CONDOR PETROLEUM INC

# Interim Condensed Consolidated Financial Statements

## For the three months ended March 31, 2016 and 2015

## (unaudited)

## Condor Petroleum Inc.

Consolidated Statements of Financial Position (unaudited)
Stated in thousands of Canadian dollars

| As at | Note | March 31, 2016 | December 31, 2015 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | | 42,858 | 50,282 |
| Trade and other receivables | | 565 | 688 |
| Other current assets | | 856 | 923 |
| Total current assets | | 44,279 | 51,893 |
| | | | |
| Exploration and evaluation assets | 3 | 72,171 | 78,676 |
| Property, plant and equipment | 2, 4 | 11,851 | 2,939 |
| Other long term assets | 5 | 8,752 | 8,295 |
| Total assets | | 137,053 | 141,803 |
| | | | |
| **Liabilities** | | | |
| Accounts payable and accrued liabilities | | 2,728 | 3,962 |
| Current portion of other long-term liabilities | 6 | 348 | 395 |
| Current portion of provisions | 7 | 275 | 266 |
| Total current liabilities | | 3,351 | 4,623 |
| | | | |
| Other long term liabilities | 6 | 2,999 | 3,105 |
| Provisions | 2, 7 | 2,750 | 1,686 |
| Deferred income tax liabilities | 8 | - | 1,803 |
| Total liabilities | | 9,100 | 11,217 |
| | | | |
| **Equity** | | | |
| Share capital | 2, 9 | 271,688 | 263,035 |
| Contributed surplus | | 19,491 | 19,380 |
| Translation reserve | | (70,331) | (62,999) |
| Deficit | | (92,895) | (88,830) |
| Total equity | | 127,953 | 130,586 |
| Total liabilities and equity | | 137,053 | 141,803 |

Commitments and contingent liabilities (Note 12)

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

## Condor Petroleum Inc.

Consolidated Statements of Comprehensive Income (Loss) (unaudited)
Stated in thousands of Canadian dollars
(except for per share amounts)

| **For the three months ended March 31** | Note | **2016** | **2015** |
|---|---|---|---|
| **Revenue** | | | |
| Crude oil sales | | - | 103 |
| Total revenue | | - | 103 |
| **Expenses** | | | |
| Production costs | | - | 567 |
| Royalty expense | | - | 17 |
| Transaction costs | 2 | 1,375 | - |
| General and administrative | | 1,987 | 2,186 |
| Depletion and depreciation | | 105 | 1,032 |
| Stock based compensation | | 111 | 225 |
| Total expenses | | (3,578) | (4,027) |
| Finance income | | 131 | 189 |
| Finance and accretion expenses | | (102) | (437) |
| Foreign exchange gain (loss) | 11 | (2,319) | 5,524 |
| Net income (loss) before tax | | (5,868) | 1,352 |
| Deferred income tax expense | 8 | 1,803 | (1,392) |
| **Net loss** | | (4,065) | (40) |
| Foreign currency translation adjustment | 11 | (7,332) | 9,203 |
| **Comprehensive income (loss)** | | (11,397) | 9,163 |
| **Basic and diluted income (loss) per share** | | | |
| Net loss before share before consolidation | 10 | (0.01) | - |
| Net loss after share after consolidation | 10 | (0.12) | - |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

## Condor Petroleum Inc.

Consolidated Statements of Cash Flows (unaudited)
Stated in thousands of Canadian dollars

| **For the three months ended March 31** | Note | **2016** | **2015** |
|---|---|---|---|
| **Operating activities:** | | | |
| Net loss | | (4,065) | (40) |
| Items not affecting cash: | | | |
| Depletion and depreciation | | 105 | 1,032 |
| Deferred income tax expense | 8 | (1,803) | 1,392 |
| Stock based compensation | | 111 | 225 |
| Non-cash finance income | | (90) | (129) |
| Non-cash finance expenses | | 102 | 437 |
| Unrealized foreign exchange (gain) loss | | 3,232 | (5,604) |
| Changes in non-cash working capital | | 88 | 109 |
| Cash used in operating activities | | (2,320) | (2,578) |
| **Investing activities:** | | | |
| Exploration and evaluation expenditures | 3 | (579) | (2,247) |
| Property, plant and equipment expenditures | 2, 4 | (21) | (138) |
| Changes in non-cash working capital | | (1,257) | (4,945) |
| Cash used in investing activities | | (1,857) | (7,330) |
| Change in cash | | (4,177) | (9,908) |
| Effect of foreign exchange on cash | 9 | (3,247) | 5,701 |
| Cash and cash equivalents, beginning of period | | 50,282 | 64,478 |
| Cash and cash equivalents, end of period | | 42,858 | 60,271 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**Condor Petroleum Inc.**
Consolidated Statements of Changes in Equity (Unaudited)
Stated in thousands of Canadian dollars (except for number of common shares)

| | Number of common shares[1] | Share capital | Contributed surplus | Translation reserve | Deficit | Total |
|---|---|---|---|---|---|---|
| As at December 31, 2014 | 34,612,087 | 263,035 | 18,429 | (7,332) | (85,512) | 188,620 |
| Stock based compensation expense | - | - | 225 | - | - | 225 |
| Foreign currency translation adjustment | - | - | - | 9,203 | - | 9,203 |
| Net loss | - | - | - | - | (40) | (40) |
| As at March 31, 2015 | 34,612,087 | 263,035 | 18,654 | 1,871 | (85,552) | 198,008 |
| Stock based compensation expense | - | - | 726 | - | - | 726 |
| Foreign currency translation adjustment | - | - | - | (64,870) | - | (64,870) |
| Net loss | - | - | - | - | (3,278) | (3,278) |
| As at December 31, 2015 | 34,612,087 | 263,035 | 19,380 | (62,999) | (88,830) | 130,586 |
| Issued on business combination (Note 2) | 8,653,013 | 8,653 | - | - | - | 8,653 |
| Stock based compensation expense | - | - | 111 | - | - | 111 |
| Foreign currency translation adjustment | - | - | - | (7,332) | - | (7,332) |
| Net loss | - | - | - | - | (4,065) | (4,065) |
| As at March 31, 2016 | 43,265,100 | 271,688 | 19,491 | (70,331) | (92,895) | 127,953 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

[1] On March 24, 2016, the Company's shares were consolidated on a ten-to-one basis. The share consolidation has been applied retrospectively.

## 1. Corporate information:

*Reporting entity*

Condor Petroleum Inc. ("Condor" or the "Company") is a publicly traded company with activities in the Republic of Kazakhstan ("Kazakhstan") and the Republic of Turkey ("Turkey"). The address of the Company's registered office is 2400, 144 – 4th Ave SW, Calgary, Alberta, Canada, T2P 3N4.

The interim condensed consolidated financial statements (the "financial statements") of the Company as at March 31, 2016 and December 31, 2015 and for the three months ended March 31, 2016 and 2015 comprise the Company and its subsidiaries. The financial statements were approved and authorized for issue on May 12, 2016 by the Board of Directors.

*Nature of operations*

Condor has a 100% interest in and operates the Zharkamys West 1 territory ("Zharkamys") in western Kazakhstan. The Zharkamys contract with the Government of Kazakhstan is currently in the exploration period until December 14, 2016. Upon commercial discovery, the Company has the exclusive right to enter the development period by executing a development contract. The Company has commenced the process of applying for an extension to the exploration period.

Effective March 24, 2016, the Company acquired a 100% interest in and operates four production licenses located at Ortakoy in the Gallipoli Peninsula in Turkey. The four production licenses were converted in 2015 from an exploration license which had been originally awarded in 2004. The Poyraz Ridge production license was awarded for an initial eight year term and the Destan production license was awarded for an initial five year term and each of these licenses may be extended for up to twenty years including the initial term. The two other production licenses, H17 b1-1 and H17 a2-1, were each awarded for an initial four year term and, upon commercial discovery, may be extended for up to twenty years including the initial term.

*Basis of presentation*

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34 'Interim Financial Reporting'. The financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2015, which have been prepared in accordance with IFRS as issued by the IASB. The accounting policies used to prepare these financial statements are consistent with the policies at December 31, 2015 except as noted below.

The financial statements are reported in Canadian dollars ("CAD") which is the functional currency of the Company. The company's subsidiary in Kazakhstan has a Kazakhstan Tenge ("KZT") functional currency. The company's subsidiary in Netherlands, which has a branch in Turkey, has a Turkish Lira ("TRY") functional currency.

The financial statements have been prepared on the historical cost basis, except for acquired net assets as a result of business combinations, which are measured at fair value.

The Company uses the acquisition method to account for business combinations. Assets acquired and liabilities assumed in a business combination are recorded at fair value at the time of acquisition. The determination of fair value requires the Company to make estimates, assumptions and judgments that are subject to measurement uncertainty. The allocation process is inherently subjective and impacts the amounts assigned to individually identifiable assets and liabilities, including the fair value of property and equipment, other long-term assets and provisions. Consequently, the purchase price allocation impacts the Company's reported assets and liabilities and future net earnings, due to the impact on future depreciation and depletion expense as well as impairment tests.

*Changes in Accounting Policies and new standards and interpretations not yet adopted*

There were no new or amended accounting standards or interpretations adopted during the three months ended March 31, 2016. A description of accounting standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the annual Consolidated Financial Statements for the year ended December 31, 2015.

## 2. Business combination:

On January 7, 2016 the Company entered into an agreement with Marsa Energy Inc. ("Marsa") to acquire all of the issued and outstanding common shares of Marsa based on an exchange ratio of 1.84326 Condor common shares for each Marsa common share (the "Marsa Transaction"). On March 24, 2016 the Marsa Transaction was completed and Condor issued 8,653,013 common shares to the Marsa shareholders (Note 9). Based on the $1.00 closing price of Condor common shares listed on the Toronto Stock Exchange on the completion date on the post share consolidation basis, the total purchase price for the Marsa Transaction is $8,653,013. Marsa, through its subsidiaries, owns a 100% interest in the Ortakoy properties in Turkey.

The purchase price has been allocated to the fair value of the net assets acquired as follows (000's):

| | |
|---|---:|
| Other current assets | 64 |
| Property, plant and equipment | 9,197 |
| Other long term assets | 890 |
| Accounts payable and accrued liabilities | (306) |
| Provisions | (1,192) |
| Total net assets acquired | 8,653 |

If the Marsa Transaction had been completed on January 1, 2016, the Company's revenues for the three months ended March 31, 2016, when combined with Marsa's revenues and not taking into consideration any combined synergies, would have remained the same at nil and net loss would have increased by $0.7 million to $4.8 million. This pro-forma information is not necessarily indicative of the results had the Marsa Transaction actually occurred on January 1, 2016.

The Company incurred $1.4 million of transaction costs related to the Marsa Transaction.

## 3. Exploration and evaluation assets:

Exploration and evaluation assets comprise the Zharkamys property in Kazakhstan.

| For the period ended (000's) | **March 31, 2016** | **December 31, 2015** |
|---|---:|---:|
| **Cost** | | |
| Balance, beginning of period | 82,962 | 126,004 |
| Capital expenditures | 579 | 11,850 |
| Change in decommissioning provision and other | (39) | (45) |
| Foreign currency translation adjustment | (7,336) | (54,847) |
| Balance, end of period | 76,166 | 82,962 |

| | | |
|---|---|---|
| **Accumulated depletion** | | |
| Balance, beginning of period | (4,286) | (5,761) |
| Depletion | - | (932) |
| Foreign currency translation adjustment | 291 | 2,407 |
| Balance, end of period | (3,995) | (4,286) |
| **Net book value, end of period** | 72,171 | 78,676 |

## 4. Property, plant and equipment:

| (000's) | Oil and gas properties | Other equipment | Total |
|---|---|---|---|
| **Cost** | | | |
| As at December 31, 2015 | - | 5,230 | 5,230 |
| Acquisition of Ortakoy properties (Turkey) | 8,842 | 355 | 9,197 |
| Capital expenditures | - | 21 | 21 |
| Foreign currency translation adjustment | | (307) | (307) |
| As at March 31, 2016 | 8,842 | 5,299 | 14,141 |
| **Accumulated depletion and depreciation** | | | |
| As at December 31, 2015 | - | (2,291) | (2,291) |
| Depletion and depreciation | - | (105) | (105) |
| Foreign currency translation adjustment | - | 106 | 106 |
| As at March 31, 2016 | - | (2,290) | (2,290) |
| **Net book value** | | | |
| As at December 31, 2015 | - | 2,939 | 2,939 |
| As at March 31, 2016 | 8,842 | 3,009 | 11,851 |

## 5. Other long term assets:

| As at (000's) | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Value added tax receivable | 6,488 | 6,536 |
| Non-current bank deposits | 2,264 | 1,759 |
| | 8,752 | 8,295 |

The undiscounted value added tax ("VAT") receivables (including non-current and current portion) of $7.4 million (December 31, 2015: $7.7 million) are available for offset against VAT collected on future domestic sales and for refund related to future export sales. Additions to VAT receivables are discounted from the expected date of receipt using a discount rate of 9.5% (2015: 7.4%), which estimates the market rate of return on a similar instrument.

The non-current bank deposits including $1.7 million in Kazakhstan and $0.6 million in Turkey are invested in special interest bearing accounts and are reserved for settling future decommissioning obligations.

## 6. Other long term liabilities:

Other long term liabilities are amounts to be reimbursed to the Government of Kazakhstan for historical costs incurred in Zharkamys by the Government prior to the Company's acquisition of the Zharkamys exploration rights and include expenditures for drilling, seismic and other geological and geophysical works. The historical cost obligations are non-interest bearing and comprise United States dollar ("USD") denominated liabilities of $2.6 million related to the initial Zharkamys license acquisition and KZT denominated liabilities of $2.3 million related to the Zharkamys territory expansion. The total undiscounted amount at March 31, 2016 of $4.9 million (December 31, 2015: $5.3 million) has been discounted to a value of $3.3 million (December 31, 2015: $3.5 million), of which $0.3 million is current, based on the estimated timing of future payments and a weighted average 8% discount rate based on historical risk-free rates.

**7. Provisions:**

Provisions are comprised of decommissioning obligations, which are estimated based on the expected costs to abandon existing wells and facilities and to restore the existing sites in Kazakhstan, Turkey and Canada, along with the estimated timing of future payments. Non-current provisions increased $1.2 million in the three months ended March 31, 2016 related to the Turkey property acquisition (Note 2). At March 31, 2016, the estimated total undiscounted cash flows required to settle the current and non-current liabilities is $4.0 million (December 31, 2015: $2.4 million) which are expected to be incurred between 2016 and 2034.

The calculation of the net present value of the decommissioning obligations included a weighted average inflation rate of 6.2% (December 31, 2015: 5.1%) and weighted average risk free rate associated with the assets of 8.4% (December 31, 2015: 7.1%).

**8. Income taxes:**

As of March 31, 2016 the Company recognized a deferred tax liability of nil (December 31, 2015: $1.8 million) arising from the foreign currency translation adjustment on Condor's intercompany loans to foreign subsidiaries denominated in USD as well as foreign exchange losses on cash held in USD due to the depreciation of USD against CAD during the period.

**9. Share capital:**

The Company has authorized an unlimited number of common shares without nominal or par value and an unlimited number of first and second preferred shares without nominal or par values. The outstanding Condor common shares were consolidated on a ten-to-one basis on March 24, 2016 and numbers of common shares have been adjusted retrospectively.

On March 24, 2016 the Marsa Transaction was completed and Condor issued 8,653,013 common shares to the Marsa shareholders (Note 2).

| | **Common shares** |
|---|---:|
| As at December 31, 2015 | 34,612,087 |
| Marsa Transaction | 8,653,013 |
| As at March 31, 2016 | 43,265,100 |

**10. Per share amounts:**

Per share amounts are calculated using weighted average number of common shares of 35,277,706 as at March 31, 2016 and 34,612,087 as March 31, 2015. Outstanding stock options have been excluded from the calculations of diluted weighted average common shares as to include them would be anti-dilutive.

**11. Financial risk management:**

*Credit risk*

Trade and other receivables at March 31, 2016 include $0.5 million of crude oil sales receivables, which are significantly past due and relate to sales from November 2014 to January 2015, which have not been fully collected to date. Due to disruptions in the local oil refining market during 2015, the refinery which accepted delivery of the Company's crude oil in late 2014 and early 2015 has had cash flow interruptions and has been unable to settle their trade payables on a timely basis. The Company has not made any provision and expects the receivables to be fully collected.

Other long term assets includes Kazakhstan VAT receivable which may be offset against VAT collected on future domestic sales or refunded on future export sales and Turkey VAT receivable which may be offset against VAT collected on future gas sales. The Company has not made any provision and considers the amounts to be fully recoverable.

*Foreign currency exchange risk*

During the three months ended March 31, 2016, the CAD appreciated from 1.38 per 1.00 USD to 1.30, which led to a foreign exchange loss of ($2.3) million (2015: gain of $5.5 million) related to USD denominated cash and cash equivalents held by the Company.

During the three months ended March 31, 2016, the KZT depreciated from 245 per 1.00 CAD to 263 resulting in a ($7.3) million translation loss adjustment through equity (2015: gain of $9.2 million). The majority of this translation change was incurred on account of exploration and evaluation assets.

The Company is exposed to significant foreign currency risk as a substantial portion of the Company's foreign activities are transacted in or referenced to foreign currencies including USD, KZT and TRY, and a significant portion of the Company's cash and cash equivalents are held in USD.

A description of the nature and extent of other financial risks, including commodity prices, interest rates and liquidity risks arising from the Company's financial assets and liabilities can be found in the notes to the annual consolidated financial statements as at December 31, 2015. The Company's exposure to these risks has not changed significantly since December 31, 2015.

## 12. Commitments and contingent liabilities:

*Kazakhstan work commitments*

The Company has contractual work commitments pursuant to the Zharkamys territory in Kazakhstan. These work commitments are amended from time to time in accordance with planned exploration and development activities proposed by the Company and approved by the Government of Kazakhstan and the amounts could be significant. In addition, any exploration period extensions or subsequent development periods would likely carry additional work commitments, which could be significant. Non-fulfilment of work commitments in Kazakhstan could result in punitive actions by the Government of Kazakhstan including suspending or revoking of contracts. Financial work commitment shortfalls may be subject to penalties of 30% of the shortfall. The remaining Zharkamys work commitments as at March 31, 2016 and for the period until the expiry of the Zharkamys exploration license on December 14, 2016 amount to $2.6 million.

*Turkey work commitments*

As at March 31, 2016 the Company has commitments to drill exploration wells during 2016-2017 on each of the H17 a2-1 and H17 b1-1 licenses in Turkey. The estimated cost is $1.1 million per well and $2.2 million in total. Failure to drill a commitment well within the required timeline on a production license could lead to the loss of that production license.

## 13. Segmented information:

Condor has foreign subsidiaries and the following operating and reportable segmented information is provided:

| (000's) | Corporate | Kazakhstan | Turkey | Total |
|---|---|---|---|---|
| As at March 31, 2016 | | | | |
| Exploration and evaluation assets | - | 72,171 | - | 72,171 |
| Property and equipment | 23 | 2,631 | 9,197 | 11,851 |
| Total assets | 40,025 | 86,650 | 10,378 | 137,053 |
| Total liabilities | 917 | 6,685 | 1,498 | 9,100 |