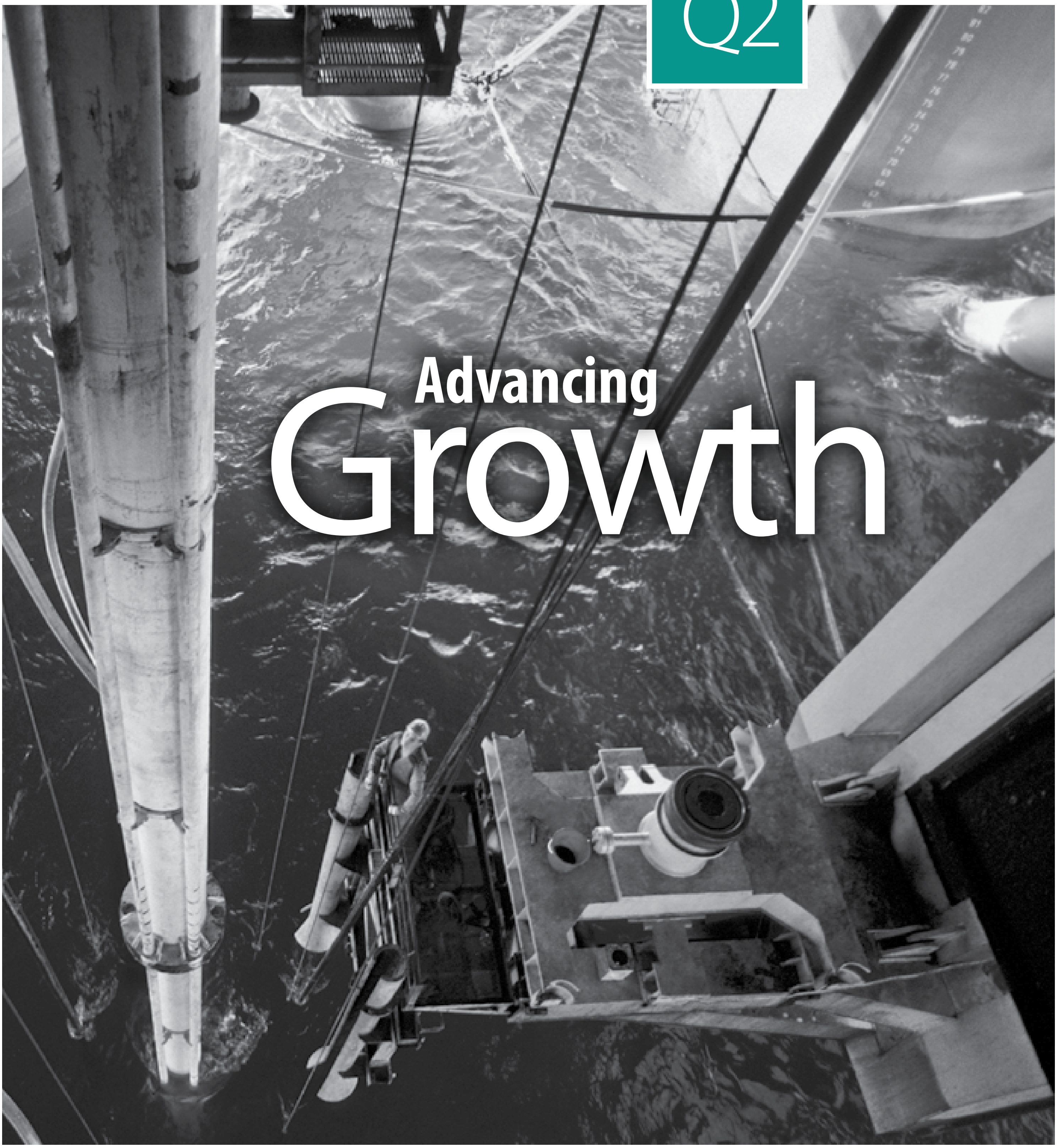
ORCA

# 2011 Q2 Interim Report

Q2



Orca Exploration Group Inc. is a well-financed, international public company engaged in hydrocarbon exploration, development and supply of gas in Tanzania, the establishment of a coastal gas pipeline network in East Africa, oil appraisal and gas exploration in Italy and the acquisition of high potential exploration opportunities in Europe and Africa.

Orca Exploration trades on the TSXV under the trading symbols ORC.B and ORC.A.



## GLOSSARY

| | |
|---|---|
| *mcf* | Thousands of standard cubic feet |
| *MMcf* | Millions of standard cubic feet |
| *Bcf* | Billions of standard cubic feet |
| *Tcf* | Trillions of standard cubic feet |
| *MMcfd* | Millions of standard cubic feet per day |
| *Mmbtu* | Millions of British thermal units |
| *HHV* | High heat value |
| *LHV* | Low heat value |
| *1P* | Proven reserves |
| *2P* | Proven and probable reserves |
| *3P* | Proven, probable and possible reserves |
| *GIIP* | Gas initially in place |
| *Kwh* | Kilowatt hour |
| *MW* | Megawatt |
| *US$* | US dollars |
| *Cdn$* | Canadian dollars |
| *Bar* | Fifteen pounds per square inch |
| *MMbbl* | Million barrels of oil |
| *€* | Euro |

# Highlights

- Increased sales of Additional Gas by 6% to 3,653 MMcf or 40.2 MMcfd (Q2 2010: 3,002 MMcf or 33.0 MMcfd). In the last ten days of June, sales increased to an average of 53 MMcfd.
- Increased working capital by 2% during the quarter to US$57.1 million (US$55.8 million at 31 March 2011).
- Signed a Re-rating Agreement with Songas Limited to increase the Songo Songo gas processing capacity from 90 MMcfd to 110 MMcfd. This has increased the infrastructure capacity to 102 MMcfd (restricted by the pipeline capacity and downstream pressure requirements).
- Made good progress with the Songas Expansion Project that will see infrastructure capacity increase to 140 MMcfd with the addition of new gas processing units and pipeline compression.
- Signed a Portfolio Gas Sales Agreement with TANESCO for the sale of Additional Gas to the power sector for the period until June 2023.
- Continued to strengthen Orca's management team by recruiting a new chief operating officer.

# Financial and Operating Highlights

| | Three months or as at | | | Six months ended or as at | | |
|---|---|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | Change | 30-Jun 2011 | 30-Jun 2010 | Change |
| FINANCIAL (FIGURES IN US$ '000 EXCEPT WHERE OTHERWISE STATED) | | | | | | |
| Revenue | 8,296 | 9,017 | (8%) | 17,936 | 17,276 | 4% |
| Profit before taxation | 1,341 | 4,092 | (67%) | 5,371 | 7,365 | (27%) |
| Operating netback (US$/MCF) | 1.80 | 2.37 | (24%) | 1.98 | 2.27 | (13%) |
| Cash and cash equivalents | 48,993 | 18,319 | 167% | 48,993 | 18,319 | 167% |
| Working capital | 57,070 | 24,941 | 129% | 57,070 | 24,941 | 129% |
| Shareholders' equity | 100,956 | 73,942 | 37% | 100,956 | 73,942 | 37% |
| Earnings per share - basic (US$) | 0.01 | 0.09 | (89%) | 0.08 | 0.15 | (47%) |
| Earnings per share - diluted (US$) | 0.01 | 0.08 | (88%) | 0.08 | 0.15 | (47%) |
| Funds flow from operating activities | 3,292 | 5,001 | (34%) | 8,239 | 9,541 | (14%) |
| Funds per share from operating activities - basic (US$) | 0.09 | 0.17 | (47%) | 0.24 | 0.32 | (25%) |
| Funds per share from operating activities - diluted (US$) | 0.09 | 0.16 | (44%) | 0.23 | 0.31 | (26%) |
| Net cash flows from operating activities | 2,142 | 3,672 | (42%) | 5,638 | 5,190 | 9% |
| Net cash flows per share from operating activities - basic (US$) | 0.06 | 0.12 | (50%) | 0.16 | 0.18 | (11%) |
| Net cash flows per share from operating activities - diluted (US$) | 0.06 | 0.12 | (50%) | 0.16 | 0.17 | (6%) |
| OUTSTANDING SHARES ('000) | | | | | | |
| Class A shares | 1,751 | 1,751 | 0% | 1,751 | 1,751 | 0% |
| Class B shares | 32,939 | 27,743 | 19% | 32,939 | 27,743 | 19% |
| Options | 2,557 | 2,797 | (9%) | 2,557 | 2,797 | (9%) |
| Additional Gas sold (MMCF) - industrial | 688 | 562 | 22% | 1,237 | 1,048 | 18% |
| Additional Gas sold (MMCF) - power | 2,965 | 2,440 | 22% | 5,759 | 5,096 | 13% |
| Additional Gas sold (MMCFD) - industrial | 7.6 | 6.2 | 22% | 6.8 | 5.8 | 18% |
| Additional Gas sold (MMCFD) - power | 32.6 | 26.8 | 22% | 31.8 | 28.2 | 13% |
| Average price per mcf (US$) - industrial | 10.28 | 9.45 | 9% | 9.90 | 9.38 | 6% |
| Average price per mcf (US$) - power | 2.64 | 2.56 | 3% | 2.63 | 2.56 | 3% |

This interim report contains certain forward-looking statements based on current expectations, but which involve risks and uncertainties. Actual results may differ materially. All financial information is reported in U.S. dollars (US$), unless otherwise noted.

# Chairman and CEO's Letter to

W. DAVID LYONS, CHAIRMAN AND CEO

By the end of the Q2, Orca Exploration Group Inc. ("Orca" or the "Company") had successfully concluded a re-rating agreement with TANESCO and Songas to increase natural gas production from the Songo Songo gas field to a maximum of 102 MMcfd. This positive development comes at a time of urgent demand within Tanzania for increased natural gas production for power generation.

Currently Tanzania does not have enough generating capacity to meet its needs. Daily power shedding and rolling blackouts are having a negative effect on the nation's industrial capacity, its economy and the livelihoods and well-being of millions of Tanzanians. The failure of this year's long rains in East Africa has seen hydro power fall from 50% to below 20% of the total power generation in Tanzania.

At the same time demand for power continues to grow. The government's announced intention is to have 2,780 MW of power by 2015. This is a huge jump from the current installed capacity of 1,117 MW. However it provides ample opportunity for companies like Orca to play a significant role in helping to develop the country's natural gas resources to the mutual benefit of Tanzanians and the Company's investors.

Orca is working with key players to help alleviate Tanzania's energy shortages and to partner in the development of the country's energy resources

Over the last 20 years Orca, and its predecessor companies EastCoast Energy, PanAfrican Energy and Ocelot International, have been key players in the development of Tanzania's first and largest natural gas development. We have a commitment to the development and efficient use of Tanzania's natural gas resources and are engaged in exploration to increase the nation's natural gas reserves. To sustain the development of Tanzania's energy resources Orca has been instrumental in raising new capital, operating the Songo Songo gas field and its processing plant and distributing natural gas for power and industrial development. Orca is working with key players to help alleviate Tanzania's energy shortages and to partner in the development of the country's energy resources.

### SUSTAINABLE GROWTH

Orca recorded gas sales of 40.2 MMcfd in the second quarter an increase of 22% compared with the same period in 2010. During the last 10 days of June, the Company's gas sales increased to an average of 53 MMcfd when the gas processing capacity was re-rated leading to increased infrastructure capacity.

# Shareholders


During Q2 Orca assisted in the planning for the Songas Expansion Project which is intended to boost infrastructure capacity to 140 MMcfd. The Company has also indicated to the Government that it is looking at ways of increasing Songo Songo production to 200 MMcfd from the existing field for a short period until other gas discoveries in Tanzania come on stream. Orca will be actively involved in this process both as operator of the gas processing plant and principal user of the infrastructure.

To provide for sustainable gas production increases Orca is planning to take a number of actions over the next 18 months:

- Drilling of a new onshore deviated well (SS-A) and an upgrade of SS-10 to increase deliverability to approximately 150 – 160 MMcfd by the end of 2011;
- Workover of SS-5 and SS-9 to increase deliverability to 250 - 260 MMcfd by the end of 2012;
- Drilling of the high potential Songo Songo West (SSW) exploration prospect in 2012;
- Negotiation of contracts with Songas and TANESCO for the Songas Expansion Project which has the potential to expand infrastructure capacity to 140 MMcfd.

## CURRENT POWER SECTOR DEMAND

The April and May long rains failed to replenish the reservoirs that the country depends on to generate up to 550 MWs. As a consequence Tanzania's installed hydro power capacity is now dramatically reduced. To address this shortfall, TANESCO recently re-commissioned a 112 MW gas fired power plant in Dar es Salaam (owned and operated by Symbion Power LLC). This will increase the total generation potentially consuming Orca's Additional Gas to 301 MWs (or approximately 66 MMcfd at peak load).

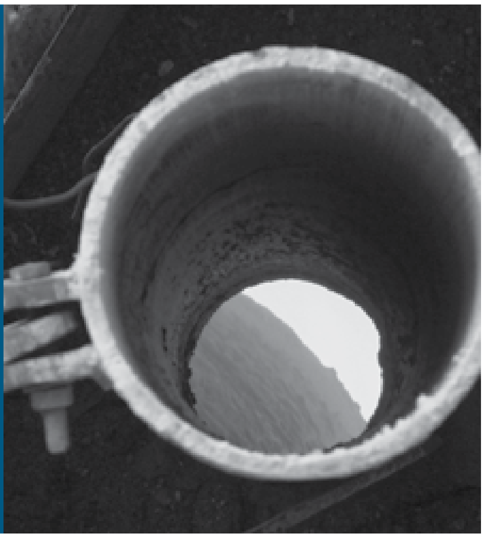
Further additions to Tanzania's generating capacity are scheduled for next year. TANESCO has contracted Jacobsen Elektro to install a new 105 MW plant (maximum demand of 22 MMcfd) in Dar es Salaam and this is forecast to be operational by the end of Q1 2012. As discussed below, it will not be possible to meet all this demand until the Songas Expansion Project materialises.

## LONGER TERM POWER SECTOR NEEDS

During Q2 2011, a long term (to June 2023) Portfolio Gas Sales Agreement (PGSA) was signed between Orca and TANESCO. Under the PGSA, Orca is obligated, subject to infrastructure capacity, to sell a maximum of approximately 37 MMcfd for use in any of the power plants except those operated by Songas at Ubungo. The current basic wellhead gas price of US$ 2.02/ Mcf is due to increase to approximately US$2.70/Mcf on 1 July 2012.

## EXPANDING INFRASTRUCTURE

As reported above, during Q2 2011 the Company signed a Re-rating Agreement with TANESCO and Songas to operate the gas processing plant on Songo Songo Island at levels of up to 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 102 MMcfd). The agreement is expected to



remain in force for the period until the Songas Expansion Project is operational. Under the terms of this agreement, the Company will effectively pay 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.

### CORROSION AND DELIVERABILITY UPDATE

Following a corrosion logging survey it was determined that Orca currently has the capacity to deliver 113 MMcfd from the five producing Songo Songo gas wells. However, in Q1 2011, it was concluded that SS-9 may need to be taken out of production by the end of Q1 2012, subject to the results of re-logging of the well in September 2011.

The Company is currently looking to contract a land rig to drill a new high producing onshore deviated well. At the same time the SS-10 well will be upgraded to increase deliverability. The contracting of a land rig to undertake this work programme within a tight timeframe is critical and there may be the need to mobilise a rig from outside of the country. It is forecast that a rig contract will be signed during September. The estimated capital cost for this programme is US$35 million. An experienced drilling team has been assembled to carry out the work and long lead items have been ordered.

With sales volumes expected to increase, cash flows should strengthen in the remainder of 2011

### ITALIAN DELINEATION WELL

The Company intends to participate in the drilling of the La Tosca gas exploration well in the Po Valley Basin in Q1 2012 as the first step in delineating the prospectivity of the Longastrino block. In the event of a discovery, it is anticipated that 3D seismic will be acquired over several potential leads in the Longastrino block. Additional drilling will be conducted if the seismic interpretation is positive.

The Company is still optimistic that the Italian government will ultimately issue a decree of environmental compatibility and allow further offshore drilling to re-commence in the Central Adriatic. The drilling of the Elsa-2 well is an excellent opportunity to participate in an appraisal project where there is a known 65 meter oil column that was drilled in 1992. This prospect is particularly attractive at the current oil price. The Company has no obligation to pay any costs until a rig contract has been signed and there is no time limit in the farm in agreement with Petroceltic plc. In addition, the farm in provides the Company with significant upside through the ability to participate in the exploration of 11 adjacent blocks at a 15% working interest.

### FINANCING

Funds flow from operating activities declined to US$3.3 million (Q2 2010: US$5.0 million) primarily due to the depletion of the cost recovery pool and the payment of past marketing costs to Tanzania Petroleum Development Corporation (TDPC) in accordance with the terms of the Production Sharing Agreement.

The Company's cost pool in Tanzania was depleted early in Q2 2011. This resulted in a reduction in the percentage of net revenue attributable to the Company that will continue until there is any significant expenditure on the drilling activities which will commence in Q3 2011. TPDC is still in the process of auditing the historic cost recovery pool and this may lead to adjustments in the future. Orca will also see a reduction in the net revenue allocated to the Company now that a significant proportion of production is coming from the deemed TPDC backed-in well (SS-10).

## In Tanzania we have an extremely strategic asset and in 2011 we will continue to work to maximize its value

With sales volumes expected to increase as a consequence of the re-rating, cash flows should strengthen for the remainder of 2011. From July 2012, the base power price is also due to increase by circa US$0.68/mcf which will have a beneficial impact on revenues.

The capital work programme for the remainder of 2011 is estimated to be US$40 million – US$48 million compared with a current cash balance of US$49.0 million. This programme includes the drilling of the deviated SS-A well, the enhancement of SS-10 and the purchase of long lead time items for the drilling of Songo Songo West. Whilst there is expected to be sufficient funds to undertake the 2011 work programme taking into account self generated cash flows for the balance of the year, the Company will look to secure a financing facility and/or raise new equity to cover planned 2012 capital expenditure.

### BOARD OF DIRECTORS AND LEADERSHIP ADDITIONS

I would like to welcome Robin Gaeta to our Board of Directors. He was elected to the Board at our Annual General Meeting in June. Robin brings broad experience in natural gas development and power generation in the Americas, Europe and Africa to the table. He has served as an executive with Shell in various roles and most recently as the head of new market development for Shell Global LNG with responsibility for the development of innovative smaller scale LNG value chains.

We also welcome Dale Rollins who has joined Orca as Chief Operating Officer (COO). As COO he will have broad management responsibilities including direction of all aspects of Orca's day-to-day operations, leading the implementation of Board strategies, targets and plans, and working collaboratively on developing the Company's asset portfolio. Prior to joining Orca Mr. Rollins had a highly successful 27-year career that included senior oil and gas management responsibilities in Nigeria, Russia, Australia, Europe and the United States.

We would like to thank Peter Clutterbuck for his years of service as both an officer and director of the Company. Peter played a pivotal role in the development of our natural gas projects in Tanzania and we thank him for his many contributions.

### THE TASK AT HAND

Orca is by far the largest producer and seller of natural gas in East Africa and it is well positioned to continue to play a key role in developing East African gas markets and infrastructure. We have partnered in developing Tanzania's natural gas resources over the past two decades and we are committed to continue to play our part in ensuring that Tanzania has adequate power to support a growing economy.

We are also aware of the expectations and trust our shareholders have placed in the Company and we are working together at all levels to deliver on those expectations. We look forward to implementing our corporate action plans for the balance of 2011.

W. David Lyons, Chairman & CEO
26 August 2011

# Management's Discussion & Analysis

## FORWARD LOOKING STATEMENTS

THIS MDA OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED 30 JUNE 2011 SHOULD BE READ IN CONJUNCTION WITH THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES THERETO AS AT AND FOR THE YEAR ENDED 31 DECEMBER 2010. THIS MDA IS BASED ON THE INFORMATION AVAILABLE ON 26 AUGUST 2011.

CERTAIN STATEMENTS IN THIS MD&A INCLUDING (I) STATEMENTS THAT MAY CONTAIN WORDS SUCH AS "ANTICIPATE", "COULD", "EXPECT", "SEEK", "MAY", "INTEND", "WILL", "BELIEVE", "SHOULD", "PROJECT", "FORECAST", "PLAN" AND SIMILAR EXPRESSIONS, INCLUDING THE NEGATIVES THEREOF, (II) STATEMENTS THAT ARE BASED ON CURRENT EXPECTATIONS AND ESTIMATES ABOUT THE MARKETS IN WHICH ORCA EXPLORATION OPERATES AND (III) STATEMENTS OF BELIEF, INTENTIONS AND EXPECTATIONS ABOUT DEVELOPMENTS, RESULTS AND EVENTS THAT WILL OR MAY OCCUR IN THE FUTURE, CONSTITUTE "FORWARD-LOOKING STATEMENTS" AND ARE BASED ON CERTAIN ASSUMPTIONS AND ANALYSIS MADE BY ORCA EXPLORATION. FORWARD-LOOKING STATEMENTS IN THIS MD&A INCLUDE, BUT ARE NOT LIMITED TO, STATEMENTS WITH RESPECT TO FUTURE CAPITAL EXPENDITURES, INCLUDING THE AMOUNT, NATURE AND TIMING THEREOF, NATURAL GAS PRICES AND DEMAND.

SUCH FORWARD-LOOKING STATEMENTS ARE SUBJECT TO IMPORTANT RISKS AND UNCERTAINTIES, WHICH ARE DIFFICULT TO PREDICT AND THAT MAY AFFECT ORCA EXPLORATION'S OPERATIONS, INCLUDING, BUT NOT LIMITED TO: THE IMPACT OF GENERAL ECONOMIC CONDITIONS IN TANZANIA, ITALY AND CANADA; INDUSTRY CONDITIONS, INCLUDING THE ADOPTION OF NEW ENVIRONMENTAL, SAFETY AND OTHER LAWS AND REGULATIONS AND CHANGES IN HOW THEY ARE INTERPRETED AND ENFORCED; SANCTITY OF CONTRACT; VOLATILITY OF OIL AND NATURAL GAS PRICES; OIL AND NATURAL GAS PRODUCT SUPPLY AND DEMAND, RIG AVAILABILITY; RISKS INHERENT IN ORCA EXPLORATION'S ABILITY TO GENERATE SUFFICIENT CASH FLOW FROM OPERATIONS TO MEET ITS CURRENT AND FUTURE OBLIGATIONS; INCREASED COMPETITION; THE FLUCTUATION IN FOREIGN EXCHANGE OR INTEREST RATES; STOCK MARKET VOLATILITY; COST POOL AUDITS AND OTHER FACTORS, MANY OF WHICH ARE BEYOND THE CONTROL OF ORCA EXPLORATION.

ORCA EXPLORATION'S ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS COULD DIFFER MATERIALLY FROM THOSE EXPRESSED IN, OR IMPLIED BY, THESE FORWARD-LOOKING STATEMENTS AND, ACCORDINGLY, NO ASSURANCE CAN BE GIVEN THAT ANY OF THE EVENTS ANTICIPATED BY THE FORWARD-LOOKING STATEMENTS WILL TRANSPIRE OR OCCUR, OR IF ANY OF THEM DO TRANSPIRE OR OCCUR, WHAT BENEFITS ORCA EXPLORATION WILL DERIVE THEREFROM. SUBJECT TO APPLICABLE LAW, ORCA EXPLORATION DISCLAIMS ANY INTENTION OR OBLIGATION TO UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. ALL FORWARD-LOOKING STATEMENTS CONTAINED IN THIS DOCUMENT ARE EXPRESSLY QUALIFIED BY THIS CAUTIONARY STATEMENT.

## NON-GAAP MEASURES

THE COMPANY EVALUATES ITS PERFORMANCE BASED ON FUNDS FLOW FROM OPERATING ACTIVITIES AND OPERATING NETBACKS. FUNDS FLOW FROM OPERATING ACTIVITIES IS A NON-GAAP (GENERALLY ACCEPTED ACCOUNTING PRINCIPLES) 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. ORCA EXPLORATION ALSO ASSESSES ITS PERFORMANCE UTILIZING OPERATING NETBACKS. OPERATING NETBACKS REPRESENT THE PROFIT MARGIN ASSOCIATED WITH THE PRODUCTION AND SALE OF ADDITIONAL GAS AND IS CALCULATED AS REVENUES LESS RINGMAIN TARIFF, 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. THE OPERATIONS IN ITALY ARE CURRENTLY IN THE EXPLORATION PHASE AND HAVE NO ASSOCIATED OPERATING REVENUE. THESE NON-GAAP MEASURES ARE NOT STANDARDISED AND THEREFORE MAY NOT BE COMPARABLE TO SIMILAR MEASUREMENTS OF OTHER ENTITIES.

ADDITIONAL INFORMATION REGARDING ORCA EXPLORATION GROUP INC IS AVAILABLE UNDER THE COMPANY'S PROFILE ON SEDAR AT *www.sedar.com*.

## BACKGROUND

*Tanzania*

Orca Exploration's principal operating asset is its interest in a Production Sharing Agreement ("PSA") with the Tanzania Petroleum Development Corporation ("TPDC") in 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, namely a gas processing plant on Songo Songo Island, 232 kilometers of pipeline to Dar es Salaam and a 16 kilometer spur to the Wazo Hill Cement Plant.

Songas utilizes the Protected Gas (maximum 45.1 MMcfd) 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. Orca Exploration 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.

Orca Exploration has the right to produce and market all gas in the Songo Songo field in excess of the Protected Gas requirements ("Additional Gas").

*Italy*

During 2010 Orca Exploration farmed in to an oil appraisal block in the Adriatic in Italy and to a gas exploration prospect in the Po Valley in north eastern Italy.

## 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 sales of Additional Gas may be made from the Discovery Blocks if in Orca Exploration'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).

In June 2008, the Company initialled a long term power contract (Amended and Restated Gas Agreement ("ARGA") with the electricity utility, Tanzania Electric Supply Company ("TANESCO"), the owner of the Ubungo power plant, Songas Limited and the Ministry of Energy and Minerals ("MEM"). This contract covers the supply of gas to the sixth turbine at the Ubungo power plant and provides for a maximum of approximately 9 MMcfd until July 2024. 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 them whole in the event of a Protected Gas insufficiency. Once the IA is 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 shall fund an escrow account at a rate of US$2/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 does not anticipate that a liability will occur in this respect.

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(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 Orca Exploration and TPDC from the Discovery Blocks prior to the occurrence of the Insufficiency, Orca Exploration 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) and the amount of transportation revenues previously credited by Songas to the electricity utility, 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.

As discussed in (c) above an Insufficiency Agreement has been negotiated with TPDC, Songas and TANESCO that reduces these potential liabilities. The Insufficiency Agreement is expected to be signed at the same time as the long term power contracts.

**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 which has a small gas field on Songo Songo Island has indicated that it wishes to tie its production into the gas processing plant. This is currently under discussion.

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 (in Q2 2011 the Company accrued US$0.7 million for marketing costs that have been incurred by TPDC since start up); 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 the Additional Gas plans as submitted to the MEM ("Additional Gas Plan") 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.

TPDC has indicated that they wish to exercise their right to 'back in' to the field development by contributing 20% of the cost of SS-10 and the cost of future new wells in return for a 20% increase in the profit share percentage for the production emanating from these wells. The implications and workings of the 'back in' are currently being discussed with TPDC and there may be the need for reserve and accounting modifications once these discussions are concluded. For the purpose of the reserves certification as at 31 December 2010, it has been assumed that they will 'back in' for 20% for all future new wells and other developments and this is reflected in the Company's net reserve position.

(h) On 27 February 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 ARGA and the Portfolio Gas Sales Agreement 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 in respect of sales to the power sector.

During Q2 2011, the Company signed a Re-rating Agreement with TANESCO and Songas to run the gas processing plant at levels of up to 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 103 MMcfd). The agreement is expected to remain in force for the period until the Songas Expansion Project is operational. 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.

(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, the higher the cumulative production or the average daily sales, whichever is higher. The profit 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 share is 55%.

Where TPDC elects to participate in a development program, their 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. Where income tax is payable, there is a corresponding deduction in the amount of the Profit Gas payable to TPDC.

(k) Additional Profits Tax 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 Additional Profits Tax is payable until the Company recovers its costs out of Additional Gas revenues plus an annual return of 25% plus the percentage change in the United States Industrial Goods Producer Price Index ("PPI"); and (ii) the maximum Additional Profits Tax 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 share can increase with larger daily gas sales and that the costs will be recovered with a 25% plus PPI annual return before Additional Profits Tax becomes payable. Additional Profits Tax can have a significant negative impact on the project economics if only limited capital expenditure is incurred.

For Additional Gas produced outside of the Proven Section, the Company's profit share increases to 55%.

Where TPDC elects to participate in a development program, their 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. Where income tax is payable, there is a corresponding deduction in the amount of the Profit Gas payable to TPDC.

**Operatorship**

(l) The Company is appointed to develop, produce and process Protected Gas and operate and maintain the 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 ("GoT") 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, Orca Exploration, Commonwealth Development Corporation or insurance coverage, then Orca Exploration 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.

# Results for the quarter ended 30 June 2011

## OPERATING VOLUMES

The sales volumes for the quarter were 3,653 MMcf or 40.2 MMcfd. This represents an increase of 22% over Q2 2010. The total sales volumes for the six months ended 30 June 2011 were 6,996 MMcf or 38.6 MMcfd an increase of 14% over 2010.

The Company sales volumes were split between the industrial and power sectors as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| GROSS SALES VOLUME (MMCF): | | | | |
| Industrial sector | 688 | 562 | 1,237 | 1,048 |
| Power sector | 2,965 | 2,440 | 5,759 | 5,096 |
| *Total volumes* | 3,653 | 3,002 | 6,996 | 6,144 |
| GROSS DAILY SALES VOLUME (MMCFD): | | | | |
| Industrial sector | 7.6 | 6.2 | 6.8 | 5.8 |
| Power sector | 32.6 | 26.8 | 31.8 | 28.2 |
| *Total daily sales volume* | 40.2 | 33.0 | 38.6 | 34.0 |

**Industrial sector**

Industrial sales volumes of 688 MMcf (7.6 MMcfd) were recorded in Q2 2011. This represents an increase of 22% over the 562 MMcf (6.2 MMcfd) recorded in Q2 2010. The increase is due to the 103% rise in the level of Additional Gas supplied to Kiln 4 at Tanzania Portland Cement Company's ("TPCC") Wazo Hill cement plant.

Industrial sales volumes for the six months ended 30 June 2011 have increased by 18% to 1,237 MMcf from 1,048 MMcfd in 2010, with the sales to Wazo Hill cement plant accounting for 33% and 23% of the total sales recorded in 2011 and 2010 respectively.

**Power sector**

Power sector sales volumes of 2,965 MMcf (32.6 MMcfd) were recorded in Q2 2011. This represents an increase of 22% over the 2,440 MMcf (26.8 MMcfd) recorded in Q2 2010. The volume of gas consumed by the Ubungo and the TANESCO 102 MW power plant, have remained at a similar level during both periods. The increase is a consequence of the supply of gas to the Symbion power plant that was commissioned during the quarter.

Power sector sales volumes for the six months ended 30 June 2011 have increased by 13% to 5,759 MMcf from 5,096 MMcf in 2010. The increase being the result of a decline in the use of hydro-generation due to the low levels of rain fall experienced during 2011.

## COMMODITY PRICES

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| US$/MCF | | | | |
| **Average sales price** | | | | |
| Industrial sector | 10.28 | 9.45 | 9.90 | 9.38 |
| Power sector | 2.64 | 2.56 | 2.63 | 2.56 |
| Weighted average price | 4.08 | 3.85 | 3.92 | 3.73 |

**Industrial sector**

The average sales price achieved for Q2 2011 was US$10.28/mcf compared to US$9.45/mcf in Q2 2010. The increase in sales price is a consequence of the fluctuation in the world energy prices. The price of gas for the industrial sector (with the exception of the gas supplied to the Wazo Hill cement plant) continued to be set at a discount to the price of Heavy Fuel Oil ("HFO") in Dar es Salaam. The supply of gas to Wazo Hill has a fixed pricing structure that was set by reference to their alternative fuel supply which is imported coal.

**Power sector**

The average sales price to the power sector was US$2.64/mcf for the quarter compared to US$2.56/mcf in Q1 2010. The increase in the sales price over Q2 2010 is primarily due to the annual inflationary increase in respect of the supply of Additional Gas to the power sector.

## OPERATING REVENUE

Under the terms of the PSA with TPDC, Orca Exploration is responsible for invoicing, collecting and allocating the revenue from Additional Gas sales.

Orca Exploration 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"). Any costs not recovered in any period are carried forward to be recovered out of future revenues. In addition the recovery of the cost pool has meant that TPDC is now able to recover its past marketing costs (US$1.3 million accrued for the six months ended 30 June 2011, an increase of US$0.8 million over Q1 2011) in accordance with the terms of the PSA. The TPDC marketing costs are treated as a reduction to the Company's Cost Gas entitlement.

The Additional Gas sales volumes were in excess of 40 MMcfd for Q2 2011 and 30 MMcfd for Q2 2010. Consequently, the revenue less cost recovery share of revenue ("Profit Gas") was 40% for Q2 2011 and 35% for Q2 2010 in accordance with the terms of the PSA.

From January 2011, a significant proportion of the gas production was from a deemed TPDC backed in well (namely SS10). As a result TPDC's profit share increased by 20% for the production attributable to the SS-10 well. The Company is still to resolve the details of the back in with TPDC.

Orca Exploration had partial cost recovery through the quarter and accordingly was allocated 60.75% (Q2 2010: 83.75%) of the Net Revenues as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Gross sales revenue | 14,888 | 11,557 | 27,400 | 22,893 |
| Gross tariff for processing plant and pipeline infrastructure | (2,155) | (1,772) | (4,128) | (3,625) |
| Gross revenue after tariff | 12,733 | 9,785 | 23,272 | 19,268 |
| *Analysed as to:* | | | | |
| Company Cost Gas | 4,948 | 7,339 | 12,306 | 14,451 |
| Company Profit Gas | 2,787 | 856 | 3,688 | 1,686 |
| Company operating revenue | 7,735 | 8,195 | 15,994 | 16,137 |
| TPDC share of revenue | 4,998 | 1,590 | 7,278 | 3,131 |
| | 12,733 | 9,785 | 23,272 | 19,268 |

The Company's revenue reported for the quarter amounted to US$8,296,000 after adjusting the Company's operating revenue of US$7,735,000 by:

- US$1,155,000 for current income tax. The Company is liable for income tax in Tanzania, but the income tax is recoverable out of TPDC's share of Profit Gas when the tax is payable. To account for this, revenue is adjusted to reflect the current income tax charge.
- US$594,000 for the deferred effect of Additional Profits Tax. This tax is considered a royalty and is netted against revenue.

The Company's cost pool in Tanzania was fully recovered during Q2 2011 as a result of strong sales revenue and relatively low capital expenditure levels. This has resulted in a reduction in the percentage of net revenue attributable to the Company prior to any significant expenditure on the drilling activities, which is due to commence in the third quarter.

Revenue per the income statement may be reconciled to the operating revenue as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Industrial sector | 7,066 | 5,304 | 12,246 | 9,829 |
| Power sector | 7,822 | 6,253 | 15,154 | 13,064 |
| **Gross sales revenue** | 14,888 | 11,557 | 27,400 | 22,893 |
| Processing and transportation tariff | (2,155) | (1,772) | (4,128) | (3,625) |
| TPDC share of revenue | (4,998) | (1,590) | (7,278) | (3,131) |
| **Company operating revenue** | 7,735 | 8,195 | 15,994 | 16,137 |
| Additional Profits Tax | (594) | (183) | (787) | (360) |
| Current income tax adjustment | 1,155 | 1,005 | 2,729 | 1,499 |
| **Revenue** | 8,296 | 9,017 | 17,936 | 17,276 |

## PROCESSING AND TRANSPORTATION TARIFF

A flat rate gas processing and transportation tariff of US$0.59/mcf was introduced on 1 January 2010 that will enable Songas to make a rate of return on their investment as determined by EWURA. This rate should remain constant until the completion of the Songas Expansion project which is scheduled for completion in Q1 2013. The Company will pass on any increase or decrease in the EWURA approved charges to TANESCO/Songas in respect of sales to the power sector. This protocol insulates Orca Exploration from any increases in the gas processing and pipeline infrastructure costs.

During Q2 2011, the Company signed a Re-rating Agreement with TANESCO and Songas to run the gas processing plant at levels of up to 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 103 MMcfd). The agreement is expected to remain in force for the period until the Songas Expansion Project is operational. The agreement was ratified in July 2011 and the Company will effectively pay 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.

## 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 quarter. The total costs for the maintenance for the quarter was US$240,000 (Q2 2010: US$230,000) and US$112,000 (Q2 2010: US$104,000) was allocated for the Additional Gas. The total cost for well maintenance for the six months ended 30 June 2011 where US$211,000 compared to US$232,000 for the six months ended 30 June 2010.

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 that are not recoverable from Songas.

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

TPDC and MEM have indicated that they wish Orca to unbundle the downstream distribution business in Tanzania. The methodology for this is still to be discussed in detail with both TPDC and MEM.

These costs are summarized in the table below:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Share of well maintenance | 112 | 104 | 211 | 232 |
| Other field and operating costs | 380 | 437 | 708 | 854 |
| | 492 | 541 | 919 | 1,086 |
| Ringmain distribution pipeline | 691 | 538 | 1,290 | 1,080 |
| **Production and distribution expenses** | 1,183 | 1,079 | 2,209 | 2,166 |

## OPERATING NETBACKS

The netback per mcf before general and administrative costs, overheads, tax and Additional Profits Tax may be analysed as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| (AMOUNTS IN US$/MCF) | | | | |
| Gas price – industrial | 10.28 | 9.45 | 9.90 | 9.38 |
| Gas price – power | 2.64 | 2.56 | 2.63 | 2.56 |
| **Weighted average price for gas** | 4.08 | 3.85 | 3.92 | 3.73 |
| Processing and transportation tariff | (0.59) | (0.59) | (0.59) | (0.59) |
| TPDC share of revenue | (1.37) | (0.53) | (1.04) | (0.51) |
| **Net selling price** | 2.12 | 2.73 | 2.29 | 2.63 |
| Well maintenance and other operating costs | (0.13) | (0.18) | (0.13) | (0.18) |
| Ringmain distribution pipeline | (0.19) | (0.18) | (0.18) | (0.18) |
| **Operating netback** | 1.80 | 2.37 | 1.98 | 2.27 |

The operating netback for the quarter was US$1.80/mcf (Q2 2010: US$2.37/mcf).

The increase in the net selling price from US$3.85/mcf to US$4.08/mcf in Q2 2011 is a consequence of the increase in both the gas price achieved in both the industrial and power markets. The increase in sales price has been further enhanced by a marginal decline in the overall cost associated with well maintenance and other field operating costs.

During Q2 2011, TPDC's share of revenue increased as a result of greater production from a backed in well, SS-10 and the recovery of US$0.77 million in Q2 2011 and US$0.5 million in Q1 2011 of past marketing costs in accordance with the terms of the PSA.

The operating netbacks have declined during the quarter as a result of the cost recovery being limited to 38.85% of the Net Revenues. This was due to the payment of TPDC's past marketing costs and the depletion of the cost recovery pool during the quarter.

## ADMINISTRATIVE EXPENSES

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Employee costs | 1,001 | 507 | 1,705 | 1,016 |
| Consultants | 765 | 664 | 1,322 | 1,335 |
| Travel and accommodation | 274 | 231 | 442 | 409 |
| Communications | 33 | 15 | 53 | 43 |
| Office | 489 | 252 | 832 | 529 |
| Insurance | 136 | 75 | 272 | 163 |
| Auditing and taxation | 155 | 45 | 216 | 88 |
| Depreciation | 49 | 57 | 92 | 109 |
| Reporting, regulatory and corporate | 202 | 163 | 420 | 228 |
| | 3,104 | 2,009 | 5,354 | 3,920 |
| Marketing costs including legal fees | 453 | 332 | 815 | 790 |
| New ventures | 93 | 77 | 258 | 145 |
| Stock based compensation | (163) | (10) | (90) | 286 |
| **General and administrative expenses** | 3,487 | 2,408 | 6,337 | 5,141 |

The G&A includes the costs of running the gas distribution business in Tanzania which is recoverable as Cost Gas and is relatively fixed in nature.

G&A averaged approximately US$1.16 million per month for Q2 2011 compared to US$0.80 million in Q2 2010. G&A per mcf increased to US$0.95/mcf (Q2 2010: US$0.80/mcf).

The main variances for both the quarter and the six months ended 30 June 2011 compared to the same periods in 2010 are summarized below:

**Employee costs**

The increase in employment costs is mainly a consequence of fees incurred in relation to senior executive appointments and their respective salaries.

**Reporting, regulatory and corporate finance**

The increase of costs is a result of the strengthening of the board of directors and the amount of time incurred in relation to the development of the drilling programme in response to the corrosion tubing issue identified in Q4 2010.

**Stock based compensation**

A total of 2,557,400 stock options were outstanding at the end of Q2 2011 compared to 2,797,400 at the end of Q2 2010. A total of 240,000 were exercised in Q4 2010. Of the outstanding options, 1,662,400 were issued in 2004 and were fully expensed by the end of 2007. The remaining 895,000 were issued during 2007 and were fully expensed by the end of 2010. The stock options have been valued using the Black-Scholes option pricing model and vest over three years from the date of grant.

A total of 930,000 stock appreciation rights were in issue at the end of Q2 2011 and Q2 2010. In June 2010, 225,000 stock appreciation rights were issued to the new non executive directors with an exercise price of Cdn$4.20 per share. These rights have a five year term and vest in five equal instalments, the first fifth vesting on the anniversary of the grant date. As stock appreciation rights are settled in cash they are re-valued at each reporting date using the Black-Scholes option pricing model. As at 30 June 2011 the following assumptions were used; stock volatility 54% to 72%, a risk free interest rate between 1.50% and 2.50% and a closing stock price of Cdn$4.75. A credit of US$0.16 million was recorded in Q2 2011 compared to a credit of US$0.40 million in Q2 2010 in respect of these stock appreciation rights, resulting in a total credit of US$0.1 million being recorded for the six months ending 30th June 2011, compared to a total credit of US$0.2 million in 2010.

The total stock based compensation charges may be summarized as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Stock options | – | 379 | – | 534 |
| Stock appreciation rights | (163) | (389) | (90) | (248) |
| | (163) | (10) | (90) | 286 |

## NET FINANCE COSTS

The loss on foreign exchange experienced in the quarter is a result of the 9% appreciation of the US Dollars against the Tanzanian Shilling. Despite the gas sales price being denominated in US Dollars, the invoices are submitted in Tanzanian Shillings. Therefore, there is an exchange exposure between the time that the invoices are submitted and the date that the payment is received. The small gain in foreign exchange is a result of the strengthening US Dollar against the British pound sterling which has resulted in gains following the payment of trade payables.

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| FINANCE INCOME | | | | |
| Interest income | 1 | 2 | 4 | 3 |
| Foreign exchange gain | 9 | 1 | 32 | 27 |
| | 10 | 3 | 36 | 30 |
| FINANCE CHARGES | | | | |
| Overdraft charges | – | (2) | – | (12) |
| Foreign exchange loss | (567) | (508) | (745) | (712) |
| | (567) | (510) | (745) | (724) |
| **Net finance costs** | (557) | (507) | (709) | (694) |

## TAXATION

### Income Tax

Under the terms of the PSA with TPDC, 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 profit share. This is reflected in the accounts by adjusting the Company's revenue by the appropriate amount.

As at 30 June 2011, 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$13.5 million which includes an additional deferred future income tax charge of US$0.2 million for the quarter (Q2 2010: US$0.8 million), resulting in a total charge for the six months to 30 June of US$0.7 million and US$1.8 million for 2011 and 2010 respectively. This 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, an Additional Profits Tax ("APT") is payable.

The Company provides for APT by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA license. The effective APT rate has been calculated to be 20%. Accordingly, US$0.6 million (Q2 2010: US$0.2 million) has been netted off revenue for the quarter ended 30 June 2011. The total adjustment for the six months to 30 June was US$0.8 million and US$0.4 million for 2011 and 2010 respectively.

Management does not anticipate that any APT will be payable in 2011, as the forecast revenues will not be sufficient to cover the un-recovered costs brought forward as inflated by 25% plus the PPI percentage change and the forecast expenditures for 2011. The actual APT that will be paid is dependent on the achieved value of the Additional Gas sales and the quantum and timing of the operating costs and capital expenditure program.

The APT can have a significant negative impact on the Songo Songo project economics as measured by the net present value of the cash flow streams. Higher revenue in the initial years leads to a rapid payback of the project costs and consequently accelerates the payment of the APT that can account for up to 55% of the Company's profit share. Therefore, the terms of the PSA rewards the Company for taking higher risks by incurring capital expenditure in advance of revenue generation.

## 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 2010 the proven reserves as evaluated by the independent reservoir engineers, McDaniel & Associates Consultants Ltd were 369.2 Bcf on a life of licence basis. This resulted in a depletion charge of US$0.47/mcf in Q1 and Q2 2011. The depletion charge in 2010 for the quarter and for the six months ended 30 June 2010 was US$0.31/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 written off and charged to earnings.

## EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit after taxation and comprehensive income for the six months ended 30 June 2011 of US$2.8 million (2010: US$4.5 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,689,810 (2010: 29,494,123).

In computing the diluted earnings per share, the dilutive effect of the stock options was 1,160,929 (2010: 1,242,359) shares. These are added to the weighted average number of common shares outstanding for the year to date resulting in a diluted weighted average number of Class A and Class B shares of 35,850,739 for the six months ended 30 June, 2011 (2010: 30,736,482).

The decrease in the earnings per share during 2011 is due to a fall in net revenue during the second quarter as the cost recovery pool in Tanzania was depleted and a rise in the level of general administrative expenditure as senior management was strengthened. The earnings per share is expected to increase in the second half of the year as expenditure is incurred on drilling activities and higher sales volumes are achieved with the increase in infrastructure capacity as a result of the re-rating.

## FUNDS GENERATED BY OPERATIONS

Funds flow from operating activities were US$3.3 million for the quarter ended 30 June 2011 (Q2 2010: US$5.0 million) and US$8.2 million for the six months ended 30 June 2011 (2010: US$9.5 million).

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| FIGURES IN US$'000 | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| Profit after taxation | 383 | 2,608 | 2,773 | 4,548 |
| Adjustments (1) | 2,909 | 2,393 | 5,466 | 4,993 |
| **Funds from operations before working capital changes** | 3,292 | 5,001 | 8,239 | 9,541 |
| Working capital adjustments (1) | (1,150) | (1,329) | (2,601) | (4,351) |
| **Net cash flows from operating activities** | 2,142 | 3,672 | 5,638 | 5,190 |
| Net cash flows used in investing activities | (838) | (670) | (2,080) | (1,163) |
| Effect of change in foreign exchange | (87) | (200) | (84) | (251) |
| **Net increase in cash and cash equivalents** | 1,217 | 2,802 | 3,474 | 3,776 |

(1) PLEASE REFER TO CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS FOR BREAKDOWN

The US$1.2 million increase in cash and cash equivalents for the quarter is a result of the US$3.3 million of funds from operations before working capital changes during the quarter being offset by US$0.8 million of capital expenditure incurred together with an overall net cash reduction of US$1.3 million in working capital.

The US$3.5 million increase in cash and cash equivalents for the six months ended 30 June 2011 is a result of the US$8.2 million of funds generated from operations before working capital changes during the period being offset by US$2.1 million of capital expenditure, together with an overall net decrease in working capital of US$2.6 million.

## CAPITAL EXPENDITURE

Gross capital expenditures amounted to US$1.6 million during the quarter (Q2 2010: US$0.9 million) and US$2.9 million for the six months ended 30 June 2011 (2010: US$1.1 million).

The capital expenditure may be analysed as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Geological and geophysical and well drilling | 1,124 | 320 | 2,023 | 489 |
| Pipelines and infrastructure | 364 | 492 | 726 | 507 |
| Power development | 11 | – | 15 | – |
| Other equipment | 94 | 77 | 185 | 127 |
| | 1,593 | 889 | 2,949 | 1,123 |

### Geological and geophysical and well drilling

A total of US$0.15 million of expenditure was incurred during the quarter on geological and geophysical studies in preparation for the drilling of Songo Songo West in 2012. The balance of US$0.975 million was spent on the preparation for the drilling of SS-A well and the enhancement of the SS-10 production well and corrosion studies in relation to developing the optimum plan for the work-over of the wells currently shut-in.

### Pipelines and infrastructure

A total of US$0.4 million of expenditure was incurred during the quarter on the development of the compressed natural gas ("CNG") distribution facilities, the long term expansion project and connection of new customers to the low pressure distribution network in Dar es Salaam.

## WORKING CAPITAL

Working capital as at 30 June 2011 was US$57.1 million compared with US$52.4 million as at 31 December 2010 and may be analyzed as follows:

| | As at | |
|---|---|---|
| | 30-Jun 2011 | 31-Dec 2010 |
| FIGURES IN US$'000 | | |
| Cash and cash equivalents | 48,993 | 45,519 |
| Trade and other receivables | 18,323 | 13,583 |
| Taxation receivable | 4,625 | 4,009 |
| Prepayments | 789 | 409 |
| | 72,730 | 63,520 |
| Trade and other payables | 13,750 | 9,156 |
| Taxation payable | 1,910 | 2,000 |
| **Working capital** | 57,070 | 52,364 |

The level of working capital has increased by 9% during the six months ended 30 June 2011.

The majority of the Company's cash is held in US dollars in Mauritius. There are no restrictions in Tanzania for converting Tanzania Shillings into US dollars.

Of the total trade and other receivables at 30 June 2011, US$14.6 million was represented by trade receivables (Q4 2010: US$11.9 million) and US$3.7 million other receivables (Q4 2010: US$1.7 million). The increase in other receivables is a consequence of the increased level of monies owed by Songas for the operation of the Songo Songo gas processing plant, together with costs that are due to be repaid by Songas once the long term expansion project reaches financial close.

Under the contract terms with the industrial customers, the Additional Gas payments must be received within 30 days of the month end. As at 30 June 2011, US$5.9 million (Q4 2010: US$4.2 million) of trade receivables was due from the industrial customers. A significant part of this amount has been subsequently received. The balance of US$8.7 million (Q4 2010: US$7.7 million) in trade receivables is made up of amounts due from the two power customers, TANESCO and Songas. The majority of this amount has subsequently been received.

The contracts with Songas and the electricity utility, TANESCO, accounted for 52% of the Company's operating revenue during the quarter. Songas' financial security is heavily reliant on the payment of capacity and energy charges by TANESCO. Despite having a history of delayed payments, TANESCO has settled in full the outstanding balance subsequent to each quarter end.

## 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) 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 (54.6 Bcf as at 30 June 2011).

The Gas Agreement has been amended by an initialled 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 them whole in the event of a Protected Gas insufficiency. Once the new Insufficiency Agreement is 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 shall fund an escrow account at a rate of US$2/Mmbtu on all industrial Additional Gas sales out of its and TPDC 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 does not anticipate that a liability will occur in this respect.

*Back in*

TPDC has indicated that they wish to exercise their right to 'back in' to the field development by contributing 20% of the costs of the future new wells including SS-10 in return for a 20% increase in the profit share percentage for the production emanating from these wells. The implications and workings of the 'back in' are currently being discussed with TPDC and there may be the need for additional reserve and accounting modifications once these discussions are concluded. For the purpose of the reserves certification, it has been assumed that they will 'back in' for 20% for all future new drilling activities and other developments and this is reflected in the Company's net reserve position.

*Re-rating Agreement*

During Q2 2011, the Company signed a Re-rating Agreement with TANESCO and Songas Limited 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). The agreement is expected to remain in force for the period until the Songas Expansion Project is operational. 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 Limited 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.

*Portfolio Gas Sales Agreement*

On 17 June 2011, a long term (to June 2023) Portfolio Gas Sales Agreement (PGSA) was signed between Orca and TANESCO. Under the PGSA, Orca 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. The current basic wellhead gas price of US$ 2.02/ Mcf is due to increase to approximately US$2.70/Mcf on 1 July 2012.

*Operating leases*

The Company has two office rental agreements in Dar es Salaam, expiring on 30 November 2012 and 31 October 2013 at an annual rental of US$122,000 and US$110,000 per annum respectively.

**Capital Commitments**

*Italy*

On 31 May 2010, the Company signed an agreement with Petroceltic International plc ("Petroceltic") to farm in on Petroceltic's Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay Petroceltic fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US$0.5 million.

Petroceltic were due to spud the Elsa-2 well prior to 31 October 2010, but the Italian government passed a decree, following the blowout of the Macondo well in the U.S., that prevented the drilling in the Italian seas within 5 nautical miles of the coastline and within 12 nautical miles around the perimeter of protected Marine Parks. In view of this, Petroceltic suspended the permit until such time as the Ministry of Environment issues a decree of environmental compatibility for the drilling program. The project in currently on hold and Orca is not liable to any costs associated with the drilling of Elsa-2 until a rig contract is signed.

In December 2010, the Company announced a farm in to Northern Petroleum (UK) Limited's Longastrino Block in the Po Valley Basin. Under the terms of the farm in, Orca will pay 100% of the costs of the La Tosca well up to a cap of approximately €4.3 million and 70% of the costs thereafter. If the well is tested and completed, Orca will earn an additional 5% (taking it to 75%) by paying 100% of the testing costs up to €1.3 million and 75% thereafter. The Company will also pay back past costs of €0.6 million.

*Songo Songo*

In Q4 2010 the Company reduced the deliverability from its Songo Songo wells following receipt of results of a corrosion logging survey. Orca suspended production from SS-5, reduced flow rates from the other wells and expedited the tie in of the new onshore well SS10. As of today, the Company can produce approximately 113 MMcfd though this is currently restricted by the infrastructure capacity to a maximum of 102 MMcfd.

The corrosion model forecasts that the offshore well, SS-9 currently producing in the region of 30 MMcfd, may need to be taken out of production at the end of Q1 2012, subject to re-logging of the well in September 2011 to confirm its condition. Accordingly, the Company has determined that in 2011, subject to TPDC approval and rig availability a new onshore deviated well should be drilled followed by an enhancement of the SS-10 well. It is anticipated that the capital cost of this programme will be approximately US$35 million and could increase deliverability from the field to 168 MMcfd by the time SS-9 is taken out of production.

*Songo Songo West*

The Company is currently planning to drill one well on the Songo Songo West prospect at an estimated cost of US$25 million. It is currently estimated that the well will be spud in the second quarter of 2012. Assuming the well is a success a substantial well test program will be undertaken before the well is suspended at the mudline as a potential future producer.

*Cost Sharing Agreement*

In January 2011, the Company signed a cost sharing agreement with Songas, whereby the Company will fund 50% of the costs of getting the Songas Expansion Project (installation of gas processing capacity and downstream compression to increase the infrastructure capacity to 140 MMcfd) to financial close, up to a maximum of US$2.4 million. In the event that the costs are approved by the regulator, EWURA, the funds will be repaid by Songas at financial close. To date the company has funded US$0.4 million of expenditure. If the project is not successful, the costs will be recoverable by the Company under the terms of the PSA with TPDC.

*Funding*

The Company's 2011 work programme principally includes the drilling of the new onshore deviated well, SS-A, the enhancement of SS-10 and the purchase of long lead items for SSW. While there should be sufficient funds to undertake this work programme in 2011 through the use of existing cash balances and self generated cash flows, the Company will look to secure a financing facility and/or raise new equity to cover planned 2012 capital expenditure.

## CONTINGENCIES

*Unbundling*

TPDC and MEM have indicated that they wish Orca to unbundle the downstream distribution business in Tanzania. The methodology for this is still to be discussed in detail with both TPDC and MEM.

*Access to infrastructure*

Ndovu Resources Limited, with support from TPDC and the Ministry of Energy, has indicated that they wish to tie into the gas processing plant on Songo Songo Island and sell up to 10 MMcfd from their Kiliwani North field. The Company is currently in discussions with Ndovu to agree appropriate commercial terms.

*Cost recovery*

The Company's cost pool in Tanzania was depleted early in Q2 2011. This resulted in a reduction in the percentage of net revenue attributable to the Company that will continue until there is any significant expenditure on the drilling activities which will commence in Q3 2011. TPDC is still in the process of auditing the historic cost recovery pool and this may lead to adjustments in the future.

## RELATED PARTY TRANSACTIONS

One of the non executive Directors is a partner at a law firm. During the quarter, the Company incurred US$37,500 (Q2 2010: US$18,300) to this firm for services provided on legal services, resulting in a total expenditure of US$75,000 for the six months ended 30 June 2011 (2010 : US$55,800) . The transactions with this related party were made at the exchange amount.

## SHAREHOLDERS' EQUITY AND OUTSTANDING SHARE DATA

| | As at | |
|---|---|---|
| | 30-Jun 2011 | 31-Dec 2010 |
| NUMBER OF SHARES ('000) | | |
| SHARES OUTSTANDING | | |
| Class A shares | 1,751 | 1,751 |
| Class B shares | 32,939 | 32,939 |
| | 34,690 | 34,690 |
| CONVERTIBLE SECURITIES | | |
| Stock options | 2,557 | 2,557 |
| **Diluted Class A and Class B shares** | 37,247 | 37,247 |
| WEIGHTED AVERAGE | | |
| Class A and Class B shares | 34,690 | 30,795 |
| Convertible securities | | |
| Stock options | 1,161 | 1,098 |
| **Weighted average diluted Class A and Class B shares** | 35,851 | 31,893 |

### Shares outstanding

No stock options were issued or exercised during the quarter.

No Class B shares were purchased under the normal course issuer bid.

As at 26 August 2011, there were a total of 1,751,195 Class A shares and 32,938,615 Class B shares outstanding.

## SUMMARY QUARTERLY RESULTS

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

| FIGURES IN US$'000 EXCEPT WHERE OTHERWISE STATED | 2011 | | 2010 | | | | 2009 | |
|---|---|---|---|---|---|---|---|---|
| | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| FINANCIAL | | | | | | | | |
| Revenue | 8,296 | 9,640 | 10,557 | 10,975 | 9,017 | 8,259 | 7,837 | 7,536 |
| Profit after taxation | 383 | 2,390 | 1,885 | 3,578 | 2,608 | 1,940 | 1,564 | 1,549 |
| Operating netback (US$/MCF) | 1.80 | 2.16 | 2.28 | 2.32 | 2.37 | 2.19 | 2.29 | 2.17 |
| Working capital | 57,070 | 55,759 | 52,364 | 30,093 | 24,941 | 20,891 | 16,385 | 12,147 |
| Shareholders' equity | 100,956 | 100,573 | 98,183 | 77,827 | 73,942 | 70,955 | 68,860 | 67,159 |
| Profit per share – basic (US$) | 0.01 | 0.07 | 0.05 | 0.12 | 0.09 | 0.07 | 0.06 | 0.05 |
| Profit per share – diluted (US$) | 0.01 | 0.07 | 0.05 | 0.12 | 0.08 | 0.06 | 0.06 | 0.05 |
| CAPITAL EXPENDITURES | | | | | | | | |
| Geological and geophysical and well drilling | 1,124 | 899 | 607 | 502 | 320 | 169 | (890) | 338 |
| Pipeline and infrastructure | 364 | 362 | 383 | 692 | 492 | 15 | 157 | 1,339 |
| Power development | 11 | 4 | – | 6 | – | – | 343 | 289 |
| Other equipment | 94 | 91 | 45 | 23 | 77 | 50 | 69 | 27 |
| OPERATING | | | | | | | | |
| Additional Gas sold – industrial (MMCF) | 688 | 550 | 687 | 770 | 562 | 485 | 542 | 581 |
| Additional Gas sold – power (MMCF) | 2,965 | 2,794 | 2,926 | 2,918 | 2,440 | 2,656 | 2,570 | 2,493 |
| Average price per mcf – industrial (US$) | 10.28 | 9.42 | 8.67 | 8.01 | 9.45 | 9.32 | 9.49 | 9.02 |
| Average price per mcf – power (US$) | 2.64 | 2.62 | 2.63 | 2.63 | 2.56 | 2.56 | 2.41 | 2.41 |

# Condensed Consolidated Interim Statement of Comprehensive Income (unaudited)

| | | Three months ended | | Six months ended | |
|---|---|---|---|---|---|
| | NOTE | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| THOUSANDS OF US DOLLARS EXCEPT PER SHARE AMOUNTS | | | | | |
| **Revenue** | | 8,296 | 9,017 | 17,936 | 17,276 |
| **Cost of sales** | | | | | |
| Production and distribution expenses | | (1,183) | (1,079) | (2,209) | (2,166) |
| Depletion expense | | (1,728) | (931) | (3,310) | (1,910) |
| | | 5,385 | 7,007 | 12,417 | 13,200 |
| General and administrative expenses | | (3,487) | (2,408) | (6,337) | (5,141) |
| Net finance costs | | (557) | (507) | (709) | (694) |
| **Profit before taxation** | | 1,341 | 4,092 | 5,371 | 7,365 |
| Taxation | 1 | (958) | (1,484) | (2,598) | (2,817) |
| **Profit after taxation and comprehensive income** | | 383 | 2,608 | 2,773 | 4,548 |
| **Earnings per share** | | | | | |
| Basic (US$) | | 0.01 | 0.09 | 0.08 | 0.15 |
| Diluted (US$) | | 0.01 | 0.08 | 0.08 | 0.15 |

SEE ACCOMPANYING NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS.

# Condensed Consolidated Interim Statement of Financial Position (unaudited)

| As at | NOTE | 30-Jun 2011 | 31-Dec 2010 |
|---|---|---|---|
| THOUSANDS OF US DOLLARS | | | |
| ASSETS | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | | **48,993** | 45,519 |
| Trade and other receivables | | **18,323** | 13,583 |
| Taxation receivable | | **4,625** | 4,009 |
| Prepayments | | **789** | 409 |
| | | **72,730** | 63,520 |
| **Non-Current Assets** | | | |
| Exploration and evaluation assets | 2 | **1,480** | 942 |
| Property, plant and equipment | 3 | **58,951** | 59,946 |
| | | **60,431** | 60,888 |
| **Total Assets** | | **133,161** | 124,408 |
| EQUITY AND LIABILITIES | | | |
| **Current Liabilities** | | | |
| Trade and other payables | | **13,750** | 9,156 |
| Taxation payable | | **1,910** | 2,000 |
| | | **15,660** | 11,156 |
| **Non-Current Liabilities** | | | |
| Deferred income taxes | 1 | **13,497** | 12,809 |
| Deferred additional profits tax | | **3,048** | 2,260 |
| | | **16,545** | 15,069 |
| **Total Liabilities** | | **32,205** | 26,225 |
| **Equity** | | | |
| Capital stock | 4 | **85,100** | 85,100 |
| Contributed surplus | | **5,288** | 5,288 |
| Accumulated income | | **10,568** | 7,795 |
| | | **100,956** | 98,183 |
| **Total Equity and Liabilities** | | **133,161** | 124,408 |

SEE ACCOMPANYING NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS.
CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT (NOTE 6)
CONTINGENCIES (NOTE 7)

The condensed consolidated interim financial statements were approved by the Board of Directors on 26 August 2011.

John Patterson

Director

Director

# Condensed Consolidated Interim Statement of Cash Flows (unaudited)

| | NOTE | Three months ended 30-Jun 2011 | Three months ended 30-Jun 2010 | Six months ended 30-Jun 2011 | Six months ended 30-Jun 2010 |
|---|---|---|---|---|---|
| THOUSANDS OF US DOLLARS | | | | | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |
| Profit after taxation | | 383 | 2,608 | 2,773 | 4,548 |
| Adjustment for : | | | | | |
| Depletion and depreciation | 3 | 1,776 | 988 | 3,406 | 2,019 |
| Gain on disposal of vehicle | | – | – | (5) | – |
| Stock-based compensation | | (163) | (10) | (90) | 286 |
| Deferred income taxes | | 150 | 781 | 688 | 1,768 |
| Deferred additional profits tax | | 595 | 183 | 788 | 360 |
| Interest income | | (1) | (2) | (4) | (3) |
| Unrealised foreign exchange loss | | 552 | 453 | 683 | 563 |
| | | 3,292 | 5,001 | 8,239 | 9,541 |
| (Increase)/decrease in trade and other receivables | | (4,431) | 614 | (5,318) | (2,911) |
| Decrease/(increase) in taxation receivable | | 846 | (703) | (616) | (851) |
| (Increase)/decrease in prepayments | | (408) | 408 | (380) | (627) |
| Increase/(decrease) in trade and other payables | | 4,035 | (1,704) | 3,803 | (364) |
| (Decrease)/increase in taxation payable | | (1,192) | 56 | (90) | 402 |
| **Net cash flows from operating activities** | | 2,142 | 3,672 | 5,638 | 5,190 |
| CASH FLOWS USED IN INVESTING ACTIVITIES | | | | | |
| Exploration and evaluation expenditures | | (314) | – | (538) | (3) |
| Property, plant and equipment expenditures | | (1,279) | (889) | (2,411) | (1,120) |
| Interest received | | 1 | 2 | 4 | 3 |
| Proceeds from sale of vehicle | | – | – | 5 | – |
| Increase/(decrease) in trade and other payables | | 754 | 217 | 860 | (43) |
| **Net cash used in investing activities** | | (838) | (670) | (2,080) | (1,163) |
| CASH FLOWS USED IN FINANCING ACTIVITIES | | | | | |
| **Net cash flow used in financing activities** | | – | – | – | – |
| **Increase in cash and cash equivalents** | | 1,304 | 3,002 | 3,558 | 4,027 |
| **Cash and cash equivalents at the beginning of the period** | | 47,776 | 15,517 | 45,519 | 14,543 |
| **Effect of change in foreign exchange** | | (87) | (200) | (84) | (251) |
| **Cash and cash equivalents at the end of the period** | | 48,993 | 18,319 | 48,993 | 18,319 |

SEE ACCOMPANYING NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS.

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

| | Capital stock | Contributed surplus | Accumulated loss/income | Total |
|---|---|---|---|---|
| THOUSANDS OF US DOLLARS | | | | |
| **Balance as at 1 January 2010** | 66,267 | 4,809 | (2,216) | 68,860 |
| Stock-based compensation | – | 534 | – | 534 |
| Total comprehensive income for the period | – | – | 4,548 | 4,548 |
| **Balance as at 30 June 2010** | **66,267** | **5,343** | **2,332** | **73,942** |

| | Capital stock | Contributed surplus | Accumulated income | Total |
|---|---|---|---|---|
| THOUSANDS OF US DOLLARS | | | | |
| Note | 4 | | | |
| **Balance as at 1 January 2011** | 85,100 | 5,288 | 7,795 | 98,183 |
| Total comprehensive income for the period | – | – | 2,773 | 2,773 |
| **Balance as at 30 June 2011** | **85,100** | **5,288** | **10,568** | **100,956** |

SEE ACCOMPANYING NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS.

# Notes
## to the Condensed Consolidated Interim Financial Statements (unaudited)

### GENERAL INFORMATION

Orca Exploration Group Inc ("Orca Exploration "or the "Company") was incorporated on 28 April 2004 under the laws of the British Virgin Islands. The Company is a participant in a gas-to-electricity project 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 six months ended 30 June 2011 comprise the Company and all its wholly owned subsidiaries (collectively, the "Company").

### BASIS OF PREPARATION

The condensed consolidated interim financial statements are measured and presented in US dollars as the main operating cash flows are linked to this currency through the commodity price.

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 2010.

The preparation of these condensed consolidated interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. 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 2010.

Certain 2010 comparative numbers have been reclassified in order to conform with the current period presentation.

### STATEMENT OF COMPLIANCE

These condensed consolidated interim financial statements of Orca Exploration Group Inc ("Orca Exploration" or the "Company"), 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. These condensed consolidated interim financial statements were approved by the Board of Directors on 26 August 2011.

### 1 TAXATION

Under the terms of the Production Sharing Agreement with TPDC, the Company is liable to pay income tax at the corporate rate of 30% on profits generated in Tanzania. The amount paid is recovered in full from TPDC by adjusting their share of profit gas.

The tax charge is as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Current tax | 808 | 703 | 1,910 | 1,049 |
| Deferred tax | 150 | 781 | 688 | 1,768 |
| | 958 | 1,484 | 2,598 | 2,817 |

**Tax Rate Reconciliation**

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | 30-Jun 2011 | 30-Jun 2010 | 30-Jun 2011 | 30-Jun 2010 |
| FIGURES IN US$'000 | | | | |
| Profit before taxation | 1,341 | 4,092 | 5,371 | 7,365 |
| Provision for income tax calculated at the statutory rate of 30% | 402 | 1,228 | 1,611 | 2,210 |
| Add (deduct) the tax effect of non-deductible income tax items | | | | |
| Administrative and operating expenses | 577 | 241 | 968 | 482 |
| Stock based compensation | (49) | (3) | (27) | 86 |
| Other income | (16) | (2) | (16) | (3) |
| Permanent differences | 44 | 20 | 62 | 42 |
| | 958 | 1,484 | 2,598 | 2,817 |

As at 30 June 2011 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 30 June 2011. The deferred income tax liability includes the following temporary differences:

| As at | 30-Jun 2011 | 31-Dec 2010 |
|---|---|---|
| FIGURES IN US$'000 | | |
| Differences between tax base and carrying amount of property, plant and equipment | 13,133 | 12,194 |
| Income tax recoverable | 1,568 | 1,349 |
| Other liabilities | (290) | (56) |
| Additional profits tax | (914) | (678) |
| | **13,497** | 12,809 |

## 2 EXPLORATION AND EVALUATION ASSETS

| | Tanzania |
|---|---|
| FIGURES IN US'000 | |
| COSTS | |
| As at 1 January 2011 | 942 |
| Additions | 538 |
| **As at 30 June 2011** | **1,480** |
| NET BOOK VALUES | |
| **As at 30 June 2011** | **1,480** |
| **As at 31 December 2010** | 942 |

### TANZANIA
The exploration and evaluation asset relates to initial evaluation of the Songo Songo West prospect which is pending the determination of proven and probable reserves. There were no general administrative costs capitalized in the quarter.

### ITALY
During 2010, the Company farmed in to two exploration licences in Italy. To date no capital costs have been incurred on these assets and all the costs associated with the farm in have been recognized in the statement of comprehensive income.

## 3 PROPERTY, PLANT AND EQUIPMENT

| FIGURES IN US'000 | Tanzania | Leasehold improvements | Computer equipment | Vehicles | Fixtures & Fittings | Total |
|---|---|---|---|---|---|---|
| **COSTS** | | | | | | |
| As at 1 January 2011 | 80,323 | 320 | 509 | 231 | 108 | 81,491 |
| Additions | 2,206 | – | 158 | 47 | – | 2,411 |
| Disposals | – | – | – | (29) | – | (29) |
| **As at 30 June 2011** | **82,529** | **320** | **667** | **249** | **108** | **83,873** |
| **DEPLETION/DEPRECIATION** | | | | | | |
| As at 1 January 2011 | 20,741 | 244 | 345 | 149 | 66 | 21,545 |
| Charge for period | 3,310 | 12 | 52 | 23 | 9 | 3,406 |
| Depreciation on disposals | – | – | – | (29) | – | (29) |
| **As at 30 June 2011** | **24,051** | **256** | **397** | **143** | **75** | **24,922** |
| **NET BOOK VALUES** | | | | | | |
| **As at 30 June 2011** | **58,478** | **64** | **270** | **106** | **33** | **58,951** |
| As at 31 December 2010 | 59,582 | 76 | 164 | 82 | 42 | 59,946 |

In determining the depletion charge, it is estimated by the independent reserve engineers that future development costs of US$115.6 million (Q2 2010: US$57.5 million) will be required to bring the total proved reserves to production.

## 4 CAPITAL STOCK

### Authorized and issued Share Capital

| **Number of shares** (THOUSANDS) | Authorised | Issued | Amount |
|---|---|---|---|
| **CLASS A** | | | |
| As at 1 January 2011 and 30 June 2011 | 50,000 | 1,751 | 983 |
| **CLASS B** | | | |
| As at 1 January 2011 and 30 June 2011 | 50,000 | 32,939 | 84,117 |
| Total Class A and Class B as at 1 January 2011 and 30 June 2011 | 100,000 | 34,690 | 85,100 |

All of the issued capital stock is fully paid.

### Stock Options

The table below details the outstanding share options and the movements for the three months ended 30 June 2011:

| THOUSANDS OF OPTIONS OR CDN$ | Options | Exercise price (CDN$) |
|---|---|---|
| Outstanding as at 1 January 2011 and 30 June 2011 | 2,557 | 1.00 to 13.55 |

The weighted average remaining life and weighted average exercise price of options at 30 June 2011 were as follows:

| Exercise Price (CDN$) | Number outstanding as at 30 June 2011 ('000) | Weighted average remaining contractual life (YEARS) | Number exercisable as at 30 June 2011 ('000) | Weighted average exercise price (CDN$) |
|---|---|---|---|---|
| 1.00 | 1,422 | 3.17 | 1,422 | 1.00 |
| 8.00 - 13.55 | 1,135 | 0.87 | 1,135 | 11.36 |
| | 2,557 | | 2,557 | |

### Stock Appreciation Rights

| | Options | Exercise price |
|---|---|---|
| THOUSANDS OF STOCK APPRECIATION RIGHTS OR CDN$ | | |
| Outstanding as at 1 January 2011 and 30 June 2011 (i)/(ii) | 930 | 4.20 to 13.55 |

*(i) A total of 225,000 stock appreciation rights were issued in June 2010 with an exercise price of Cdn$4.20. These rights have a term of five years and vest in five equal instalments, the first fifth vesting on the anniversary of the grant date. There is no maximum liability associated with these rights.*

*(ii) A total of 705,000 stock appreciation rights have a term of five years. All of these options vested over a period of three years and are now fully vested. There is no maximum liability associated with these rights .*

The Company records a charge to the income statement using the Black-Scholes fair valuation option pricing model every reporting period with a resulting liability being recognised in the balance sheet. In the valuation of these stock appreciation rights at the reporting date, the following assumptions have been made: a risk free rate of interest of 1.50% to 2.50%, stock volatility of 54% to 72%, 0% dividend yield and a range of forfeiture from 0% to 33% and a closing stock price of Cdn$4.75 per share.

As at 30 June 2011, a total accrued liability of US$0.4 million has been recognised in relation to the stock appreciation rights. The liability having been reduced by US$0.2 million during the period as a result in an overall decline in the valuation of the stock appreciation rights, a reduction of US$0.4 million having been recorded in Q2 2010.

### Shareholders' Equity and Outstanding Share Data

| | As at 30-Jun 2011 | As at 31-Dec 2010 |
|---|---|---|
| NUMBER OF SHARES ('000) | | |
| SHARES OUTSTANDING | | |
| Class A shares | 1,751 | 1,751 |
| Class B shares | 32,939 | 32,939 |
| | 34,690 | 34,690 |
| CONVERTIBLE SECURITIES | | |
| Stock options | 2,557 | 2,557 |
| Diluted Class A and Class B shares | 37,247 | 37,247 |
| WEIGHTED AVERAGE | | |
| Class A and Class B shares | 34,690 | 30,795 |
| CONVERTIBLE SECURITIES | | |
| Stock options | 1,161 | 1,098 |
| **Weighted average diluted Class A and Class B shares** | 35,851 | 31,893 |

## 5 RELATED PARTY TRANSACTIONS

One of the non executive Directors is a partner at a law firm. During the quarter, the Company incurred US$37,500 (Q2 2010: US$18,300) to this firm for services provided on legal services, resulting in a total expenditure of US$75,000 for the six months ended 30 June 2011 (2010 : US$55,800) . The transactions with this related party were made at the exchange amount.

## 6 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) 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 (54.6 Bcf as at 30 June 2011).

The Gas Agreement has been amended by an initialled 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 them whole in the event of a Protected Gas insufficiency. Once the new Insufficiency Agreement is 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 shall fund an escrow account at a rate of US$2/Mmbtu on all industrial Additional Gas sales out of its and TPDC 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 does not anticipate that a liability will occur in this respect.

#### *Back in*

TPDC has indicated that they wish to exercise their right to 'back in' to the field development by contributing 20% of the costs of the future new wells including SS-10 in return for a 20% increase in the profit share percentage for the production emanating from these wells. The implications and workings of the 'back in' are currently being discussed with TPDC and there may be the need for additional reserve and accounting modifications once these discussions are concluded. For the purpose of the reserves determination, it has been assumed that they will 'back in' for 20% for all future new wells and other developments and this is reflected in the Company's net reserve position.

#### *Operating leases*

The Company has two office rental agreements in Dar es Salaam, expiring on 30 November 2012 and 31 October 2013 at an annual rental of US$122,000 and US$110,000 per annum respectively.

#### *Re-rating Agreement*

During Q2 2011, the Company signed a Re-rating Agreement with TANESCO and Songas Limited 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). The agreement is expected to remain in force for the period until the Songas Expansion Project is operational. 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 Limited 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.

#### *Portfolio Gas Sales Agreement*

On 17 June 2011, a long term (to June 2023) Portfolio Gas Sales Agreement (PGSA) was signed between Orca and TANESCO. Under the PGSA, Orca 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. The current basic wellhead gas price of US$ 2.02/ Mcf is due to increase to approximately US$2.70/Mcf on 1 July 2012.

## Capital Commitments

### *Italy*

On 31 May 2010, the Company signed an agreement with Petroceltic International plc ("Petroceltic") to farm in on Petroceltic's Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay Petroceltic fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US$0.5 million.

Petroceltic were due to spud the Elsa-2 well prior to 31 October 2010, but the Italian government passed a decree, following the blowout of the Macondo well in the U.S., that prevented the drilling in the Italian seas within 5 nautical miles of the coastline and within 12 nautical miles around the perimeter of protected Marine Parks. In view of this, Petroceltic suspended the permit until such time as the Ministry of Environment issues a decree of environmental compatibility for the drilling program. The project in currently on hold and Orca is not liable to any costs associated with the drilling of Elsa-2 until a rig contract is signed.

In December 2010, the Company announced a farm in to Northern Petroleum (UK) Limited's Longastrino Block in the Po Valley Basin. Under the terms of the farm in, Orca will pay 100% of the costs of the La Tosca well up to a cap of approximately €4.3 million and 70% of the costs thereafter. If the well is tested and completed, Orca will earn an additional 5% (taking it to 75%) by paying 100% of the testing costs up to €1.3 million and 75% thereafter. The Company will also pay back past costs of €0.6 million.

### *Songo Songo*

In Q4 2010 the Company reduced the deliverability from its Songo Songo wells following receipt of results of a corrosion logging survey. Orca suspended production from SS-5, reduced flow rates from the other wells and expedited the tie in of the new onshore well SS10.  As of today, the Company can produce approximately 113 MMcfd though this is currently restricted by the infrastructure capacity to a maximum of 102 MMcfd.

The corrosion model forecasts that the offshore well, SS-9 currently producing in the region of 30 MMcfd, may need to be taken out of production at the end of Q1 2012, subject to re-logging of the well in September 2011 to confirm its condition.  Accordingly, the Company has determined that in 2011, subject to TPDC approval and rig availability a new onshore deviated well should be drilled followed by an enhancement of the SS-10 well. It is anticipated that the capital cost of this programme will be approximately US$35 million and could increase deliverability from the field to 168 MMcfd by the time SS-9 is taken out of production.

### *Songo Songo West*

The Company is currently planning to drill one well on the Songo Songo West prospect at an estimated cost of US$25 million. It is currently estimated that the well will be spud in the second quarter of 2012.  Assuming the well is a success a substantial well test program will be undertaken before the well is suspended at the mudline as a potential future producer.

### *Cost Sharing Agreement*

In January 2011, the Company signed a cost sharing agreement with Songas, whereby the Company will fund 50% of the costs of getting the Songas Expansion Project (installation of gas processing capacity and downstream compression to increase the infrastructure capacity to 140 MMcfd) to financial close, up to a maximum of US$2.4 million. In the event that the costs are approved by the regulator, EWURA, the funds will be repaid by Songas at financial close. To date the Company has incurred US$0.4 million of expenditure.  If the project is not successful, the costs will be recoverable by the Company under the terms of the PSA with TPDC.

## 7 CONTINGENCIES

### *Unbundling*

TPDC and MEM have indicated that they wish Orca to unbundle the downstream distribution business in Tanzania. The methodology for this is still to be discussed in detail with both TPDC and MEM.

### *Access to infrastructure*

Ndovu Resources Limited, with support from TPDC and the Ministry of Energy, has indicated that they wish to tie into the gas processing plant on Songo Songo Island and sell up to 10 MMcfd from their Kiliwani North field. The Company is currently in discussions with Ndovu to agree appropriate commercial terms.

### *Cost recovery*

The Company's cost pool in Tanzania was depleted early in Q2 2011. This resulted in a reduction in the percentage of net revenue attributable to the Company that will continue until there is any significant expenditure on the drilling activities which will commence in Q3 2011. TPDC is still in the process of auditing the historic cost recovery pool and this may lead to adjustments in the future.

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