Oando Energy Resources

# Management's Discussion and Analysis
For the three and six month periods ended June 30, 2014 and 2013

*This Management's Discussion and Analysis (**"MD&A"**) should be read in conjunction with the unaudited Interim Consolidated Financial Statements of Oando Energy Resources Inc. (**"OER"**) and its subsidiaries (together, the **"Corporation"**) for the three and six month periods ended June 30, 2014 (the **"Interim Financial Statements"**), as well as the audited Consolidated Financial Statements and MD&A for the year ended December 31, 2013.*

*The Interim Financial Statements and comparative information have been prepared in accordance with IAS 34, Interim Reports. All financial information is presented in US dollars, unless otherwise noted. Production volumes are presented on a working interest basis, before royalties, unless otherwise noted. Natural gas volumes have been converted to barrels of oil equivalent (**"boe"**) using a conversion ratio of six thousand cubic feet (**"mcf"**) of natural gas to one boe. This MD&A is dated August 14, 2014.*

***Readers should also read the Advisory section located at the end of this document, which provides information on Forward-Looking Statements, Foreign Operations, Oil and Gas Information and Currency.***

# 1. Description of Business

OER (previously known as Exile Resources Inc.) is a publicly traded company that is listed on the Toronto Stock Exchange ("**TSX**") under the symbol "OER". The Corporation is involved in the acquisition of petroleum and natural gas rights, the exploration for, and development and production of, oil and natural gas primarily focused in Nigeria and São Tomé and Príncipe. The ultimate controlling shareholder and parent company of the Corporation is Oando PLC. The Corporation holds interests in 16 licences for the exploration, development and production of oil and gas fields or blocks located onshore on land or swamp, and offshore in shallow or deep waters.

For the six months ended June 30, 2014, total production of 821,786 barrels (**"bbls"**) of crude oil (or an average of 4,540 barrels per day (**"bbl/d"**)) was attributable to the Corporation's working interests in OML 125 and the Ebendo Marginal Field (also known as OML 56).

OER was originally incorporated under the Canada Business Corporation Act on August 9, 2005 as "Exile Resources Inc." and subsequently, on conclusion of the reverse takeover acquisition on July 24, 2012, OER's name was changed to Oando Energy Resources Inc. The Corporation's registered office is located at 3400 First Canadian Center, 350-7th Avenue SW, Calgary AB, Canada T2P 3N9. The Corporation's head office is located at Suite 1230, Sunlife Plaza, 112 4th Avenue SW, T2P 0H3, Calgary, Canada. The Corporation also has an office in Toronto, located at Suite 1210, 333 Bay Street, Bay-Adelaide Centre, M5H 2R2 Toronto, Canada. The Corporation's operations are carried out of its Lagos office located at 8th Floor, 2, Ajose-Adeogun Street, Victoria Island, Lagos Nigeria.

# 2. Acquisitions

## COP Acquisition

On July 30, 2014, the Corporation completed the acquisition of certain Nigerian onshore and offshore assets owned by ConocoPhillips Company ("**COP**") with an effective date of January 1, 2012 (the "**COP Acquisition**") following the receipt of consent from the Honourable Minister of Petroleum Resources of Nigeria on June 18, 2014. On December 20, 2012, the Corporation entered into share purchase agreements (the "**Acquisition Agreements**") for the COP Acquisition as well as COP's interest in Phillips (Brass) Limited ("**Phillips**"). At the time of execution of the Acquisition Agreements, the total consideration was estimated to be approximately $1.79 billion (including an initial deposit of $435 million), subject to customary adjustments related to working capital and interest on the balance purchase commitment for the COP Acquisition. On September 13, 2013, the Corporation signed a termination agreement with respect to the acquisition of Phillips which reduced the purchase price to $1.65 billion.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

The Acquisition Agreements were subsequently amended several times (amendment dates of September 13, 2013, December 16, 2013, February 28, 2014, March 27, 2014, April 30, 2014, and June 30, 2014) and the outside closing date was extended from September 19, 2013 to July 31, 2014. Prior to closing, the Corporation had paid $550 million in deposits to COP ($450 million in 2013 and prior years and $100 million in 2014).

The final purchase consideration for the COP Acquisition transferred on July 30, 2014, net of working capital adjustments, transaction costs, purchase price adjustments, and deposits was $1.09 billion as shown in the table below.

| | **$'000** |
|---|---|
| Net Purchase Price: | |
| Purchase Price | 1,650,000 |
| Working Capital Adjustments | 189,749 |
| Net Purchase Price Adjustments(1) | 72,750 |
| Purchase Price Increase(2) | 30,000 |
| Interest on Unpaid Purchase Price(3) | 112,923 |
| Dividends Paid(4) | (557,000) |
| | 1,498,422 |
| Less Acquisition Deposits: | |
| December 2012 | (435,000) |
| December 2013 | (15,000) |
| February 2014 | (50,000) |
| April 2014 | (25,000) |
| May 2014 | (25,000) |
| | (550,000) |
| Final Payment | 948,422 |
| Estimated Transaction Costs | 137,001 |
| **Final Purchase Consideration** | **1,085,423** |

The Corporation funded the final purchase consideration from the following sources:

| | |
|---|---|
| Proceeds from debt financing – $450 Million Senior Secured Facility | 450,000 |
| Proceeds from debt financing – $350 Million Corporate Loan Facility | 150,222 |
| Proceeds from debt financing – $1.2 Billion Oando PLC Loan Facility | 385,201 |
| Proceeds from debt financing – $100 Million Subordinated Loan Facility | 100,000 |
| | **1,085,423** |

The Corporation plans to continue to finance on-going operations, including those related to the COP Acquisition, with a mixture of debt and equity financing. Refer to Section 6 *Liquidity* and Section 7 *Capital Resources* for a detailed discussion of the Corporation's financing plans and the related liquidity risks.

*(1) Relates to cash advances and receipts (excluding dividends) between COP and its previous owners prior to the closing date.*
*(2) The purchase price of Philips Oil Company Nigeria Limited, an entity acquired in the COP acquisition, was increased by $30million.*
*(3) The Corporation was charged interest on the unpaid purchase price from the effective date to the closing date at LIBOR plus 2%.*
*(4) A total of $557 million in dividends has been paid to the previous owners of COP between the effective date and closing date of the Acquisition. This has been used to offset the final purchase price.*

### Medal Oil Acquisition

On July 11, 2014, the Corporation completed the acquisition of Medal Oil Company Limited ("**Medal Oil**"). The purchase consideration for the Medal Oil acquisition was $5 million, satisfied through the issuance of 3,491,082 units. Each unit consists of one common share of OER and one-half of one warrant to purchase an additional common share of OER at a price of $2.00 Canadian dollars ("**CAD**") per common share for a period of 24 months from July 30, 2014. However, if after a period of six months from July 30, 2014, the closing price of the common shares on the TSX is greater than $3.50 CAD for a period of at least 10 consecutive trading days, the warrants will expire within 30 days. Medal Oil holds a 5% interest in OML 131. With the completion of the COP Acquisition, the Corporation owns a 100% interest in OML 131.

## 3. Loan Conversion and Private Placement

### Oando PLC Loan Conversion

On February 10, 2014, the Corporation entered into a new $1.2 billion facility agreement with Oando PLC to replace its existing loan agreement with Oando PLC. Pursuant to this new loan agreement, the Corporation in agreement with Oando PLC could elect to repay the outstanding principal with securities of the Corporation, based on:

(a) the terms provided in a final prospectus of the Corporation, in which case the price for conversion and nature of securities to be received shall be as set out under the offering.

(b) where no final prospectus has been filed, the terms provided in an arm's length private placement, in which case the price for conversion and nature of securities to be received shall be as set out under the private placement agreement

(c) where there has been no prospectus or private placement offering, common shares based on the 5-day volume weighted average price of the Shares as at the time of the completion or termination of the proposed acquisition of the Nigerian upstream oil and gas business of COP; and

(d) Notwithstanding the foregoing, such terms as may be agreed by the Corporation and Oando PLC. In addition, Oando PLC has the sole right to also convert interest accruing under the Facility after the execution date of the repayment deed, on the terms and conditions set out therein. The price for conversion is subject to compliance with applicable rules of the TSX and prior approval by the TSX.

On February 26, 2014, the Corporation exercised the conversion option on loans from Oando PLC. On February 26, 2014 the Corporation raised $50 million in exchange for shares and warrants as part of a private placement between arm's length parties (described below) which allowed the Corporation to exercise the conversion feature on loans from Oando PLC. . The exchange price of $1.57/unit established in negotiations with arm's length private placement investors was also used as the exchange price on the February 26, 2014 conversion. This resulted in the settlement of $601 million of principal plus $11.7 million of interest accrued to the conversion date. The exercise of the conversion was done through the issuance of 432,565,768 common shares and 216,282,884 common share purchase warrants to a subsidiary of Oando PLC. The warrants remain exercisable for a period of 24 months from July 30, 2014 and have identical terms to the warrants issued with the private placement (described below). However, if after a period of six months from July 30, 2014, the closing price of the common shares on the TSX is greater than $3.50 CAD for a period of at least 10 consecutive trading days, the warrants will expire within 30 days.

On July 9, 2014, the Corporation further exercised the conversion option on loans from Oando PLC. This resulted in the settlement of $168 million of principal, $2.9 million of interest accrued to the conversion date, and $48 million of financing fees. The exercise of the conversion was done through the issuance of 150,075,856 common shares and 75,037,928 common share purchase warrants with terms identical to those issued on February 26, 2014 as described above. Subsequent to this conversion and before closing the COP Acquisition, an aggregate principal amount of approximately $431 million remained available to be drawn under the Oando Loan. Refer to Section 2, *Acquisitions*, above for the details of amounts drawn on this facility to fund the final purchase consideration for the COP Acquisition. The exchange price of $1.57/unit established in negotiations with arm's length private placement investors was also used as the exchange price on the July 9, 2014 conversion. The exchange price of $1.57 per unit will expire on August 20, 2014 unless otherwise extended by OER and Oando PLC with the approval of the TSX.

As a result of the conversions, Oando PLC currently beneficially owns, or exercises control or direction over, 677,963,723 common shares, representing 93.7% of OER's issued and outstanding common shares. If Oando PLC (through its subsidiary) exercises its warrants, it would own 969,284,535 common shares, representing 95.5% of OER's issued and outstanding common shares; however, Oando PLC is restricted from exercising any warrants that would result in its ownership of OER exceeding 94.6%.

## Oando Energy Resources Private Placement

On February 26, 2014, the Corporation concluded a Private Placement Offering with arm's length investors for gross proceeds of $50 million. Under the Private Placement, the Corporation issued units (the **"Units"**) comprising, in aggregate, 35,070,063 common shares and 17,535,032 common shares purchase warrants at a price of $1.57 CAD per Unit. Each whole warrant entitles the holder thereof to acquire one common share of OER at a price of $2.00 CAD per common share for a period of 24 months from July 30, 2014. However, if after a period of six months from July 30, 2014, the closing price of the common shares on the TSX is greater than $3.50 CAD for a period of at least 10 consecutive trading days, the warrants will expire within 30 days.

The proceeds from the Private Placement offerings have been utilised to satisfy a portion of the purchase price for the COP Acquisition. The Private Placement was negotiated and concluded on an arm's length basis. The securities issued were subject to a hold period, which expired on June 27, 2014.

## Accounting for Warrants Issued to Oando PLC and Private Placement Investors

The warrants issued to Oando PLC's subsidiary and the Private Placement Investors described above have been classified as financial liabilities in the financial statements of the Corporation rather than equity as the exercise price is not fixed in the functional currency of the Corporation. The warrants are therefore required to be initially recognized at fair value with changes in fair value recognized in profit and loss for the period. For the six months ended June 30, 2014, a $48.3 million loss from warrants was recorded (refer to net financing expenses discussion below in Section 4, *Financial and Operational Results* for further details).

*All tabular amounts are in thousands of US dollars unless otherwise noted*

# 4. Financial and Operational Results

The table below provides a summary of the Corporation's financial and operating results for the six-month periods ended June 30, 2014 and 2013:

| | **Six Months Ended June 30 (unless otherwise noted)** | |
|---|---|---|
| | **2014** | **2013** |
| Revenue | 62,603 | 65,774 |
| Barrels of oil produced (bbl) [1] | 821,786 | 687,757 |
| Average sales price per barrel (Gross) | 108.79 | 109.00 |
| Average sales price per barrel (Net, Including unrecognized revenue)[2] | 91.25 | 95.64 |
| Average sales price per barrel (Net)[2] | 76.18 | 95.64 |
| Cash flows from operating activities | (11,220) | (22,171) |
| Comprehensive income/(loss) | (177,549) | (8,866) |
| Net income/(loss) per share: Basic | (0.41) | (0.08) |
| Net income/(loss) per share: Diluted[3] | (0.41) | (0.08) |
| Total assets[4] | 1,662,142 | 1,299,422 |
| Total non-current Financial liabilities[4] | 245,925 | 275,195 |

*([1]) The Corporation consolidates 45% revenue of Ebendo (OML56) which is Oando Production and Development Company (**"OPDC"**) ownership interest in the field and recognises a minority interest of 5% in OPDC.*

*[2] Price excludes royalties (8% on OML 125 and 5% on the Ebendo Marginal Field), the Nigerian Government profit share of profit oil in the production sharing contract in respect of OML 125 and crude losses on the Ebendo Marginal Field. If unrecognised revenues related to excessive NNPC lifting's at OML 125 of $13.0 million is included, the net average sales price per barrel is $91.25.*

*[3] In determining the diluted EPS of the Corporation in 2014 and 2013, the impact of the warrants, the stock based compensation and the convertible loan have not been considered as their impact is antidilutive.*

*[4] Prior year comparatives are as at December 31, 2013.*

## Financial and Operational Highlights

- On July 30, 2014, the Corporation completed the COP Acquisition with an effective date of January 1, 2012. The final purchase consideration for the COP Acquisition transferred on July 30, 2014, net of working capital adjustments, transaction costs, purchase price adjustments, and deposits of $550 million was $1.09 billion. Refer to Section 2, *Acquisitions* above for further details.

- For the six months ended June 30, 2014, the Corporation had an adjusted working capital deficiency of $253.1 million and a comprehensive loss of $177.5 million. On July 9, 2014, the Corporation reduced its borrowings by exercising the conversion option on $168 million of principal, $2.9 million of interest accrued to the conversion date, and $48 million of financing fees to common shares and warrants. Refer to Section 6, *Liquidity* and Section 7, *Capital Resources*.

- Revenue for the six months ended June 30, 2014 decreased by $3.2 million from the comparative period despite higher production and relatively consistent market prices. This is due primarily to the Corporation's decision to defer revenue recognition on excessive lifting's by the Nigerian National Petroleum Corporation (**"NNPC"**) at OML 125. In the six months ended June 30, 2014, the Corporation deferred the recognition of $13.0 million in revenue pursuant to this policy.

- Production for the six months ended June 30, 2014 was 821,786 bbls compared to 687,757 bbls for the comparative period primarily as a result of improved well optimization at OML 125.

- Excluding the impact of unrecognised revenues related to excessive NNPC liftings at OML 125, a net average sales price $91.95/bbl was realized for the six months ended June 30, 2014. The actual net average sales price realized in the six months ended June 30, 2014, incorporating the non-recognition of $13.0 million in revenues related to excessive liftings by the NNPC, is $76.18/bbl. Excessive NNPC liftings is the primary driver of the net average sales price decline from the comparative six month period.

- Cash outflow from operating activities for the six months ended June 30, 2014 was $11.2 million, compared to $22.2 million in the comparative prior year period. The $11.0 million improvement was primarily the result of improved cash flows from working capital management offset by higher general and administrative costs.

- Capital expenditures for the six months ended June 30, 2014 were $66.9 million, compared to $44.7 million for comparative period. Significant capital expenditures in 2014 relate primarily to Abo 8 and Abo 12 drilling and completions activities as well as Abo 3 flow line remedial works.

- Tax expense decreased by $8.0 million for the six months ended June 30, 2014 in comparison with the comparative period due increased tax recovery on higher capital expenditures on OML 125.

- Net financing expenses for the six months ended June 30, 2014 increased by $130.5 million primarily as a result of the recognition of a $24.0 million financing fee expense incurred on the conversion of $601 million of principal on the Oando PLC loan facility, a fair value loss of $48.3 million incurred on the warrants issued on February 26, 2014 on the conversion of the Oando PLC loan and the Private Placement (refer to section 3, *Oando Loan Conversion and Private Placement*), and a fair value loss of $68.9 on the conversion feature associated with the Oando PLC loan, which is accounted for as an embedded derivative. These were negated by a net reduction in interest expense of $8.5 million as a result of changes in borrowings during the quarter.

## Results of Operations

The following provides an analysis of the Corporation's financial condition, results of operations and cash flows for the three months and six months ended June 30, 2014. Results have been compared to the Corporation's financial performance for the three months and six months ended June 30, 2013. The Corporation has only one reportable segment which consists of the Corporation's oil and gas operations in Nigeria.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

## Revenues

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **Total Production, net WI (bbls)** | 413,985 | 353,145 | 821,786 | 687,757 |
| **Crude oil net sale price (average $ / bbl)** | 73.53 | 102.15 | 76.18 | 95.64 |
| **Total Revenue ($'000)** | 30,440 | 36,072 | 62,603 | 65,774 |

Revenue is generated by the production and sale of crude oil produced from the Corporation's working interest in OML 125 (offshore) and OML 56 (Ebendo marginal field, onshore). Both oil licenses are located in Nigeria. The Corporation sells 100% of its oil production to ENI Trading and Shipping S.P.A., a subsidiary of Nigeria Agip Exploration (**"NAE"**).

For the three months ended June 30, 2014 revenue declined from the comparative period by $5.6 million. During this period, lower realized net sales prices reduced revenues by $10.1 million and increased production increased revenues by $4.5 million. Lower revenues from lower realized net sales prices were primarily due to $3.5 million in unrecognized revenue at OML 125 (see below for further details), a $3.6 million increase in government royalties and share of profit oil, and slightly declining crude oil prices reducing revenue by $0.6 million. Increases in production were due primarily to increased production at OML 125 which increased by 24% to 335 thousand bbls in the three months ended June 30, 2014 from 269 thousand bbls in the comparative period.

For the six months ended June 30, 2014 revenue declined from the comparative period by $3.2 million. During this period, lower realized net sales prices reduced revenues by $13.4 million and increased production increased revenues by $10.2 million. Lower revenues from lower realized net sales prices were primarily due to $13.0 million in unrecognized revenue at OML 125 (see below for further details. Increases in production were due primarily to increased production at OML 125 and OML 56. OML 125 production increased by 17% to 651 thousand bbls in the six months ended June 30, 2014 from 557 thousand bbls in the comparative period. OML 56 production increased by 30% to 171 thousand bbls in the six months ended June 30, 2014 131 thousand bbls in the comparative period.

### *Crude Oil Losses (OML 56)*

Production from OML 56 is transported using the Umusadege pipeline and export facility operated by Nigerian Agip Oil Company Limited (**"NAOC"**). This pipeline experiences a significant amount of crude oil losses due to theft of crude oil and/or sabotage of crude oil pipelines.

Total net crude oil deliveries into the export pipeline from the Ebendo marginal field for the three months ended June 30, 2014 was approximately 102,682 bbls before pipeline losses. Pipeline and export facility losses reported by NAOC and allocated to the Corporation for the three months ended June 30, 2014 was 26,994bbls or 26%, (2013 – 21,326 bbls or 25%) of total crude oil deliveries into the export pipeline for the year. This resulted in approximately $3.2 million (2013: $2.2 million) of oil production not being recognized in revenue (before royalties) for the three month period ended June 30, 2014 on the basis that it is not probable that the economic benefits will flow to the Corporation.

Total net crude oil deliveries into the export pipeline from the Ebendo marginal field for the six months ended June 30, 2014 was approximately 206,135 bbls before pipeline losses. Pipeline and export facility losses reported by NAOC and allocated to the Corporation for the six months ended June 30, 2014 was 38,286 bbls (2013: 32,236 bbls), or 19% (2013: 20%) of total crude oil deliveries into the export pipeline for the year. This resulted in approximately $4.4 million (2013: $3.4 million) of oil production not being recognized in revenue (before royalties) for the six month period ended June 30, 2014 on the basis that it is not probable that the economic benefits will flow to the Corporation.

***Excessive lifting activity by NNPC (OML 125)***

The Corporation receives lifting schedules for OML 125 that identify the order and frequency with which each partner can lift its share of production. In normal operating conditions, over lift and underlift are accounted for as a sale of oil at the point of lifting by the under lifter to the over lifter as the criteria for revenue recognition is considered to have been met. The Corporation is currently in a dispute with the NNPC in relation to over lifting by the NNPC between 2008 and 2014 and which, in the view of NAE its partner, exceeded the NNPC's entitlements.

For the six months ended June 30, 2014, the NNPC has continued to lift production volumes that exceed their entitlement, despite arbitration rulings that have found in favour of the Corporation. On February 28, 2014, a prior injunction obtained by the NNPC restraining the arbitration was set aside by the Nigerian Court of Appeal. NNPC appealed the setting aside of the injunction to the Supreme Court, and also filed an application for an injunction to prevent the continuation of the Arbitration.

Although the application at the Supreme Court is yet to be heard, on July 9, 2014 a final award was granted by the Arbitration Panel in favour of NAE and the Corporation entitling NAE and the Corporation to collect amounts overlifted by the NNPC. The Corporation's share of the damages awarded is $72.9 million plus interest on damages, legal and expert costs, interest on legal and expert costs, and additional interest from the date the award was granted until payment. Of this amount, $47.3 is due to Oando PLC as the Corporation assumed a contractual obligation to pay a portion of those cash flows to Oando PLC when the company was re-organized on July 24, 2012. The final award was based on amounts overlifted by NNPC up to January 2014; the award indicates that the NAE and the Corporation are also entitled to amounts overlifted by NNPC subsequent to January 2014.

On July 21, 2014, NAE and the Corporation sent a statutory pre-action notice to NNPC, giving the latter notice of their intention to file an action at the Federal High Court (**"FHC"**) for relief in relation to the recognition and enforcement of the Partial and Final Awards. The FHC action will be filed 30 days after the service of the pre-action notice to NNPC.

Furthermore, in respect of the suit filed by NNPC in October 2011 at the FHC seeking to set aside the Partial Award (**"NNPC Set Aside Proceedings"**), the Court of Appeal in its judgement given on February 25, 2014 (vacating the injunction restraining the continuation of the Arbitration) ordered that the NNPC Set Aside Proceedings be assigned to a new judge of the FHC. NAE and the Corporation await notification of this reassignment as well as a hearing notice.

As a result of this dispute, from October 1, 2013, the Corporation has deferred the recognition of revenue for oil production that is subject to overlift by the NNPC. In addition to the $14.5 million of oil production from the Abo field not recognized as a result of this policy in 2013, $13 million has not been recognized in revenue in the six months ended June 30, 2014 (2013 – NIL), $3.5 million of which was deferred in the three months ended June 30, 2014 (2013 – NIL). The Corporation continues to defer the recognition of revenue for oil production that is subject to overlift by the NNPC and will do so until it is determined that the economic benefits of the overlifted amounts will accrue to the Corporation.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

## Production expenses

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **Production expenses** | 7,992 | 3,905 | 15,558 | 12,730 |

Production expenses consist of direct operating expenditures relating to lifting, handling, transportation and production maintenance and operators' general and administrative (**"G&A"**) cost.

For the three months ended June 30, 2014, production expenses were approximately $8.0 million compared to the comparative period when they were $3.9 million. Over the course of the quarter, 69% of the cost arose from OML 125 (2013: 85%), with the rest being incurred in operations at OML 56. The increase in production expenses was largely driven by a $0.8 million increase in pipeline and tariff costs, $0.9 million increase in administrative overhead costs on OML 56, and a $2.3 million increase in production expenses at OML 125. The OML 125 production expenses increase of $2.3 million related to a $4.3 million increase in the operators' lifting's and associated transportation costs negated by a reduction of $1.9 million in administrative overhead costs. Production expense per barrel for the three months ended June 30, 2014 was $19.31/bbl compared with $11.06/bbl in the comparative period.

For the six months ended June 30, 2014, production expenses increased by 22.2% to $15.6 million versus the comparative period. The increase in production expenses was driven primarily by a $1.4 million increase in pipeline tariff and maintenance costs, a $0.3 million increase in Community and Niger Delta Development Commission (**"NDDC"**) trust funds for community development, and a $0.9 million increase in administrative overhead costs. Production expense per barrel for the six months ended June 30, 2014 was $18.93/bbl compared with $18.51/bbl in the comparative period.

## General and administrative costs

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **General and administrative costs** | 36,152 | 3,014 | 41,746 | 6,973 |

General and administrative costs for the three months ended June 30, 2014 were $36.2 million compared to $3.0 million for the comparative period. The increase in general and administrative costs was driven primarily by $27.3 million in non-recurring parent company cost allocations and other related costs due to the COP acquisition, $2.0 million in professional services fees, an increase of $3.1 million attributable to personnel costs and increased rental and lease expenses of $0.8 million. The non-recurring allocated costs came as a result of additional work done by the parent company and an agreement with OER to compensate the parent company for this extra ordinary work.

For the six months ended June 30, 2014, general and administrative costs of $41.7 was incurred compared to $7.0 million for the comparative 2013 period. The increase was driven primarily by $27.3 million in non-recurring parent company cost allocations and other related costs due to the COP acquisition, $2.0 million in professional services fees, an increase of $4.1 million attributable to personnel costs and increased rental and lease expenses of $1.2 million.

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## Depletion, depreciation and amortization

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **Depletion, depreciation and amortisation** | 11,444 | 9,186 | 21,444 | 16,125 |

Depletion, depreciation and amortization charges for the three months ended June 30, 2014 were $11.4 million compared to $9.2 million for the prior year. The depletion, depreciation and amortization expense per barrel for the three months ended June 30, 2014 was $27.6/bbl compared to $26.0/bbl for the three months ended June 30, 2013. OML 56 depletion, depreciation and amortization expense increased by $0.6 million due to higher production levels, higher future development capital expenditures additions and the depletion of additional EB 4 well costs which was not in operation in the prior year comparative 3 month period. OML 125 depletion, depreciation and amortization expenses increased by $1.5 million in the 3 months ended June 30, 2014 due to higher production levels and increased capital expenditures on Abo 12, FPSO upgrades, drilling activities on Abo 4 producing wells and the Abo 3 Side track.

Depletion, depreciation and amortization charges for the six months ended June 30, 2014 were $21.4 million compared to $16.1 million for the prior year. The depletion, depreciation and amortization expense per barrel for the three months ended June 30, 2014 was $26.1/bbl compared to $23.4/bbl for the six months ended June 30, 2013. OML 56 depletion, depreciation and amortization expense increased by $1.4 million due to higher production levels, higher future development capital expenditures additions and the depletion of additional EB 4 well costs which was not in operations in the prior year 6 month comparative period. OML 125 depletion, depreciation and amortization expenses increased by $3.8 million in the six months ended June 30, 2014 due to higher production levels and increased capital expenditures on Abo 12, FPSO upgrades, drilling activities on Abo 4 producing wells and the Abo 3 Side track.

## Net financing expenses

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Net fair value losses / (gains) on financial instruments | 106,909 | 205 | 115,374 | (2,278) |
| Interest expense | 7,439 | 12,752 | 41,391 | 25,846 |
| Other net financing expenses / (income) | (324) | 1,104 | (1,390) | 1,261 |
| **Net financing expenses** | **114,024** | **14,061** | **155,375** | **24,829** |

Net financing expenses for the three months ended June 30, 2014 were $114 million compared to $14.1 million for the comparative period. The increase in net financing expenses for the three months ended June 30, 2014 was primarily a result of $39.9 million in losses on derivative financial instruments associated with warrants issued to Oando PLC and Private Placement investors (see Section 3, *Loan Conversion and Private Placement* above) and a fair value loss of $68.9 million on the Oando PLC loan conversion feature which is accounted for as an embedded derivative. These losses were partially offset by a $5.3 million decrease in interest expense in the three months ended June 30, 2014 from the comparative period.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

Net financing expenses for the six months ended June 30, 2014 was $155.4 million compared to $24.8 in the comparative period. The increase in net financing expenses for the six months ended June 30, 2014 was, in part, the result of the recognition of a $24.0 million financing fee expenses (recorded in interest expense) incurred on the conversion of $601 million of principal on the Oando PLC loan facility pursuant to the Corporation's accounting policies for transaction costs – refer to Section 11, *Accounting Policies and Critical Estimates & Judgement* for further details. In addition, losses of $48.3 million on derivative financial instruments were recorded in this timeframe associated with warrants issued to Oando PLC and Private Placement investors (see Section 3, *Loan Conversion and Private Placement* above) and $68.9 million in fair value losses due to the Oando plc loan conversion feature. These losses were partially offset by a decrease in interest expenses by $8.5 million as a result of changes in loan facilities from the comparative period.

### Income tax expense

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **Income tax expense** | (1,504) | 7,073 | 6,029 | 13,983 |

Tax expense decreased by $8.6 million for the three months ended June 30, 2014 in comparison with the comparative period. This decrease was driven primarily by lower deferred taxes in OML125 and OML56. Tax expense decreased by $8.0 million for the six months ended June 30, 2014 in comparison with the comparative period. This decrease was due to increased tax recovery on higher capital expenditures on OML 125.

### Net income/ (loss) for the period

| | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|---|---|
| **Net income/loss for the period** | (137,668) | (1,167) | (177,549) | (8,866) |

For the three months ended June 30, 2014, a net loss of $137.7 million was incurred compared to a net loss of $1.2 million incurred in the comparative three month period. For the six months ended June 30, 2014 a net loss of $177.5 million was incurred compared to a net loss of $8.9 million in the comparative six month period. The increase in net losses compared to the prior periods was primarily a result of increased general and administrative costs, increased depletion, depreciation and amortisation expenses, increased net financing expenses, and lower revenues, which were partially offset by lower taxes as explained above.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

## Capital expenditures

| | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|
| **Capital expenditures** | 66,905 | 44,698 |

For the six months ended June 30, 2014, the Corporation spent $66.9 million on capital expenditures for oil and gas assets and exploration and evaluation assets. Significant capital expenditures for the six months ended June 30, 2014, related to the following activities:

- OML 125 capital expenditures of $40.7 million were incurred on Abo 8 and Abo 12 drilling and completions activities as well as Abo 3 flow line remedial works.

- OML 56 capital expenditures of $9.2 million were incurred on the drilling and completion of Ebendo Well 7 and the Umuginni pipeline. Further work on this well has been suspended pending the completion of the Umuginni pipeline.

- OML 13 capital expenditures of $9.4 million were incurred on pipeline and GGF facility costs as well as flow station construction.

- OML 134 capital expenditures of $7.0 million were incurred on exploratory activities on the drilling of the Mindiogoro prospect.

- Other movable capital expenditures of $0.6 million were incurred by the Corporation.

Further details on capital expenditures and commitments have been included in Section 7, *Capital Resources* of this MD&A.

## Cash flows from operating activities

| | For the six months ended June 30, 2014 | For the six months ended June 30, 2013 |
|---|---|---|
| **Cash flows from operating activities** | (11,220) | (22,171) |

Cash outflow from operating activities for the six months ended June 30, 2014 was $11.2 million, compared to $22.2 million in the comparative prior year period. The $11.0 million improvement was primarily the result of improved cash flows from working capital management of $43 million offset by higher general and administrative costs of $35.4 million.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

## 5. Summary of Quarterly Results

The following table presents a summary of financial information for the last eight quarters. Information has been derived from the Corporation's Interim Financial Statements:

| | For the three months ended | | | |
|---|---|---|---|---|
| | June 30, 2014 | March 31 2014 | December 31 2013 | September 30 2013 |
| **Production (bbls)** | 413,985 | 407,802 | 406,029 | 363,032 |
| **Total Revenue** | 30,440 | 32,163 | 23,976 | 37,461 |
| **Net Income for the Period** | (137,668) | (39,881) | (41,008) | 11,645 |
| **Earnings Per Share** | (0.24) | (0.14) | (0.32) | 0.12 |
| **Diluted Earnings Per Share** | (0.24) | (0.14) | (0.32) | 0.12 |
| **Capital Expenditures** | 24,355 | 42,550 | 45,573 | 29,684 |
| **Total Assets** | 1,662,142 | 1,689,937 | 1,299,422 | 1,223,808 |
| **Total Non-Current Liabilities** | 245,925 | 274,812 | 275,195 | 206,150 |

| | For the three months ended | | | |
|---|---|---|---|---|
| | June 30 2013 | March 31 2013 | December 31 2012 | September 30 2012 |
| **Production (bbls)** | 353,145 | 334,612 | 326,819 | 370,928 |
| **Total Revenue** | 36,072 | 30,699 | 27,746 | 38,546 |
| **Net Income for the Year** | (1,167) | (7,187) | (9,625) | 4,841 |
| **Earnings Per Share** | (0.01) | (0.07) | (0.09) | 0.05 |
| **Diluted Earnings Per Share** | (0.01) | (0.07) | (0.09) | 0.05 |
| **Capital Expenditures** | 36,353 | 8,345 | 37,752 | 684 |
| **Total Assets** | 1,193,585 | 1,079,899 | 1,127,050 | 657,203 |
| **Total Non-Current Liabilities** | 207,981 | 156,457 | 177,699 | 154,232 |

The Corporation's quarterly financial information can be significantly impacted by fluctuations in commodity prices, production volumes, interest rates, the timing of and access to crude oil lifting entitlements at OML 125 and the occurrence of crude oil losses due to theft and sabotage at OML 56. Refer to the relevant sections of this MD&A for discussions of the results for the three and six months ended June 30, 2014, the MD&A for the three months ended March 31, 2014, and the MD&A for the year ended December 31, 2014.

## 6. Liquidity

For the six months ended June 30, 2014, the Corporation had a net loss of $177.5 million, an adjusted working capital deficiency of $253.1 million, and an accumulated deficit of $499.2 million. In addition to its on-going working capital requirements, the Corporation must secure sufficient funding to repay $281.9 million in current borrowings and fund ongoing operations. The Corporation has incurred significant levels of debt and equity financing to finance on-going operations and the COP Acquisition, which closed on July 30, 2014 (refer to Section 3, *Acquisitions*, above for details).

*All tabular amounts are in thousands of US dollars unless otherwise noted*

On February 26, 2014, the Corporation exercised the conversion option on borrowing agreements with Oando PLC, and this resulted in the settlement of $601 million of the existing Oando PLC Loan Facility through issuance of 432,565,768 common shares and 216,282,384 warrants giving the holder the right to purchase common shares subject to certain restrictions. Also, on July 9, 2014, the Corporation exercised the conversion option on an additional $168 million of borrowings on the Oando PLC Loan Facility through the issuance of 150,075,856 common shares and 75,037,928 common share warrants. However, the Corporation's outstanding borrowings remain significant and have increased as a result of the COP Acquisition. In addition, the Corporation secured equity financing in the form of a $50 million private placement with arm's length investors completed on February 26, 2014 for which the proceeds have been used to assist in the closing of the COP Acquisition and fund on-going working capital requirements. Further details are disclosed in Section 3, *Loan Conversion and Private Placement*.

These undertakings are not sufficient in and of themselves to enable the Corporation to fund all aspects of its operations and, accordingly, management is pursuing other financing alternatives to fund the Corporation's commitments and operations so it can continue as a going concern. Management plans to secure the necessary financing through the issue of new equity or debt instruments. Nevertheless, there is no assurance that these initiatives will be successful. The Corporation's ability to continue as a going concern is dependent upon its ability to fund the repayment of existing borrowings, secure additional financing and generate positive cash flows from operations.

## Payments Due by Period

The following table represents a summary of the obligations of the Corporation as at June 30, 2014:

| | Total | Less than 1 year | 1 to 3 years | 4 to 5 years | After 5 years |
|---|---|---|---|---|---|
| Borrowings and Interest Payable[1] | 413,872 | 301,750 | 93,141 | 18,981 | - |
| Trade and other payables | 223,133 | 223,133 | - | - | - |
| Other long term payables | 76,399 | - | 47,272 | 1,983 | 27,144 |
| Derivative financial instruments | 184,596 | 184,596 | - | - | - |
| Purchase commitments | 11,565 | 11,565 | - | - | - |
| Budgeted capital expenditure[2] | 11,950 | 11,950 | | | |
| Acquisition of COP[3] | 1,085,423 | 1,085,423 | | | |
| | **2,006,938** | **1,818,417** | **140,413** | **20,964** | **27,144** |

*[1]Interest payable is expected to be $37.9 million over the remainder of the contractual term of the loan, calculated using interest rates applicable to borrowings at year end.*
*[2]The capital expenditure budget represents the estimated level of required funding to support the planned growth, development and maintenance of the Corporation's interest in oil and gas fields.*
*[3]Acquisition of COP includes estimated $137 million transaction costs and assumes working capital adjustments of $190 million. The purchase commitment on the COP Acquisition is $1.09 billion these figures are Management's best estimate as of the date of this MD&A and are subject to change*

Subsequent to June 30, 2014, the Corporation closed the COP acquisition and satisfied the Acquisition of COP obligation noted in the table above. Refer to Section 2, *Acquisitions* for the details of the COP Acquisition. With the COP Acquisition, the Corporation expects to inherit additional obligations to those disclosed in the table above however these cannot be reliably estimated as of the date of this MD&A.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

### Sources of Funding

The following sources of funding are expected to assist the Corporation in generating sufficient cash and cash equivalents to execute the Corporation's business plans:

- Cash inflows from sales of production of crude oil from OML 125 and OML 56;
- Cash inflows from sales of production of crude oil from Qua Ibo (also referred to as "**OML13**"). The field is currently in the development stage and the Corporation expects that production form this field will now commence in the fourth quarter of 2014;
- Cash inflows from producing oil properties acquired on closing of the COP Acquisition;
- The remaining $45.8 million available on the $1.2 Billion Oando PLC Loan Facility after the closing of the COP Acquisition will be used to fund ongoing operations of the Corporation; and
- Subject to market conditions and financing being available on terms acceptable to the Corporation, additional proceeds from additional debt and equity financing will be sought.

# 7. Capital Resources

In order to finance on-going operations following the closure of the COP acquisition, the Corporation may require additional financing, either in the form of debt or equity.

### BORROWINGS

The following table summarizes borrowings outstanding at June 30, 2014:

| | **As at June 30, 2014** | **As at December 31, 2013** |
|---|---|---|
| Oando PLC Loan - Facility A | 168,473 | 401,000 |
| First Bank of Nigeria (Loan #1) | 16,834 | 32,944 |
| First Bank of Nigeria (Loan #2) | 70,000 | 70,000 |
| First Bank of Nigeria (Short term loan) | - | 7,779 |
| Ecobank Nigeria Loan | 20,000 | 20,000 |
| Diamond Bank Loan | 65,000 | 59,152 |
| Enterprise Bank | 30,000 | 30,000 |
| | **370,307** | **620,875** |
| Less: Borrowings, current | (281,915) | (496,099) |
| **Borrowings, non-current** | **88,392** | **124,776** |

The carrying amounts of all Corporation borrowings are denominated in US dollars. Subsequent to June 30, 2014, the Corporation closed the COP Acquisition and, as a result, the borrowings of the Corporation changed. Refer to Section 2, *Acquisitions* for the details of the borrowings used to fund the COP Acquisition.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

## $1.2 Billion Oando PLC Loan Facility

On February 10, 2014, the Corporation signed an agreement with Oando PLC for a $1.2 billion loan facility. The loan agreement amends and governs the Oando PLC loan (facility A, B1, and B2) and the $200 million loan facility which was signed on December 24, 2013. In addition, the loan agreement made available to the Corporation an additional $599 million. The funds will be used to fund the closure of the COP Acquisition and for other general corporate requirements. The annual interest rate of the facility is 4% calculated on a quarterly basis and principal is due to be repaid on December 31, 2015. The only financial covenant of the loan limits capital expenditures to $500 million per year for 2014 and 2015. The loan also includes a financing fee of $48 million which was converted to equity on July 9, 2014.

The table below summarizes the movement of the $1.2 billion facility during the six months ended June 30, 2014.

| | **Six months ended** |
|---|---:|
| **Balance, beginning of period** | 401,000 |
| Drawings | 368,000 |
| Converted to shares | (601,000) |
| | **168,000** |
| Conversion feature on borrowings | 6,102 |
| Unamortized transaction costs | (5,629) |
| **Balance, June 30, 2014** | **168,473** |

During the six months ended June 30, 2014, the facility was drawn by an amount of $368 million. Also, during this period, $601 million of principal and $11,710,445 of accrued interest was exchanged for 432,565,768 common shares and 216,282,884 warrants. Of the $612,710,445 conversion amount, $67,311,725 was allocated to the warrants and recorded as a derivative financial liability (refer to Section 12, *Accounting Policies and Critical Estimates and Judgements* below) and the residual amount of $545,398,720 was recorded as share capital. The balance at June 30, 2014 includes unamortized transaction costs of $5.6 million (described below). As at June 30, 2014, $431 million remained available for drawdown on the loan.

### *Oando PLC Loan $48 Million Financing Fee*

Management has determined that the obligation to pay the financing fee represents a financial liability of the Corporation and as amounts are drawn down on the facility, a financing fee liability is recorded. In the six months ended June 30, 2014, the cumulative amount drawn on the facility to date was $769 million for which a financing fee liability of $30.8 million was recorded. The financing fee liability has been recorded in other payables. The financing fee of $48 million was converted to equity on July 9, 2014 - Refer to Note 19 of the interim consolidated financial statements for further details.

Furthermore, Management determined that the financing fee should be accounted for as a transaction cost. Specifically, to the extent that the facility is drawn, a portion of the facility fee is allocated to the drawn amount and used to estimate the effective interest rate on the loan over the estimated expected life of the drawings; in the event the loan is converted to equity, the financing fee is expensed. In the six months ended June 30, 2014, $30.8 million was recorded as a transaction cost. Of this amount, $24 million was recorded as an interest expense on the conversion of $601 million of principal noted above and $1.1 million was amortized to interest expense in the period.

As at June 30, 2014, the unamortized portion of the transaction costs allocated to the principal balance of $168 million was $5.6 million.

***Post Quarter End Conversion and Amounts Drawn Prior to Closing of COP Acquisition***

As noted above, the Corporation converted $168 million in principal to shares and warrants on July 9, 2014. After this Conversion, the Corporation had $431 million available to draw. Prior to the closing of the COP Acquisition, the Corporation drew $352.2 million on this facility and recognized an additional $33 million as an amount drawn to compensate Oando PLC for the $33 million promissory note issued on behalf of the Corporation leaving $45.8 million available after the closing of the COP Acquisition.

## $450 Million Senior Secured Facility

The Corporation entered into a $450 million Senior Secured Facility agreement on January 31, 2014. The purpose of the facility is to finance the closing of the COP Acquisition. The agreement consists of two facilities – Facility A and Facility B.

- Facility A provides for a loan amount of $181.7 million. Facility A is required to be repaid one business day subsequent to the completion of the COP Acquisition with the proceeds of the repayment of an existing shareholder loan. This repayment of the shareholder loan is to be funded by a $181.7 million facility (the "**Target Facility Loan**") to be provided by the same set of lenders to Phillips Oil Company Nigeria Limited (one of the entities being acquired as part of the COP Acquisition).
- Facility B provides for a loan amount of $268.3 million. The facility can be draw down until the earlier of (i) two days before the COP Acquisition closes or (ii) July 31, 2014. Once drawn down, the loan is repayable in quarterly instalments in accordance with a repayment schedule. Following the repayment of Facility A the aggregate amount owed by the Corporation would be $450 million.

Interest will be charged on the loans at LIBOR plus 8.5% per annum and interest payments are due at the end of each quarterly period. Loan B and the Target Facility Loan will be repaid each calendar quarter using the proceeds from sales of the Corporation's share of crude oil from its various operations. In addition to regular repayments, 25% of any excess cash from the proceeds of sales of crude oil, natural gas liquids and electric power from its various operations (subsequent to the completion of the COP Acquisition) would also be applied against outstanding principal. The loans have a final maturity date of June 30, 2019.

The facility has an amended expiry date of August 31, 2014. The Corporation has paid the agreed commitment fee for the extension to the Mandated Lead Arrangers (**"MLAs"**) and the Corporation has executed the relevant documentation reflecting the amendment. As at June 30, 2014, the loan had not been drawn. Subsequent to June 30, 2014, the Corporation drew down on the facility to fund the closing of the COP Acquisition – refer to Note 19 of the interim consolidated financial statements for further details on the amount drawn.

## $350 Million Corporate Finance Loan Facility

On January 17, 2014, the Corporation signed an agreement with a consortium of lenders led by FBN Capital Markets Limited and FCMB Capital Markets Limited to secure a Corporate Finance Loan Facility for $329 million. Pursuant to an amendment agreement executed on January 31, 2014 the facility amount was increased to $350 million. The loan purpose of the facility is to fund the repayment of the existing loans of the Corporation as well as to finance a portion of the COP Acquisition. Interest will be charged from draw down at LIBOR plus 9.5% per annum for the first fifty-seven months of the facility, with an increase of 1% for the remaining life of the facility. The loan will be available for the Corporation to draw down for 12 months from January 17, 2014. The loan will be repaid quarterly using the proceeds of sales of the Corporation's share of crude oil, natural gas liquids and electric power from its various operations subsequent to the completion of the COP Acquisition. As at June 30, 2014, the loan had not been drawn. The full $350 million facility was drawn subsequent to June 30, 2014 to fund the closing of the COP Acquisition and repay existing debt. Specifically, $150.2 million was used to fund the final purchase consideration of the COP Acquisition and $199.8 million was used to settle the First Bank of Nigeria Loans (Loan #1 and Loan #2), the Ecobank Nigeria Loan, the Diamond Bank Loan, and the Enterprise Bank Loan.

## $100 Million African Export Import Bank Subordinated Debt Facility

On June 6, 2014, the Corporation signed an agreement with African Export-Import Bank to secure a one year subordinated structured debt facility for $100 million. The loan was designated to fund a portion of the COP Acquisition. Interest is charged at LIBOR plus 7% per annum and is due semi-annually. The loan will be repaid quarterly using the proceeds of sales of the Corporation's share of crude oil, natural gas liquids and electric power from its various operations. The full amount of the facility was drawn to fund the final purchase consideration for the COP acquisition.

## Commitments and Capital Expenditures

The following provides an update to the commitments and capital expenditures disclosed in the MD&A for the period ended June 30, 2014. Historically, the Corporation has experienced significant variability in the actual costs incurred and timing of expenditure, as compared to initial estimated budgeted amounts and timing. This section of the capital resources discussion contains forward-looking information. Refer to *Advisory – Forward-Looking Information* section of this MD&A for material risks and assumptions underlying this forward-looking information.

Subsequent to June 30, 2014, the Corporation closed the COP Acquisition. Refer to Section 2, *Acquisitions* for the details of the COP Acquisition. With the COP Acquisition, the Corporation expects to inherit additional obligations for commitments and capital expenditures however these cannot be reliably estimated as of the date of this MD&A.

### OML 125 (Abo Field)

Budgeted capital expenditures for OML 125 for the six months ended June 30, 2014 was $26.6 million. The Corporation incurred $40.7 million during the first six months of the year on Abo 8 and Abo 12 drilling and completion activities, FPSO revamp and Abo 3 flow line de-sanding.

Abo 8 re-entry and completion was budgeted at $9.1 million with actual expenditure incurred to date being $5.8 million with remedial works still ongoing to put the well back on stream. Abo 12 drilling and completion was budgeted at $12.9 million for the first half of the year. Actual expenditures to date of $20 million has been incurred. The increase in expenditure was as a result of a delay increase in completions costs. The well is temporarily plugged pending planned hook up in 2015.

Abo 3 flow line de-sanding costs of $5.5 million were incurred during the first six months of the year but were not budgeted for in 2014. This expenditure was incurred to remove sand from flow lines. Remedial works are ongoing to put well back on stream.

FPSO revamp activities were planned for the fourth quarter of 2014 at a budget of $4.5 million. However, this expenditure has been incurred during the first six months of the year at a cost of $5.6 million.

### OML 56 (Ebendo Field)

Budgeted capital expenditures for OML 56 for the six months ended June 30, 2014 was $11 million. The Corporation incurred $9.2 million on construction of the Umuginni pipeline, Ebendo Well 7 drilling and completion activities, and flow station de-bottlenecking.

In 2014, the Corporation completed the fiber optic cable laying and pipeline construction milestones associated with the Umuginni pipeline project; the projected delivery date remains the fourth quarter of 2014. Ebedo Well 7 was successfully drilled and completed on the 1st of April 2014. The well has since been shut in pending completion of Umugini pipeline. The Akri-Kwale flow lines were also de-bottlenecked during the first six months of the year to increase crude production capacity for the field. The cost of the de-bottlenecking was $1.1 million.

### OML 13 (Qua Ibo Field)

Budgeted capital expenditures for OML 13 – Qua Ibo field were set at $40.6 million for 2014. In the six months ended June 30, 2014, the Corporation incurred capital expenditures of about $9.4 million on pipeline and facility costs as well as flow station construction. Oil production from the Qua Ibo field's D5 reservoir is expected to commence in the fourth quarter of 2014 after the commissioning of a crude processing facility which is currently under construction and should be finalized in the third quarter of 2014. Production from the C4 reservoir of the Qua Ibo is expected to commence in the first quarter of 2015.

### OML 134 (Oberan Field)

Budgeted capital expenditures for OML 134 were set at $7.4million for 2014. In the six months ended June 30, 2014, the Corporation paid $7 million of the costs incurred on exploratory activities related to the Mindiogboro prospect. Based on results from the drilling of the exploration well into the Mindiogboro prospect, the Corporation plans to continue geological, geophysical, and environmental studies in 2015.

### OML 90 (Akepo Field) and Blocks 5 & 12, EEZ of São Tomé & Príncipe

Budgeted capital expenditures for OML 90 and Block 5 and 12, EEZ of Sao Tome & Principe were set at $2.0 million and $5.2 million, respectively, for 2014. No significant capital expenditures were incurred in these fields in the six months ended June 30, 2014. For OML 90, planned capital expenditures to develop an evacuation route for crude production remain. For Blocks 5 & 12, planned capital expenditures related to a four year work programme of 2D and 3D seismic acquisition and studies remains.

### Purchase Commitments

As at June 30, 2014, the Corporation had contracted to receive goods and services of an aggregate amount of $11.6 million which had not been delivered as at such date.

## 8. Related Party Transactions

The ultimate parent of the Corporation is Oando PLC, incorporated in Nigeria. At June 30, 2014, Oando PLC beneficially owned 92% of the Corporation's share capital. There are other companies that are related to Oando PLC through common shareholdings or common directorships with Oando PLC. The operations of the Corporation have historically been financed by Oando PLC and recognized as intercompany transactions.

*All tabular amounts are in thousands of US dollars unless otherwise noted*

As at June 30, 2014, the Corporation had the following outstanding related party balances with Oando PLC:

**Accounts receivable**

| | As at June 30, 2014 | As at December 31, 2013 |
|---|---|---|
| Accounts receivable from Oando PLC | 17,035 | 18,582 |
| | **17,035** | **18,582** |

**Accounts payable**

| | As at June 30, 2014 | As at December 31, 2013 |
|---|---|---|
| Under lift payable to Oando PLC | 47,272 | 47,272 |
| Loan payable to Oando PLC | 168,473 | 401,000 |
| Financing fee on Oando PLC loan | 32,300 | - |
| Payable to Oando PLC (Equator loan) | 10,501 | 9,914 |
| Payable to Oando PLC for COP Acquisition | - | 7,612 |
| Oando Energy Services | - | 1,228 |
| Oando PLC (Payments on behalf of the Corporation) | 24,156 | 37,463 |
| Payables to Oando PLC (Qua Ibo and ORPSL acquisition) | 7,488 | 9,260 |
| **Related party payables** | **290,190** | **513,749** |

For the six months ended June 30, 2014, $20.8 million (2013: $1.3 million) was charged to general and administrative costs under the terms of the Cooperation and Services Agreement dated July 24, 2012 between Oando PLC and the Corporation.

# 9. Outstanding Share Data

As at the date of this MD&A OER had outstanding: (i) 727,272,098 common shares; (ii) options exercisable to acquire up to 7,761,666 common shares, (iii) 310,887,109 warrants outstanding, each entitling the holder to acquire one common share of OER at an exercise price of $2.00 CAD per share 24 months from the date of the closing of the COP Acquisition (which closed on July 30, 2014); and (iv) 2,000,000 restricted share units outstanding, each entitling the holder to acquire one common share of OER at no additional cost.

# 10. Contingencies

## Crude oil under lift receivable (OML 125)

On February 25, 2014, the Nigerian Court of appeal delivered judgement in favour of NAE and the Corporation vacating the injunction granted by the Federal High Court. In light of this development, the claimants continued with the arbitration process towards final award. NNPC has appealed the setting aside of the injunction to the Supreme court and also filed an application for an injunction to prevent the continuation of the Arbitration. These applications are yet to be heard. NNPC filed an affidavit of urgency in May 2014, requesting that its applications be heard before June 11, 2014. This date is now passed without a hearing date being fixed by the Supreme Court.

Although the application at the Supreme Court is yet to be heard, on July 9, 2014 a final award was granted by the Arbitration Panel in favour of NAE and the Corporation entitling the Corporation to collect amounts overlifted by the NNPC. It is yet to be determined if the NNPC will honor the award granted by the Arbitration Panel. The Corporation's share of the damages awarded $72.9 million plus interest on damages, legal and expert costs, interest on legal and expert costs, and additional interest from the date the award was granted until payment. Of this amount, $47.3 is due to Oando PLC as the Corporation assumed a contractual obligation to pay a portion of those cash flows to Oando PLC when the company was re-organized on July 24, 2012.

Following issuance of the Final Award, NAE and the Corporation on July 21, 2014 sent a statutory pre-action notice to NNPC, giving the latter notice of their intention to file an action at the FHC for relief in relation to the recognition and enforcement of the Partial and Final Awards. The FHC action will be filed 30 days after the service of the pre-action notice to NNPC.

Furthermore, the Court of Appeal in its judgement given on February 25, 2014 (vacating the injunction restraining the continuation of the Arbitration) ordered that the NNPC Set Aside Proceedings be assigned to a new judge of the FHC. NAE and the Corporation await notification of this reassignment as well as a hearing notice.

### Other Contingencies

There have been no material changes to contingencies related to *Bilbari & Owanare (OML 122), OML 122, and OPL 321 and OPL 323* as previously disclosed in MD&A for the period ended December 31, 2013.

## 11. Accounting Policies and Critical Estimates and Judgements

The principal accounting policies applied in the preparation of the Interim Financial Statements are set out at Note 3 to the Interim Financial Statements.

### Changes in accounting policies and disclosures

The Corporation adopted IFRIC 21, Accounting for levies imposed by governments, which clarifies that the obligating event giving rise to a liability to pay a levy is the activity described in the relevant legislation that triggers payment of the levy. The Corporation's adoption of IFRIC 21 on January 1, 2014 did not result in changes in the accounting for government levies.

There are no other IFRSs or IFRIC interpretations that are effective January 1, 2014 that would be expected to have a material impact on the Corporation.

### New accounting standards and amendments issued but not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after January 1, 2014, and have not been applied in preparing these Interim Consolidated Financial Statements. Those with the potential to affect the Interim Consolidated Financial Statements of the Corporation are: IFRS 9 Financial Instruments. In February 2014, the IASB indicated that IFRS 9 will be effective for annual periods beginning on or after Jan. 1, 2018. The Corporation continues to assess the impact of adopting this standard.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of interim financial statements requires management to make estimates and judgements that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In preparing these financial statements, the significant judgements made by management in applying the Corporation's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended December 31, 2013 except as described below.

### Estimate: crude oil losses

Production from the Ebendo marginal field (OML 56) is transported using the Umusadege pipeline and export facility operated by Nigerian Agip Oil Company Limited ("**NAOC**"). This pipeline experiences a significant amount of crude oil losses due to theft of crude oil and/or sabotage of crude oil pipelines. Revenue is recognized on oil production net of crude oil losses.

Total net crude oil deliveries into the export pipeline from the Ebendo marginal field for the six months ended June 30, 2014 was approximately 206,135 bbls before pipeline losses. Pipeline and export facility losses reported by NAOC and allocated to the Corporation for the six months ended June 30, 2014 was 38,286 bbls (2013: 32,236 bbls), or 19% (2013: 20%) of total crude oil deliveries into the export pipeline for the year. This resulted in approximately $4.4 million (2013: $3.4 million) of oil production not being recognized in revenue (before royalties) for the six month period ended June 30, 2014 on the basis that it is not probable that the economic benefits will flow to the Corporation.

NAOC has been unable or unwilling to provide the marginal field companies that produce through the Umusadege export facility with an explanation for the basis for the pipeline and export facility losses or for the reasons for the fluctuations in allocated pipeline losses. The Corporation has used the existing allocations provided by NAOC as their best estimate of crude oil losses. As such, the resulting crude loss estimate may not be equal the related actual results. Total revenue recognized for production from the Ebendo field net of crude oil losses and before royalties, was $17.0 million for the six month period ended June 30, 2014 (2013 - $12.8 million). If the percentage of crude oil losses experienced was 5% higher, this would results in a further reduction of sales volumes by 10,307 bbls (2013: 8,164 bbls) and revenue by $1.1 million (2013: $0.9 million).

### Estimate: fair value of warrants and conversion feature on borrowings

On February 26, 2014 the Corporation closed a private placement with arm's length investors where $50 million was received in exchange for OER common shares and warrants which entitle the holders to purchase additional OER common shares subject to certain restrictions. Also on February 26, 2014, Oando PLC exchanged $601 million of convertible debt to equity for OER common shares and warrants with identical terms to those issued with the private placement shares. Pursuant to the Corporation's accounting policy for derivative financial instruments, the warrants have been recognized as a current liability at fair value with subsequent changes in fair value recognized in profit and loss. The fair values of the warrants, which are not traded in an active market, have been determined using a valuation technique.

On February 10, 2014, the Corporation signed an agreement with Oando PLC for a $1.2 billion loan facility. As a part of this arrangement, the Corporation entered into the Repayment Deed allowing either Oando PLC or the Corporation to elect for the Corporation to repay the Oando PLC Facility by the issuance of common shares, provided that all regulatory approvals have been obtained. The Corporation has determined that the conversion feature represents an embedded derivative. Accordingly, as amounts are drawn on the Oando PLC loan, an embedded derivative is recognized as a current liability at fair value with subsequent changes in fair value recognized in profit and loss. The fair value of this conversion feature has been determined using a valuation technique.

The Corporation used judgement to select the valuation models and made assumptions based mainly on market conditions to determine the fair value of the warrants and the conversion feature on borrowings. Refer to Note 9 in the interim consolidated financial statements for descriptions of the valuation models applied and the significant inputs into the models.

## Judgement: financing fees

On February 10, 2014, the Corporation signed a loan facility agreement with Oando PLC which included a $48 million financing fee. The financing fee is due on repayment of the loan or conversion of the loan to equity; the Corporation also has the option to settle the financing fee in equity if the loan is converted to equity. Management has determined that the obligation to pay the financing fee represents a financial liability of the Corporation when amounts are drawn. Accordingly, as amounts are drawn down on the facility, a financing fee liability is recorded; pursuant to the Corporation's accounting policy for "Other financial liabilities" the financing fee liability is recorded at its fair value on initial recognition and is subsequently measured at amortized cost.

Furthermore, the financing fee has been accounted for as a transaction cost and allocated to the entire $1.2 billion facility. To the extent that the facility is drawn, a portion of the facility fee is allocated to the drawn amount and used to estimate the effective interest rate on the loan over the estimated expected life of the drawings. In the event the loan is converted to equity, the unamortized portion of the financing fee is expensed. The portion of the facility fee related to undrawn amounts is not recognized until the drawings occur.

## 12. Internal Controls over Financial Reporting and Disclosure Controls

In the MD&A for the period ended December 31, 2013, Management disclosed material weaknesses with respect to disclosure controls and procedures ("**DCP**") and internal controls over financial reporting ("**ICFR**"). The following is a summary of actions taken to date to remediate those weaknesses:

- Lack of Financial Reporting Expertise (DCP): Beginning in February 2014, the Corporation has implemented a training program to assist existing employees in attaining appropriate financial reporting expertise. The Corporation is in the process of hiring employees and consultants who have the appropriate level of experience, including experience in Canadian financial reporting and continuous disclosure matters. The Corporation has formed a multi-disciplinary team of employees and consultants who will be involved with the preparation of the Corporation's annual disclosure documents and be responsible for the fulsome disclosure of relevant financial, legal and operational information

- Lack of Review of Press Releases (DCP): The Corporation has provided an education program to relevant Corporation representatives to ensure that its disclosure policies are followed in the future.

- Manual Consolidation Process Performed outside ERP (ICFR): In January 2014, the Corporation began to implement an updated version of the Corporation's ERP accounting system, which is expected to reduce the level of manual intervention required to prepare consolidated financial statements. It is expected that this will be implemented during the fourth quarter of 2014. Pending implementation of this updated system, this weakness is mitigated by the fact that the Corporation has hired employees and consultants with relevant experience and management relies heavily on manual procedures and detection controls, and quarterly reviews of financial statements by management and by the Audit Committee.

In addition to the above, the Corporation has engaged an independent and reputable professional services firm to assist with the assessment of design and operating effectiveness of DCP and ICFR in accordance with applicable securities laws. Furthermore, the CEO and CFO oversee all material transactions, the Audit Committee of the Board of Directors reviews on a quarterly basis the financial statements and key risks of the Corporation and queries management about significant transactions, and senior management perform daily oversight over the accounting records of the organization. Management is evaluating the design and operating effectiveness of DCP and ICFR (together "**internal controls**") and expects that its assessment of the design and operating effectiveness of internal controls will be completed in concert with the completion of the 2014 year end filings.

## 13. Advisory

### Forward Looking Statements

Certain information contained in management's discussion and analysis of the Corporation's financial condition and results of the Corporation's operations constitute forward-looking statements. This MD&A contains forward-looking statements. Management's assessment of future plans and operations, capital expenditures, methods of financing capital expenditures and the ability to fund financial liabilities and the impact on OER, future operating costs, future transportation costs, expected change in royalty rates and interest rates may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation to; the ability to successfully integrate the assets to be acquired under the COP Acquisition and derive the anticipated economic benefits therefore; statements with respect to the Corporation's development potential and program; the Corporation's ability to raise required capital or draw down on existing loans, the future price of oil and gas; the continuing impact of the change of management; the estimation of oil and gas reserves; conclusions of economic evaluation; the realization of reserve estimates; the timing and amount of estimated future production; costs of production; capital and operating expenditures; success of exploration activities; currency exchange rates; the impact of illegal bunkering and over lifting; potential and stability of foreign jurisdictions; government relations and regulation; and environmental risks. Generally, forward-looking information can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". Forward-looking information is based on the opinions and estimates of management as of the date such statements are made. Estimates regarding the potential of the Corporation's properties in Nigeria are based on the Corporation's understanding of regional geology and neighbouring properties and the continued development of the regions. Capital and operating cost estimates are based on terms of the Corporation's agreements with its partners, regulatory authorities, and extensive research of the Corporation, proposed budgets and programs under the agreements, recent estimates of exploration costs and other factors that are set out herein. Production estimates are based on past experience and plans and production schedules that have been developed by personnel and independent consultants of the Corporation and its business partners. Forward-looking information is subject to known and unknown risks, uncertainties and other factors that may cause the actual results, level of activity, performance or achievements of the Corporation to be materially different from those expressed or implied by such forward-looking statements, including but not limited to risks related to: unexpected events and delays during exploration, development and construction; revocation of government approvals and contracts; timing and availability of external financing on acceptable terms; actual results of exploration activities; changes in project parameters as plans continue to be refined; future prices of oil and gas; failure of plant, equipment or processes to operate as anticipated; accidents, labour disputes; risks inherent in foreign operations of the oil and gas industry. Although management of the Corporation has attempted to identify important factors that could cause actual results to differ materially from those contained in forward-looking information, there may be other factors that cause results not to be as anticipated, estimated or intended. There can be no assurance that such information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect the Corporation's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com), or at the Corporation's website (www.oandoenergyrresources.com). Furthermore, the forward looking statements contained in this document are made as at the date of this document and the Corporation does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

## Foreign Operations and Risk Factors

The majority of the Corporation's focus is related to Nigeria. As such, the Corporation is subject to political, economic, and other uncertainties, including, but not limited to, the uncertainty of negotiating with the Nigerian government, expropriation of property without fair compensation, adverse determinations or rulings by governmental authorities, changes in energy policies or in the personnel administering them, nationalization, currency fluctuations and devaluations, disputes between various levels of authorities, arbitrating and enforcing claims against entities that may claim sovereignty, authorities claiming jurisdiction, potential implementation of exchange controls and royalty and government take increases and other risks arising out of foreign governmental sovereignty over the areas in which the Corporation's operations are conducted, as well as risks of loss due to civil strife, acts of war, guerrilla activities and insurrections.

As such, the Corporation's operations may be adversely affected by changes in government policies and legislation or social instability and other factors which are not within the Corporation's control. This includes, but is not limited to, changes in legislation in the aforementioned regions, the risks of war, terrorism, abduction, expropriation, nationalization, renegotiation or nullification of existing concessions and contracts, taxation policies, economic sanctions, the imposition of specific drilling obligations and the development, forced abandonment of fields and/or facilities or changes in crude oil or natural gas pricing policy.

For the reasons stated above, and other factors, an investment in securities of OER should be considered speculation. OER's Annual Information Form contains a summary of various risk factors which are relevant to investors. Refer to "Additional Information" below.

## Non-GAAP Financial Measures

The non-GAAP financial measure "adjusted working capital deficiency" is not a measure recognized by GAAP and therefore may not be comparable to similar measures presented by other entities. Investors are cautioned that non-GAAP financial measures should not be construed as alternatives to other measures of financial performance calculated in accordance with GAAP. Adjusted working capital deficiency is calculated by subtracting current liabilities from current assets including cash and excluding the fair value of derivative financial instruments as noted in the table below.

| | **As at June 30, 2014** |
|---|---|
| Current assets | 252,970 |
| Deduct: current liabilities | (690,685) |
| Add: derivative financial instruments | 184,596 |
| Adjusted working capital deficiency | **(253,119)** |

## Oil and Gas Information

National Instrument 51-101 of the Canadian Securities Administrators imposes oil and gas disclosure standards for Canadian public companies engaged in oil and gas activities.

In this document, certain oil and NGL volumes have been converted to Bcfe on the basis of one bbl to six Mcf.

Cubic feet equivalent may be misleading, particularly if used in isolation. A conversion ratio of 6:1 is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent value equivalency at the wellhead.

Given that the value ratio based on the current price of oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

## Currency and References to the Corporation

All information included in this document and the Interim Financial Statements and comparative information is shown in US dollars, after royalty basis, unless otherwise noted. The Corporation's financial results are consolidated in US dollars and the Corporation has adopted the US dollars as its reporting currency to facilitate a more direct comparison to other North American oil and gas companies.

For convenience, references in this document to "OER", the "Corporation", "we", "us", "our" and "its" may, where applicable, refer only to or include any relevant direct and indirect subsidiary corporations and partnerships ("Subsidiaries") of Oando Energy Resources Inc., and the assets, activities and initiatives of such Subsidiaries.

## Additional Information

Further information regarding Oando Energy Resources Inc., including its Annual Information Form, can be accessed under the Corporation's public filings found on SEDAR at www.sedar.com, and on the Corporation's website at http://www.oandoenergyresources.com.