year over year is due to the granting of an additional 1.8 million SARS in January 2014.

13 EARNINGS PER SHARE

	As at	
Number of shares ('000s)	**31 Mar 2014**	**31 Mar 2013**
Weighted average number of shares outstanding		
Class A and Class B shares	**34,823**	34,643
Convertible securities		
Stock options	**643**	767
Weighted average diluted Class A and Class B shares	**35,466**	35,410

The calculation of basic earnings per share is based on the comprehensive profit for the quarter of US$1.6 million (Q1 2013: profit US$2.9 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,823,210 (Q1 2013: 34,643,210).

In computing the diluted earnings per share, the effect of the stock options is added to the weighted average number of Class A and Class B shares outstanding during the quarter. For Q1 2014 the number was 642,853 (Q1 2013: 767,480) shares, resulting in a diluted weighted average number of Class A and Class B shares of 35,466,063 (Q1 2013: 35,410,690). No adjustments were required to the reported earnings from operations in computing diluted per share amounts.

14 RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm. During the quarter, the Company incurred US$0.04 million (Q1 2013: US$0.1 million) to this firm for services provided. The transactions with this related party were made at the exchange amount. The Chief Financial Officer provided services to the Company through a consulting agreement with a personal services company, during the quarter the Company incurred US$0.1 million (Q1 2013 US$ nil) to this firm for services provided. As at 31 March 2014 the Company has a total of US$0.04 million (Q1 2013: US$0.2 million) recorded in trade and other payables in relation to the related parties.

15 CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENTS

CONTRACTUAL OBLIGATIONS

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, then 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 (113.5 Bcf as at 31 March 2014). 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.

The Gas Agreement may be superseded by an initialed Amended and Restated Gas Agreement ("ARGA"). The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and the consequences of any insufficiency to 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 shall 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.

Re-rating Agreement

During Q2 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 Ubungo 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.

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 or Songas' insurance policies. The Re-rating Agreement expired on 31st December 2012 and in September was extended by Songas to 31 December 2013. At this time, the Company knows of no reason to de-rate the Songas plant. Since 31 December 2013 production has continued at 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 assurances that this will occur.

Portfolio Gas Supply Agreement

On 17 June 2011, a long term (to June 2023) PGSA was signed between the Company, TPDC and TANESCO. Under the PGSA, the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 37 MMcfd for use in any of TANESCO's current power plants except those operated by Songas at Ubungo. Under the agreement, the current basic wellhead is approximately US$2.88/mcf on 1 July 2014 this will increase to US$2.94/mcf. Any volumes of gas delivered under the PGSA in excess of 36 MMcfd are subject to a 150% increase in the basic wellhead gas price.

Operating leases

The Company has two office rental agreements, one in Dar es Salaam, Tanzania and one in Winchester, United Kingdom. The agreement in Dar es Salaam was entered into on 1 November 2013 and expires on 31 October 2015 at an annual rent of US$401 thousand. The agreement in Winchester expires on 25 September 2022 and is at an annual rental of GBP35 thousand (US$58 thousand) per annum during 2012 and 2013 and GBP71 thousand (US$115 thousand) per annum thereafter. The costs of these leases are recognised in the General and Administrative expenses.

CAPITAL COMMITMENTS

There are no capital commitments at this time.

16 CONTINGENCIES

Downstream unbundling

The separation or unbundling of the downstream assets currently in the PSA has been an objective of TPDC and MEM for some time. Unbundling was an issue raised by TPDC in the 2012 GNT negotiations and in the recently issued National Natural Gas Policy which contemplates TPDC as a monopoly aggregator and distributor of gas. In the context of the gas policy, TPDC and MEM have indicated that they wish the Company to unbundle the downstream distribution business in Tanzania. The methodology for this has been discussed with TPDC in the course of GNT negotiations. During 2013, the Company tabled a proposal with alternative mechanisms to unbundle the downstream from the PSA which were economically neutral to the parties. TPDC did not respond to the proposal and it was later withdrawn by the Company in connection with the termination of negotiations arising from the GNT and TPDC was advised that the downstream would remain in the PSA until mutually agreed otherwise. The disposition of the downstream business will be addressed at such a time as there is a conflict between new legislation and the Company's rights under the PSA.

TPDC Back-in

TPDC has previously indicated a wish to exercise its right under the PSA to 'back in' to the Songo Songo field development and a further wish to convert this into a carried interest in the PSA. The current terms of the PSA require TPDC to provide formal notice in a defined period and contribute a proportion of the costs of any development, sharing in the risks in return for an additional share of the gas. To date, TPDC has not contributed any costs. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however there were no changes to the PSA agreed between the parties. As such the Company continues to stand behind the original terms of the PSA. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively.

For the purpose of the reserves certification as at 31 December 2013, it was assumed that, on the basis of economically rational behavior, TPDC will elect to 'back-in' for 20% for all future new drilling activities with-in the prescribed period as determined by the current development plan and this is reflected in the Company's net reserve position.

Cost recovery

The Company's Cost Pool in Tanzania has been fully recovered resulting in a reduction in the percentage of net revenue attributable to the Company.

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. The Company has contended that the disputed costs were appropriately incurred on the Songo Songo project in accordance with the terms of the PSA. Undertakings to resolve this matter were an outcome of GNT negotiations and the matter was referred to the Controller and Auditor General ("CAG"), head of the National Audit Office of Tanzania. With no progress on resolving the matter, the Company served a Notice of Dispute on TPDC to put the matter to a definitive timeline for resolution, following which the CAG appointed an international independent audit firm to review the disputed costs. The work of the CAG has recently been completed and once TPDC has completed its review of the findings, TPDC and Company senior management will hold discussions to determine whether a settlement is possible. If the matter is not resolved to the Company's satisfaction, it intends to proceed to ICSID arbitration pursuant to the terms of the PSA. This matter has had no impact on the results for the period.

TPDC marketing costs

Under the Songo Songo PSA, all reasonable marketing costs including those incurred by TPDC, with the prior approval by the Company are recoverable. TPDC has to date attempted to claim US$3.6 million in marketing costs from the Company. Management reviewed the claims and can demonstrate that there was no prior approval for such costs, no supporting documentation provided evidencing the expenditure, and further believes the nature of the costs to be unreasonable and not related to marketing the downstream business. Accordingly the Company has rejected the claim by TPDC.

Taxation

During 2013 the Company received a number of assessments for additional tax from the Tanzania Revenue Authority ("TRA"), which together with interest penalties total US$18.4 million at 31 December 2013. Management, together with tax advisors, have reviewed each of the assessments and believe them to be without merit. The Company has appealed against assessments for additional withholding tax and employment related taxes, and has filed formal objections against TRA's claims for additional corporation tax and VAT.

The Tax Revenue Appeals Board (TRAB) considered the Company's appeal against a withholding tax assessment of US$2.4 million in March 2013 and upheld the assessment. The Company then appealed to Tax Revenue Appeals Tribunal whose decision is awaited. Although a similar appeal to the Tribunal has been decided in favour of TRA, management continues to believe this assessment is flawed and, if necessary, will pursue the case in the Court of Appeal where a similar case is currently being heard.

The Company, based on legal counsel's advice, believes it has strong support, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US$7.8 million, including penalties. Subsequent to the quarter end TRA notified the Company that it would not accept the objection relating to 2009 and issued a notice confirming the assessment for US$2.5 million. The Company now intends to appeal to the TRAB in respect of 2009. In the event that the Company's 2008 and 2010 objections are rejected and subsequent appeals are overturned, any additional tax payable will be recoverable from TPDC under the terms the PSA.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US$7.5 million. Again, the Company, based on legal counsel's advice, believes that it has strong grounds for objecting to this assessment and accordingly has made no provision.

The Company has received an assessment of US$0.7 million in respect of employment related taxes which TRA believe to have been underpaid. The Company does not accept TRA's finding and has appealed.

Management continues to review the progress of the above appeals and objections and, as of the date of this report, does not believe any provision is required.

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Chief Executive Officer

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