# Tethys Petroleum Limited

Interim Financial Information
(Unaudited)
**September 30, 2016**

**NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4.3 (3) (a), if an auditor has not performed a review of the financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying condensed interim financial statements of Tethys Petroleum Limited have been prepared by and are the responsibility of the Company's management and approved by the Board of Directors of the Company. The Company's independent auditor has not performed a review of these condensed financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

## Contents

## Responsibility Statement of the Directors in Respect of the Interim Report and Accounts

We confirm on behalf of the Board that to the best of our knowledge, the condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting.

We draw attention to the section entitled “Going Concern” in Note 2 to the Condensed Consolidated Interim Financial Statements which describes the material uncertainties relating to the Company’s adoption of the going concern basis in preparing the Financial Statements for the period ended September 30, 2016.

For and on behalf of the Board

| | |
|---|---|
| **W. Wells** | **A. Ogunsemi** |
| Chairman | Director |
| November 15, 2016 | November 15, 2016 |

# Tethys Petroleum Limited

## Condensed Consolidated Statements of Financial Position (unaudited)

(in thousands of US dollars)

| | | As at | |
|---|---|---|---|
| | Note | September 30, 2016 | December 31, 2015 |
| **Non-current assets** | | | |
| Intangible assets | 7 | 67,227 | 64,202 |
| Property, plant and equipment | 8 | 105,699 | 113,397 |
| Restricted cash | 9 | 2,237 | 2,233 |
| Investment in joint arrangements | | 4 | 4 |
| Trade and other receivables | | 1,910 | 2,457 |
| Deferred tax | 5 | 211 | 226 |
| | | **177,288** | **182,519** |
| **Current assets** | | | |
| Cash and cash equivalents | | 1,800 | 3,272 |
| Trade and other receivables | | 7,349 | 3,710 |
| Inventories | | 821 | 879 |
| Restricted cash | 9 | 65 | 215 |
| | | **10,035** | **8,076** |
| **Total assets** | | **187,323** | **190,595** |
| **Non-current liabilities** | | | |
| Trade and other payables | | 70 | 133 |
| Financial liabilities - borrowings | 10 | 1,811 | 22,873 |
| Deferred tax | 5 | 10,133 | 10,792 |
| Provisions | | 894 | 846 |
| | | **12,908** | **34,644** |
| **Current liabilities** | | | |
| Financial liabilities - borrowings | 10 | 32,356 | 9,159 |
| Derivative financial instruments | 11 | - | 275 |
| Current taxation | 5 | 491 | 398 |
| Trade and other payables | | 18,133 | 14,189 |
| Provisions | | 25 | 360 |
| | | **51,005** | **24,381** |
| **Total liabilities** | | **63,913** | **59,025** |
| **Equity** | | | |
| Share capital | 0 | 4,000 | 33,696 |
| Share premium | 0 | 357,803 | 321,803 |
| Other reserves | | 43,349 | 43,166 |
| Accumulated deficit | | (287,838) | (273,189) |
| Non-controlling interest | | 6,096 | 6,094 |
| **Total equity** | | **123,410** | **131,570** |
| **Total equity and liabilities** | | **187,323** | **190,595** |
| Going concern | 2 | | |
| Commitments and contingencies | 15 | | |

The notes on pages 6 to 27 form part of these condensed consolidated interim financial statements. The condensed consolidated interim financial statements were approved by the Board on November 15, 2016 and were signed on its behalf.

**W. Wells**
Chairman
November 15, 2016

**A. Ogunsemi**
Director
November 15, 2016

# Tethys Petroleum Limited

Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited)

(in thousands of US dollars except per share information)

| | Note | Three months ended September 30 2016 | Three months ended September 30 2015 | Nine months ended September 30 2016 | Nine months ended September 30 2015 |
|---|---|---|---|---|---|
| Sales and other revenues | 3 | 3,119 | 5,736 | 10,103 | 18,528 |
| Sales expenses | | (665) | (1,182) | (2,132) | (3,563) |
| Production expenses | | (1,979) | (1,811) | (4,503) | (8,578) |
| Depreciation, depletion and amortisation | | (2,473) | (3,716) | (8,256) | (25,004) |
| Administrative expenses | | (1,354) | (2,073) | (4,379) | (7,608) |
| Restructuring costs | | 23 | (586) | (1,400) | (2,907) |
| Transaction costs of assets held for sale | | - | - | - | (1,065) |
| Share based payments | 4 | (20) | (93) | (183) | (358) |
| Profit on sale of fixed assets | | - | 10 | 10 | 53 |
| Foreign exchange gain/(loss) | | 20 | (716) | 141 | (931) |
| Fair value gain/(loss) on derivative financial instrument | 11 | 4 | 236 | 275 | (233) |
| Loss from jointly controlled entity | | - | (15) | - | (250) |
| Finance costs | | (893) | (321) | (4,835) | (2,848) |
| | | (7,337) | (10,267) | (25,262) | (53,292) |
| **Loss before tax from continuing operations** | | **(4,218)** | **(4,531)** | **(15,159)** | **(34,764)** |
| Taxation | 5 | 182 | 833 | 512 | 3,754 |
| **Loss from continuing operations** | | **(4,036)** | **(3,698)** | **(14,647)** | **(31,010)** |
| **Loss from discontinued operations net of tax** | | **-** | **(11)** | **-** | **(88)** |
| **Loss and total comprehensive income** | | **(4,036)** | **(3,709)** | **(14,647)** | **(31,098)** |
| **Loss and total comprehensive income attributable to:** | | | | | |
| Shareholders | | (4,196) | (3,711) | (14,649) | (31,097) |
| Non-controlling interest | | 160 | 2 | 2 | (1) |
| **Loss and total comprehensive income** | | **(4,036)** | **(3,709)** | **(14,647)** | **(31,098)** |
| **Loss per share attributable to shareholders:** | | | | | |
| Basic and diluted - from continuing operations (USD) | 6 | **(0.01)** | **(0.01)** | **(0.04)** | **(0.09)** |
| Basic and diluted - from discontinued operations (USD) | 6 | - | - | - | - |

No dividends were paid or are declared for the period (2015: none).

The notes on pages 6 to 27 form part of these condensed consolidated interim financial statements.

# Tethys Petroleum Limited

## Condensed Consolidated Statements of Changes in Equity (unaudited)

(in thousands of US dollars)

| | | Attributable to shareholders | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Share premium | Accumulated deficit | Option reserves | Warrant reserves | Non-controlling interest | Total equity |
| **At January 1, 2015** | | **33,645** | **321,724** | **(198,560)** | **26,244** | **16,601** | **6,096** | **205,750** |
| Comprehensive loss for the period | | - | - | (31,097) | - | - | (1) | (31,098) |
| **Transactions with shareholders** | | | | | | | | |
| Shares issued | | 39 | 60 | - | - | - | - | 99 |
| Share-based payments | | - | - | - | 259 | - | - | 259 |
| Total transactions with shareholders | | **39** | **60** | **-** | **259** | **-** | **-** | **358** |
| **At September 30, 2015** | | **33,684** | **321,784** | **(229,657)** | **26,503** | **16,601** | **6,095** | **175,010** |
| **At January 1, 2016** | 0 | **33,696** | **321,803** | **(273,189)** | **26,565** | **16,601** | **6,094** | **131,570** |
| Comprehensive loss for the period | | - | - | (14,649) | - | - | 2 | (14,647) |
| **Transactions with shareholders** | | | | | | | | |
| Shares issued | | 6,304 | - | - | - | - | - | 6,304 |
| Share-based payments | | - | - | - | 183 | - | - | 183 |
| Par value reduction[1] | | (36,000) | 36,000 | - | - | - | - | - |
| Total transactions with shareholders | | (29,696) | 36,001 | - | 183 | - | - | 6,488 |
| **At September 30, 2016** | 0 | **4,000** | **357,803** | **(287,838)** | **26,748** | **16,601** | **6,096** | **123,410** |

Note 1 - See note 12 for further details.

The option reserve and warrant reserve are denoted together as “other reserves” on the condensed consolidated statement of financial position. These reserves are non-distributable.

The notes on pages 6 to 27 form part of these condensed consolidated interim financial statements.

# Tethys Petroleum Limited

## Condensed Consolidated Statements of Cash Flows (unaudited)

(in thousands of US dollars)

| | Note | Three months ended September 30 2016 | Three months ended September 30 2015 | Nine months ended September 30 2016 | Nine months ended September 30 2015 |
|---|---|---|---|---|---|
| **Cash flow from operating activities** | | | | | |
| Loss before tax from continuing operations | | (4,218) | (4,531) | (15,159) | (34,764) |
| Loss before tax from discontinued operations[1] | | - | (11) | - | (88) |
| Adjustments for: | | | | | |
| Share based payments | | 20 | 93 | 183 | 358 |
| Net finance cost | | 893 | 321 | 4,835 | 2,848 |
| Depreciation, depletion and amortisation | | 2,473 | 3,716 | 8,256 | 25,004 |
| Profit on sale of fixed assets | | - | (10) | (10) | (53) |
| Fair value gain on derivative financial instruments | | (4) | (236) | (274) | 233 |
| Net unrealised foreign exchange loss/(gain) | | 109 | (87) | (246) | (61) |
| Loss from jointly controlled entity | | - | 15 | - | 250 |
| Movement in provisions | | (100) | (1,308) | (1,736) | (3,298) |
| Net change in working capital | 14 | (883) | (3,085) | (1,099) | (970) |
| **Cash used in operating activities** | | **(1,710)** | **(5,123)** | **(5,250)** | **(10,541)** |
| Corporation tax paid | | (7) | - | (28) | (134) |
| **Net cash used in operating activities** | | **(1,717)** | **(5,123)** | **(5,278)** | **(10,675)** |
| Cash flow from investing activities: | | | | | |
| Interest received | | - | 46 | - | 137 |
| Expenditure on exploration and evaluation assets | | (90) | (1,588) | (545) | (5,530) |
| Expenditure on property, plant and equipment | | (228) | (350) | (509) | (2,389) |
| Proceeds from sale of fixed assets | | - | 8 | 33 | 121 |
| Movement in restricted cash | | (2) | (87) | 146 | (238) |
| Movement in advances to construction contractors | | 193 | (11) | (6) | 179 |
| Movement in value added tax receivable | | 131 | 339 | 559 | 1,058 |
| Net change in working capital | 14 | 200 | 598 | 239 | (924) |
| **Net cash used in investing activities** | | **204** | **(1,045)** | **(83)** | **(7,586)** |
| Cash flow from financing activities: | | | | | |
| Proceeds from issuance of borrowings, net of issue costs | | 4,430 | 5,000 | 7,930 | 23,235 |
| Repayment of borrowings | | (715) | (288) | (1,289) | (4,953) |
| Interest paid on borrowings | | (903) | (311) | (2,616) | (1,219) |
| Movement in other non-current liabilities | | (22) | (27) | (90) | (83) |
| **Net cash generated from financing activities** | | **2,790** | **4,374** | **3,935** | **16,980** |
| Effects of exchange rate changes on cash and cash equivalents | | (177) | 1,138 | (46) | 1,699 |
| **Net increase/(decrease) in cash and cash equivalents** | | **1,100** | **(656)** | **(1,472)** | **418** |
| Cash and cash equivalents at beginning of the period | | 700 | 4,942 | 3,272 | 3,868 |
| **Cash and cash equivalents at end of the period** | | **1,800** | **4,286** | **1,800** | **4,286** |

Note 1 - The Company has elected to present a statement of cash flows that analyses cash flows for both continuing and discontinued operations.

The notes on pages 6 to 27 form part of these condensed consolidated interim financial statements.

## 1 General information

Tethys Petroleum Limited is incorporated in the Cayman Islands and the address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. Tethys is an oil and gas company operating within the Republic of Kazakhstan, Republic of Tajikistan and Georgia. Tethys' principal activity is the acquisition of and exploration and development of crude oil and natural gas fields.

The Company has its primary listing on the Toronto Stock Exchange ("TSX") and a standard listing on the London Stock Exchange ("LSE"). The Company is also listed on the Kazakhstan Stock Exchange ("KASE").

## 2 Basis of preparation and accounting policies

The condensed consolidated interim financial statements of the Company are prepared on a going concern basis under the historical cost convention except as modified by the revaluation of financial assets and financial liabilities at fair value through profit and loss and are in accordance with International Financial Reporting Standards ("IFRSs") issued by the IASB and IFRIC interpretations issued by the IFRS Interpretations Committee and effective or issued and early adopted as at the time of preparing those condensed consolidated interim financial statements.

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as applicable to interim financial reporting and do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the annual consolidated financial statements reported for the year ended December 31, 2015.

### *Going concern*

The Management and the Board has considered the Company's current activities, funding position and projected funding requirements for the period of at least twelve months from the date of approval of the Condensed Consolidated Interim Financial Statements in determining the ability of the Company to adopt the going concern basis in preparing the Condensed Consolidated Interim Financial Statements for the nine months period ended September 30, 2016. The Company currently does not have sufficient funding to fund its obligations for the next twelve months.

Although these Condensed Consolidated Interim Financial Statements have been prepared on a going concern basis in accordance with IFRS, which contemplates the realisation of assets and settlement of liabilities in the normal course of business as they come due, events and uncertainties which are discussed below raise substantial doubt about the Company's ability to continue as a going concern, and accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

The Company reported a loss of USD14.6m for the nine months period ended September 30, 2016 (year ended December 31, 2015: USD74.6m) and an accumulated deficit as at that date of USD287.8m (December 31, 2015: USD273.2m) and negative working capital of USD41.0m (December 31, 2015: negative USD16.3m). In addition, the Company reported negative cash flow from operating activities before tax of USD4.9m for the nine months period ended September 30, 2016 (year ended December 31, 2015: USD 11.6m).

The Company also has various commitments and contingencies as described in note 15. These include a Kazakhstan Court imposed freezing order on the bank accounts, production assets, shares and subsoil use contracts of Tethys subsidiary Tethys Aral Gas LLP (“TAG”) pending the outcome of a commercial claim which the Company considers to be without merit or substance.

In order to support the Company’s short term liquidity position, which has been adversely affected by the decrease in world oil prices, management has been implementing a cost reduction programme with respect to its operational, G&A costs and capital expenditures.

On April 28, 2016 Tethys signed an investment agreement with Olisol Petroleum Limited and Olisol Investments Limited (together "Olisol") under which Olisol undertook by October 27, 2016 to provide equity investments to Tethys in the amount of CDN9.8 million and also extended a working capital loan in the amount of USD5.7 million which Olisol could convert into additional shares ("Investment Agreement"). It was expected that Olisol would acquire at least 42% of the ordinary shares of Tethys and become a good in-country partner for Tethys in Kazakhstan. Olisol did not perform its financing obligations under the Investment Agreement and has sought to terminate the Investment Agreement and demand repayment of its loan. The Company does not believe that Olisol has the right to terminate the Investment Agreement or that the loan is repayable.

On November 6, 2016 the Company announced that it had received non-binding proposals from private investors, to acquire ordinary shares in the Company. The total initial proceeds would amount to approximately USD1.4 million. The investors have offered to work with Tethys to obtain a bank loan in Kazakhstan for TAG to enable it to repay and restructure current loans and to fund operations. The parties are working to close the placements as soon as possible.

The Company is currently owed more than USD3 million owed by Inter Gas Central Asia, the Kazakhstan State gas company for gas sales and USD1.4 million owed by Eurasia Gas Group LLP for oil sales. The Company will be able to receive payments when the Court imposed freezing order over TAG’s bank accounts referred to above have been lifted.

The Company is actively exploring other financing options including restructuring existing loans and drilling companies providing the funding to develop specific licence assets owned by the Company on a contingent production sharing basis.

Tethys’ future operations and earnings will depend upon the results of its operations in the Republic of Kazakhstan, Tajikistan and Georgia. There can be no assurance that Tethys will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys’ financial position, results of operations and cash flows. Also, the success of Tethys’ operations will be subject to numerous contingencies, some of which are beyond management’s control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competition and changes in regulation. Since Tethys is dependent on international operations, Tethys will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys’ operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

These circumstances indicate the existence of a material uncertainty related to events or conditions that may cast significant doubt about the Company's ability to continue as a going concern and accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to secure and deliver the above-described additional funding required to meet capital expenditure programs including its contractual obligations, its ability to renew and maintain access to debt facilities, equity issuances, manage risks associated with depressed oil prices and potential Tenge devaluation and ability to generate positive cash flows from operations. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported revenues, expenses and balance sheet classifications that would be necessary if the Company was unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

*New accounting policies*

The Company adopted the following revised standards as part of the 2012-2014 improvement cycle, along with any consequential amendments. These changes were made in accordance with applicable transitional provisions. 2012-2014 improvement cycle is effective for annual periods beginning on or after 1 January 2016. They include IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 7 Financial Instruments: Disclosures, IAS 19 Employee Benefits and IAS 34 Interim Financial Reporting. These amendments do not have any impact on the Company.

*Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

The following are standards that are being considered by the Group:

- IFRS 15, "Revenue from contracts with customers" deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard replaces IAS 18 "Revenue" and IAS 11 "Construction contracts" and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018 and earlier application is permitted. The Company is assessing the impact of IFRS 15.

- IFRS 16, "Leases" replaces IAS 17 and related interpretations. It introduces a new approach to lease accounting that requires a lessee to recognize assets and liabilities for the rights and obligations created by leases. It brings most leases on-balance sheet for lessees, eliminating the distinction between operating and finance leases. However, lessor accounting remains similar to previous guidance and the distinction between operating and finance leases is retained. The standard is effective for annual periods beginning on or after January 1, 2019. The Company is assessing the impact of IFRS 16.

There are no significant new or amended standards that have been early adopted by the Company.

(in thousands of US dollars)

## 3 Segmental Reporting

*Geographical segments*

Management has determined the operating segments based on the reports reviewed by the Directors that are used to make strategic decisions. Reports provided to the Directors with respect to segment information are measured in a manner consistent with that of the condensed consolidated interim financial statements. The assets and liabilities are allocated based on the operations of the segment and for assets, the physical location of the asset.

The Directors consider the business from predominantly a geographic perspective and the Company currently operates in three geographical markets: Kazakhstan, Tajikistan and Georgia. In Kazakhstan, the Company is producing oil and gas from the Kyzyloi and Akkulka fields and is undertaking exploration and evaluation activity in the Kul-bas field. In Tajikistan and Georgia, the Company is currently undertaking exploration and evaluation activity. The Company also operates a corporate segment which acquired a number of drilling rigs and related oil and gas equipment which are utilised in Kazakhstan according to operational requirements.

The following is an analysis of the Company's revenue, results and assets by reportable segment for the nine months ended September 30, 2016:

| | Kazakhstan | Tajikistan | Georgia | Other and corporate | Total |
|---|---|---|---|---|---|
| Gas sales | 8,529 | - | - | - | 8,529 |
| Oil sales | 1,591 | - | - | - | 1,591 |
| Other income | (18) | - | - | 1 | (17) |
| Other operating income | - | - | - | 575 | 575 |
| **Segment revenue and other income** | **10,102** | **-** | **-** | **576** | **10,678** |
| Inter-segment revenue | - | - | - | (575) | (575) |
| **Segment revenue and other income from external customers** | **10,102** | **-** | **-** | **1** | **10,103** |
| **Loss before taxation** | **(4,890)** | **1** | **9** | **(10,279)** | **(15,159)** |
| Taxation | 627 | - | - | (115) | 512 |
| **Loss for the period** | **(4,263)** | **1** | **9** | **(10,394)** | **(14,647)** |
| Total assets | 134,860 | 24,171 | 13,189 | 15,103 | 187,323 |
| Total liabilities | 20,844 | 11,468 | 1 | 31,599 | 63,912 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 655 | 103 | 283 | 13 | 1,054 |
| Depreciation, depletion & amortisation | 6,252 | 1 | - | 2,003 | 8,256 |

Borrowing costs of USD227,000 incurred in the Corporate segment were capitalised in the Kazakhstan segment during the period.

(in thousands of US dollars)

The following is an analysis of the Company's revenue, results and assets by reportable segment for the nine months ended September 30, 2015:

| | Kazakhstan | Tajikistan | Georgia | Other and corporate | Continuing operations | Uzbekistan[1] | Total |
|---|---|---|---|---|---|---|---|
| Gas sales | 13,636 | - | - | - | 13,636 | - | 13,636 |
| Oil sales | 4,884 | - | - | - | 4,884 | - | 4,884 |
| Other income | 8 | - | - | - | 8 | - | 8 |
| Other operating income | - | - | - | 726 | - | - | - |
| **Segment revenue and other income** | **18,528** | **-** | **-** | **726** | **19,254** | **-** | **19,254** |
| Inter-segment revenue | - | - | - | (726) | (726) | - | (726) |
| **Segment revenue and other income from external customers** | **18,528** | **-** | **-** | **-** | **18,528** | **-** | **18,528** |
| | | | | | | | - |
| Loss from jointly controlled entity | (250) | - | - | - | (250) | - | (250) |
| | | | | | | | - |
| **Loss before taxation** | **(20,979)** | **(14)** | **(2)** | **(13,769)** | **(34,764)** | **(88)** | **(34,852)** |
| Taxation | 3,881 | - | - | (127) | 3,754 | - | 3,754 |
| **Loss for the period** | **(17,098)** | **(14)** | **(2)** | **(13,896)** | **(31,010)** | **(88)** | **(31,098)** |
| Total assets | 145,781 | 43,781 | 12,828 | 22,780 | 225,170 | - | 225,170 |
| Total liabilities | 9,824 | 6,050 | 1 | 34,134 | 50,009 | 151 | 50,160 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 2,563 | 4,561 | 795 | - | 7,919 | - | 7,919 |
| Depreciation, depletion & amortisation | 22,355 | 1 | - | 2,648 | 25,004 | - | 25,004 |

Note 1 - Discontinued operation in 2013.

Borrowing costs of USD250,000 and USD536,000 incurred in the Corporate segment were capitalised in the Kazakhstan and Tajikistan segments respectively during the period.

The following is an analysis of the Company's revenue, results and assets by reportable segment for the three months ended September 30, 2016:

| | Kazakhstan | Tajikistan | Georgia | Other and corporate | Total |
|---|---|---|---|---|---|
| Gas sales | 2,659 | - | - | - | 2,659 |
| Oil sales | 459 | - | - | - | 459 |
| Other income | 2 | - | - | (1) | 1 |
| Other operating income | - | - | - | 193 | 193 |
| **Segment revenue and other income** | **3,120** | **-** | **-** | **192** | **3,312** |
| Inter-segment revenue | - | - | - | (193) | (193) |
| **Segment revenue and other income from external customers** | **3,120** | **-** | **-** | **(1)** | **3,119** |
| **Loss before taxation** | (2,023) | 1 | 7 | (2,203) | (4,218) |
| Taxation | 218 | - | - | (36) | 182 |
| **Loss for the period** | **(1,805)** | **1** | **7** | **(2,239)** | **(4,036)** |
| Total assets | 134,860 | 24,171 | 13,189 | 15,103 | 187,323 |
| Total liabilities | 20,844 | 11,468 | 1 | 31,599 | 63,912 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 252 | 22 | 44 | - | 318 |
| Depreciation, depletion & amortisation | 1,877 | - | (7) | 603 | 2,473 |

(in thousands of US dollars)

Borrowing costs of USD204,000 incurred in the Corporate segment were capitalised in the Kazakhstan and segment respectively during the period.

The following is an analysis of the Company's revenue, results and assets by reportable segment for the three months ended September 30, 2015:

| | Kazakhstan | Tajikistan | Georgia | Other and corporate | Continuing operations | Uzbekistan[1] | Total |
|---|---|---|---|---|---|---|---|
| Gas sales | 4,103 | - | - | - | 4,103 | - | 4,103 |
| Oil sales | 1,631 | - | - | - | 1,631 | - | 1,631 |
| Refined product sales | (6) | - | - | - | (6) | - | (6) |
| Other income | 8 | - | - | (533) | (525) | - | (525) |
| Other operating income | - | - | - | 726 | 726 | - | 726 |
| **Segment revenue and other income** | **5,736** | **-** | **-** | **193** | **5,929** | **-** | **5,929** |
| Inter-segment revenue | - | - | - | - | (193) | - | (193) |
| **Segment revenue and other income from external customers** | **5,736** | **-** | **-** | **193** | **5,736** | **-** | **5,736** |
| Loss from jointly controlled entity | (15) | - | - | - | 15 | - | 15 |
| | | | | | | | - |
| **Profit/ (loss) before taxation** | **(1,807)** | **1** | **-** | **(2,725)** | **(4,531)** | **(11)** | **(4,542)** |
| Taxation | 868 | - | - | (35) | 833 | - | 833 |
| **Profit/ (loss) the period** | **(939)** | **1** | **-** | **(2,760)** | **(3,698)** | **(11)** | **(3,709)** |
| Total assets | 145,781 | 43,781 | 12,828 | 22,780 | 225,170 | - | 225,170 |
| Total liabilities | 9,824 | 6,050 | 1 | 34,134 | 50,009 | 151 | 50,160 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 2,563 | 4,561 | 795 | - | 7,919 | - | 7,919 |
| Depreciation, depletion & amortisation | 2,998 | - | - | 718 | 3,716 | | 3,716 |

Note 1 - Discontinued operation in 2013.

Borrowing costs of USD434,000 and USD408,000 incurred in the Corporate segment were capitalised in the Kazakhstan and Tajikistan segments respectively during the period.

## 4 Share based payments

### *Share options*

Full details of the share options and stock incentive plan are outlined in the Company's annual consolidated financial statements for the year ended December 31, 2015. The options under the plan vest in three tranches over either two or three years. These options are equity settled share based payment transactions.

In respect of both share options and in the prior period shares issued a charge for the value of services of USD183,000 (2015: USD358,000) was recorded for the period. No amounts were capitalised in the current or prior periods.

(in thousands of US dollars)

The following tables summarise the stock option activity for the periods ended September 30, 2016 and September 30, 2015.

| | Nine months ended September 30 | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Number of options | Weighted average exercise price ($) | Number of options | Weighted average exercise price ($) |
| Outstanding at January 1 | 11,025,500 | 0.31 | 15,362,400 | 1.58 |
| Granted | 14,307,500 | 0.03 | 10,422,500 | 0.23 |
| Forfeited | (2,910,000) | 0.18 | (1,077,500) | 0.28 |
| Expired | (2,624,500) | 0.33 | (9,588,400) | 1.80 |
| **Outstanding at September 30** | **19,798,500** | **0.12** | **15,119,000** | **0.60** |
| **Exercisable at September 30** | **3,062,667** | **0.42** | **6,594,000** | **1.08** |

### *Warrants classified as derivative financial instruments*

The Company has issued warrants which are classified as derivative financial instruments. Details of these are given in note 11.

### *Warrants issued in connection with loans*

The following table summarises the warrant activity for the periods ended September 30, 2016 and September 30, 2015.

| | Nine months ended September 30 | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Number of warrants | Weighted average exercise price ($) | Number of warrants | Weighted average exercise price ($) |
| Outstanding at January 1 | 2,090,000 | 2.50 | 2,090,000 | 2.50 |
| Expired | | | | |
| **Outstanding at September 30** | **2,090,000** | **2.50** | **2,090,000** | **2.50** |
| **Exercisable at September 30** | **2,090,000** | **2.50** | **2,090,000** | **2.50** |

(in thousands of US dollars)

## 5 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax. The Company also operates in other tax jurisdictions, the most significant of which is Kazakhstan where the tax rate is 20%.

The provision for income taxes is different from the expected provision for income taxes for the following reasons:

| | Nine months ended September 30 2016 | Nine months ended September 30 2015 |
|---|---|---|
| Loss before income taxes from continuing operations | (15,159) | (34,764) |
| Income tax rate | 20% | 20% |
| **Expected income tax recovery** | **3,032** | **6,953** |
| Decrease resulting from: | | |
| Non-deductible expenses net of functional currency foreign exchange impact | (234) | 8,046 |
| Revisions in tax estimates and foreign exchange impact on tax pools | 357 | (6,338) |
| Impact of effective tax rates in other foreign jurisdictions | (1,919) | (2,433) |
| Losses and tax assets not utilised/recognised | (724) | (2,474) |
| | **512** | **3,754** |
| Current tax (expense)/credit | (100) | 134 |
| Deferred tax credit | 612 | 3,830 |
| **Total** | **512** | **3,754** |

The temporary differences comprising the net deferred income tax liability are as follows:

| | As at September 30, 2016 | As at December 31, 2015 |
|---|---|---|
| Tax losses | 211 | 226 |
| **Deferred tax asset** | **211** | **226** |
| Capital assets | 12,403 | 13,008 |
| Other | (2,270) | (2,216) |
| **Deferred tax liability** | **10,133** | **10,792** |

No current and deferred tax was charged or (credited) to equity or other comprehensive income. Total tax was charged (credited) to the statement of comprehensive income.

## 6 Loss per share

| Continuing operations | Units | Three months ended September 30 2016 | Three months ended September 30 2015 | Nine months ended September 30 2016 | Nine months ended September 30 2015 |
|---|---|---|---|---|---|
| Loss for the purpose of basic and diluted loss attributable to ordinary shareholders | $'000 | (4,196) | (3,700) | (14,649) | (31,009) |
| Weighted average shares | 000s | 400,005 | 336,785 | 379,262 | 336,653 |
| Per share amount | $ | (0.01) | (0.01) | (0.04) | (0.09) |

Loss from discontinued operations was nil cents per share in each period.

Basic loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the year. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares, comprising share options and warrants, are currently anti-dilutive and therefore there is no difference between basic and diluted earnings per share.

## 7 Intangible assets

| Exploration and evaluation assets | Kazakhstan | Georgia | Tajikistan | Total |
|---|---|---|---|---|
| **January 1, 2015** | **-** | **11,996** | **35,634** | **47,630** |
| Additions | 129 | 909 | 12,284 | 13,322 |
| Exploration and evaluation expenditure written off | - | - | (25,918) | (25,918) |
| Transfer from assets held for sale | 29,168 | - | - | 29,168 |
| **December 31, 2015** | **29,297** | **12,905** | **22,000** | **64,202** |
| Additions | 188 | 282 | 2,555 | 3,025 |
| **September 30, 2016** | **29,485** | **13,187** | **24,555** | **67,227** |

## 8 Property, plant and equipment

| | Oil and gas properties | | | Oil and gas equipment | | | Other fixed assets[1] | | | Total net book amount |
|---|---|---|---|---|---|---|---|---|---|---|
| | Cost | Amortisation | Total | Cost | Depreciation | Total | Cost | Depreciation | Total | |
| **January 1, 2015** | **-** | **-** | **-** | **22,184** | **(8,882)** | **13,302** | **1,690** | **(1,188)** | **502** | **13,804** |
| Additions | 2,113 | - | 2,113 | - | - | - | 94 | - | 94 | 2,207 |
| Transfer from assets held for sale (see note 2) | 166,069 | (43,367) | 122,702 | 3,159 | (696) | 2,463 | 3,785 | (2,764) | 1,021 | 126,186 |
| Disposals | - | - | - | - | - | - | (474) | 405 | (69) | (69) |
| Amortisation and depletion | - | (24,870) | (24,870) | - | (2,976) | (2,976) | - | (885) | (885) | (28,731) |
| **December 31, 2015** | **168,182** | **(68,237)** | **99,945** | **25,343** | **(12,554)** | **12,789** | **5,095** | **(4,432)** | **663** | **113,397** |
| Additions | 558 | - | 558 | - | - | - | 55 | - | 55 | 613 |
| Disposals | - | - | - | - | - | - | (846) | 791 | (55) | (55) |
| Amortisation and depletion | - | (5,861) | (5,861) | - | (2,080) | (2,080) | - | (315) | (315) | (8,256) |
| **September 30, 2016** | **168,740** | **(74,098)** | **94,642** | **25,343** | **(14,634)** | **10,709** | **4,304** | **(3,956)** | **348** | **105,699** |

Note 1 – Consists of vehicles, computers and office equipment.

(in thousands of US dollars)

## 9 Restricted cash

Non-current amounts consist of interest bearing deposits held in Kazakhstan that have been placed to satisfy local Kazakh requirements in respect of asset retirement obligations. Current amounts consist of monies placed on temporary deposit as security against corporate credit cards and a deposit with the Ministry of Finance in Dubai.

## 10 Financial liabilities

| | Effective interest rate per annum | Maturity date | As at September 30, 2016 | As at December 31, 2015 |
|---|---|---|---|---|
| **Current** | | | | |
| Rig loans | 14.80% | 2017 | 4,157 | 1,386 |
| Kazakh loan | 11.0%-15.9% | 2019 | 2,035 | 2,571 |
| Corporate loans | 22.60% | 2017 | 12,577 | - |
| Convertible loans | 10.60% | 2017 | 7,842 | - |
| Olisol loan | 8.20% | 2016 | 5,745 | 5,202 |
| | | | **32,356** | **9,159** |
| **Non-current** | | | | |
| Rig loans | 14.80% | 2017 | - | 3,995 |
| Kazakh loan | 11.0%-15.9% | 2019 | 1,811 | - |
| Corporate loans | 22.60% | 2017 | - | 9,846 |
| Convertible loans | 10.60% | 2017 | | 9,032 |
| | | | **1,811** | **22,873** |
| **Total** | | | **34,167** | **32,032** |

The fair value of financial liabilities held at amortised cost approximates the carrying value. As at September 30, 2016, the Company is in compliance with all debt covenants relating to all borrowing contracts.

### *Rig loans*

On February 13, 2014, the Company entered into a loan agreement to borrow up to USD12 million. The loan is secured by the shares of the borrower, a wholly owned subsidiary of the Company, which in turn owns two drilling rigs and other equipment. At September 30, 2016, loans with a face value of USD4.7 million and GBP2.1 million have been borrowed under the agreement.

The lenders receive an initial repayment followed by 34 equal monthly instalments, incorporating interest and capital, together with a single balloon repayment of half of the principal amount at the maturity date.

These borrowings are held at amortised cost with interest payable of 12% per annum and an effective interest rate of 14.8% per annum.

### *Kazakh loan*

On September 29, 2012, the Company announced that it had secured a loan facility from a Kazakh bank to fund capital expenditures in Kazakhstan (the “bank loan facility”).

The bank loan facility was arranged by Eurasia Gas Group LLP ("EGG"), with the Company's consent, and is a bank loan to Eurasia Gas Group LLP, the Company's principal oil buyer and customer of the AOT, whereby Eurasia Gas Group LLP draws down on the bank loan facility with the approval of the Company and funds are transferred to the Company's subsidiary, TAG. The bank loan facility has a term of up to four years depending on the Company's requirements and bears an interest rate of between 12% and 15% per annum on sums drawn down.

In January 2013, the Kazakh loan arrangement was terminated and replaced with an arrangement whereby funds are advanced to the Company and repaid as a deduction against oil sales. Terms of the arrangement are principally the same (i.e. the principal repayment to be completed by April 2016 with monthly repayments of both principal and interest) and therefore, under IFRS, the amounts advanced continue to be treated as a loan. Under this arrangement the Company is tied to EGG for its oil sales on an exclusive basis whilst the loan remains outstanding.

A total of 1.9 billion KZT (USD12.9 million) of funds have been advanced to the Company under the loan agreement, with monthly repayments of both principal and interest (at a weighted average effective interest rate of between 14.0% and 15.9%). The outstanding balance of the loan at September 30, 2016 is shown in the table above.

In the event that oil production is suspended for more than 30 days, the outstanding amount is to be repaid to Eurasia Gas Group LLP within 30 days from the receipt of its notice of return.

Certain oil and gas property assets have been pledged by TAG as security for the above-mentioned bank loan facility.

On September 7, 2016, the Company received an additional USD1.0 million drawdown. The loan interest on the initial USD1.0 million is 11%, maturing in July 2017 and also includes a nine month principal grace period.

*Olisol loan*

On November 19, 2015 the Company announced that it had entered into an interim convertible financing facility of up to USD15 million (the "Interim Financing Facility") with Olisol. The Interim Financing Facility was convertible into Tethys ordinary shares at CDN0.17 per share. The Interim Financing Facility had a maturity date of August 31, 2016 and bears interest at a rate of 9% per annum which together with the principal is payable at the maturity date.

On March 2, 2016 the Company announced that it had signed an amendment to the Interim Financing Facility (the "Facility Agreement Amendment") under which Olisol agreed, subject to certain approvals, to convert all but USD1 million of the outstanding amount of principal and accrued interest under the Interim Financing Facility (approximately USD6.25 million) into ordinary shares at a price of USD0.10 per share.

On March 21, 2016, Olisol converted USD3.7 million of the outstanding amount into 37,440,042 shares. On April 15, 2016, Olisol converted a further USD2.6 million of the outstanding amount into 25,604,419 shares.

On April 28, 2016 the Company and Olisol signed an Amended and Restated Investment Agreement ("Investment Agreement"). Olisol is obliged under the legally binding terms of the Investment Agreement to continue to provide Tethys with amounts reasonably requested by

Tethys, to fund working capital requirements during the period ending on the latest of (i) the completion of the TAG Loan and (ii) the occurrence of the Closing Date. Olisol undertook to work with Tethys and a Kazakh bank to obtain a bank loan of not less than US$10 million for TAG ("TAG Loan") and to date Olisol has not been able to complete the TAG Loan.

Olisol did not perform its financing obligations under the Investment Agreement by the October 27, 2016 Closing Date and has sought to terminate the Investment Agreement and demand repayment of its loan. The Company does not believe that Olisol has the right to terminate the Investment Agreement or that the loan is repayable.

*Corporate - New USD6.0 million loan financing*

On January 16, 2015 the Company announced that it had secured a new USD6.0 million unsecured loan facility. The principal was due at the end of two years with interest payments at the rate of 8% per annum being due every six months. The loan has been fully drawn down by the Company.

In connection with the loan financing, the Company issued the lender with 35,600,000 warrants over the Company's shares with a price of CDN0.19. The Company valued these warrants at initial recognition at USD2.1 million. The warrants were surrendered during the prior year for the surrender value of USD2.1 million which has been added to the principal amount and is repayable on the two year maturity date.

On March 12, 2016 certain terms of the loan were amended including a change in the interest rate to 10.5% per annum being due every three months.

*Corporate - New USD3.5 million loan financing*

On March 10, 2015 the Company secured a new USD3.5 million unsecured loan facility from Annuity and Life Reassurance Ltd ("ALR"), a company controlled by Pope Asset Management, the Company's largest shareholder. The principal is due at the end of two years with interest payments at the rate of 8% per annum being due every 6 months. The loan has been fully drawn down by the Company.

In connection with the loan financing, the Company has issued the lender with 23,333,333 warrants over the Company's shares with a price of CDN0.19. The Company has valued these warrants at initial recognition at USD0.8 million.

*Unsecured convertible loan facility from AGR Energy No. 1*

On May 15, 2015, the Company issued USD7.5 million aggregate principal amount of convertible debentures (the "AGR Debentures") to AGR Energy Limited No. 1 ("AGR Energy No. 1"). The AGR Debentures are convertible into Ordinary Shares, subject to customary adjustment provisions, at a conversion price of USD0.10 per share for an aggregate of up to 75,000,000 Ordinary Shares. The conversion option has been accounted for as an embedded derivative and valued by the Company at initial recognition at USD180,000.

The AGR Debentures mature on September 30, 2017 and pay interest at a rate of 9% per annum.

(in thousands of US dollars)

*Unsecured convertible loan facility from ALR*

On September 1, 2015, the Company issued USD1,760,978 aggregate principal amount of convertible debentures to ALR (the "ALR Debentures") a company controlled by Pope Asset Management, the Company's largest shareholder. The ALR Debentures are convertible into Ordinary Shares, subject to customary adjustment provisions, at a conversion price of USD0.10 per share for an aggregate of up to 17,609,780 Ordinary Shares. The conversion option has been accounted for as an embedded derivative and valued by the Company at initial recognition at USD70,000.

The ALR Debentures pay interest at a rate of 9% per annum and mature on September 30, 2017.

## 11 Derivative financial instruments

*Warrants*

| | As at September 30, 2016 | December 31, 2015 |
|---|---|---|
| Balance, beginning of period | 275 | - |
| Issued during the period | - | 2,949 |
| Fair value gain | (275) | (573) |
| Surrender of warrants (see note 10) | - | (2,101) |
| **Balance, end of period** | **-** | **275** |

The warrant liability represents the financial liability relating to share warrants where the shares are denominated in a currency that is not the Company's functional currency. These warrants were issued in connection with the two corporate loans described in note 10.

The liability was initially recognised at fair value. As the warrants are denominated in a foreign currency, there is a written option for the holder to exchange the foreign currency denominated warrant for a fixed number of functional currency denominated shares. This option is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income.

The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

| | As at September 30, 2016 | December 31, 2015 |
|---|---|---|
| Weighted average fair value | USD0.01 | USD0.01 |
| Risk free rate | 0.52% | 0.48% |
| Expected term | 0.8 years | 1.2 years |
| Volatility | 94.79% | 108.00% |
| Dividend | Nil | Nil |

(in thousands of US dollars)

The following table summarises the warrant activity for the year ended December 31, 2015 and the period ended September 30, 2016.

| | Number of warrants | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1, 2015 | - | - |
| Issued | 58,933,333 | 0.15 |
| Surrender of warrants (see note 10) | (35,600,000) | 0.15 |
| **Outstanding and exercisable at December 31, 2015** | **23,333,333** | **0.15** |
| **Outstanding and exercisable at September 30, 2016** | **23,333,333** | **0.15** |

There are no performance conditions attached to the warrants and all the granted warrants were immediately vested. Warrants are equity settled share based payment transactions.

In estimating expected volatility, the Company considers the historical volatility of its own share price over the most recent period that is commensurate with the expected warrant term.

*Convertible loans*

In May and September 2015 the Company issued two convertible loans, the terms of which are described in note 10. The AGR Debentures contain a cash settlement feature which does not meet the conditions for compound instrument treatment in accordance with IAS 32.25 and/or IAS 32.26. As a result, the instrument is a hybrid instrument containing an embedded derivative conversion feature. The ALR Debentures contains a separate cash settlement feature, which requires the Company to indemnify the holder for the offer amount. This is treated as a contingent settlement provision under IAS 32.25. Accordingly, the instrument is a hybrid instrument containing an embedded derivative feature. The embedded derivative has been valued at inception and revalued at the period end and details are provided below.

| | As at September 30, 2016 | December 31, 2015 |
|---|---|---|
| Balance, beginning of period | - | 250 |
| Fair value gain | - | (250) |
| **Balance, end of period** | **-** | **-** |

The fair value of the liability was estimated using a valuation model using the following assumptions:

| | As at September 30, 2016 | December 31, 2015 |
|---|---|---|
| Credit spread | 9.94% | 9.94% |
| Volatility | 70.00% | 70.00% |

(in thousands of US dollars)

## 12 Share capital

*Share capital and share premium*

| | Number of shares |
|---|---|
| **Authorised as at December 31, 2015:** | |
| Ordinary shares with a par value of $0.10 each | 700,000,000 |
| Preference shares with a par value of $0.10 each | 50,000,000 |
| | |
| **Authorised as at September 30, 2016:** | |
| Ordinary shares with a par value of $0.01 each | 1,450,000,000 |
| Preference shares with a par value of $0.01 each | 50,000,000 |

| **Ordinary equity share capital**<br>**Allotted and fully paid** | **Number** | **Share Capital** | **Share Premium** |
|---|---|---|---|
| At January 1, 2015 | 336,452,667 | 33,645 | 321,724 |
| Issued during the year | 507,720 | 51 | 79 |
| **At December 31, 2015** | **336,960,387** | **33,696** | **321,803** |
| Issued during the year (see note 10): | | | |
| Debt conversion by Olisol – March 21, 2016 | 37,440,042 | 3,744 | - |
| Debt conversion by Olisol – April 15, 2016 | 25,604,419 | 2,560 | - |
| Par value reduction – August 31, 2016 | - | (36,000) | 36,000 |
| **At September 30, 2016** | **400,004,848** | **4,000** | **357,803** |

On August 31, 2016, to facilitate the Olisol private placement transaction (see note 13), the Company reduced the par value of its ordinary shares from USD0.10 to USD0.01 per share.

## 13 Related party transactions

Transactions between the Company's subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

*Olisol Investments Limited and Olisol Petroleum Limited*

Alexander Abramov, former Chairman and Non-Executive Directors of Tethys Petroleum Limited, and Alexander Skripka, the Company's former Chief Commercial Officer are controlling parties of Olisol Investments Limited and its wholly owned subsidiary Olisol Petroleum Limited (together "Olisol"). Olisol and the Company are:

(i) Equal partners in the Aral Oil Terminal ("AOT"), a limited liability partnership in Kazakhstan. All of the oil produced and sold by the Company is trans-shipped through the AOT. At September 30, 2016, AOT had a loan owing to Olisol, including accrued interest, of USD3,224,000 (September 30, 2015: USD2,989,000) and a loan owing to the Company of USD2,681,000 (September 30, 2015: USD2,501,000);

(ii) Parties to the Interim Financing Facility and Facility Amendment Agreement, details of which are given in note 10;

(iii) Parties to investment agreement under which Olisol undertook by October 27, 2016 to provide equity investments to Tethys in the amount of CDN9.8 million and also extended a working capital loan in the amount of USD5.7 million which Olisol could convert into additional shares ("Investment Agreement"). Olisol did not perform its financing obligations under the Investment Agreement and has sought to terminate the Investment Agreement and demand repayment of its loan. The Company does not believe that Olisol has the right to terminate the Investment Agreement or that the loan is repayable.

(in thousands of US dollars)

*Eurasia Gas Group*

Alexander Skripka, the former Company's Chief Commercial Officer, is the controlling party of Eurasia Gas Group LLP ("EGG"). EGG is the sole customer for oil produced by the Company and purchases the oil at the wellhead. In the nine months to September 30, 2016 oil sales of USD1,591,000 were made by the Company to EGG (2015: USD4,884,000). At September 30, 2016 amounts owing to the Company by EGG for oil sales amounted to USD1,341,000.

EGG has arranged a loan for the Company from a Kazakh bank which is repaid as a deduction from oil sales. Further details of this arrangement are given in note 10.

EGG is also the sole customer of the AOT. In the nine months to September 30, 2016 EGG paid trans-shipment fees of USD342,000 to the AOT (2015: USD1,042,000). At September 30, 2016 the AOT had a loan owing to EGG, including accrued interest, of USD2,596,000 (September 30, 2015: USD3,328,000).

## 14 Change in working capital

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| **Condensed Statement of Financial Position:** | | | | |
| Trade and other receivables | (2,602) | 132 | (3,639) | (2,882) |
| Inventories | 83 | 79 | 58 | 382 |
| Trade and other payables | 2,351 | 1,532 | 3,882 | 4,464 |
| Change in working capital | (168) | 1,743 | 301 | 1,964 |
| Non-cash transactions | (515) | (4,230) | (1,161) | (3,858) |
| **Net changes in working capital** | **(683)** | **(2,487)** | **(860)** | **(1,894)** |
| **Condensed Statement of Cash Flows:** | | | | |
| Operating activities | (883) | (3,085) | (1,099) | (970) |
| Investing activities | 200 | 598 | 239 | (924) |
| **Net changes in working capital** | **(683)** | **(2,487)** | **(860)** | **(1,894)** |

## 15 Commitment and contingencies

*Litigation, claims and assessments*

The Company is involved in claims and actions arising in the course of the Company's operations and is subject to various legal actions and exposures, including potential environmental claims and tax positions taken by the Company. Although the outcome of these claims cannot be predicted with certainty, the Company does not expect these matters to have a material adverse effect on the Company's financial position, cash flows or results of operations. If an unfavourable outcome were to occur, there exists the possibility of a material adverse impact on the Company's consolidated net earnings or loss in the period in which the outcome is determined. Accruals for litigation, claims and assessments are recognised if the Company determines that the loss is probable and the amount can be reasonably estimated. The Company believes it has made adequate provision for such claims. While fully supportable in the Company's view, some of these positions, including uncertain tax positions, if challenged may not be fully sustained on review.

*Kazakhstan regulatory and legal environment*

The regulatory and legal environment including tax environment in the Republic of Kazakhstan is subject to change and inconsistent application, interpretations and enforcement, and in particular, existing subsurface use contracts are under close scrutiny by the tax and other authorities. This could result in unfavourable changes to the Company's tax positions. Non-compliance with Kazakhstan law and regulations as interpreted by the Kazakhstan authorities may lead to the assessment of additional taxes, penalties and interest. Kazakhstan tax legislation and practice is in a state of continuous development and therefore is subject to varying interpretations and frequent changes, which may be retroactive. Tax periods remain open to retroactive review by the tax authorities for five years. Management believes that its interpretation of the relevant legislation is appropriate and the Company's tax, currency legislation and customs positions will be sustained.

*Disputes with Eurasia Gas Group LLP ("EGG")*

EGG is the sole buyer of oil produced by the Company's subsidiary Tethys Aral Gas LLP ("TAG").

EGG has not paid in full for oil purchases from TAG for more than 10 months. More than US$1.4 million is now owed by EGG and, after exhausting other efforts to secure payment, TAG wrote to EGG on October 13, 2016 demanding repayment within 10 days or that it would be forced to take court action to recover the amounts owed by EGG.

On October 26, 2016 the Company was notified of a claim lodged by EGG in the Almaty City Court against TAG. EGG is seeking an award equivalent to US$2.6 million for the alleged failure by TAG to deliver certain minimum volumes of crude oil to EGG. The Company's view is that the claim is without merit or substance as TAG has no contractual obligation to deliver minimum volumes of crude oil to EGG, nor is there any penalty clause in contracts entered into between TAG and EGG for failure to deliver minimum volumes of crude oil.

Despite the Company only being notified of the claim on October 26, 2016 the Statement of Claim was filed on October 21, 2016 and on October 24, 2016 the Judge issued a freezing order on the bank accounts, production assets, shares and subsoil use contracts of TAG. Tethys has raised its serious concerns about these actions as the lawsuit was accepted by the Court in breach of the statutory pre-trial dispute resolution procedure which requires a 30 day negotiation period prior to filing a lawsuit.

The Judge's ruling also prohibited general meetings of the shareholders of TAG and the management of the company was prohibited from issuing certain resolutions and orders. In other words, the management of TAG is restricted from performing some of its functions according to its Charter. The freezing order was imposed on all bank accounts, and the company is unable to pay salaries to employees, suppliers or taxes due to Government authorities until the accounts are unblocked. It is also unable to receive payment of the more than US$3 million owed by ICA for gas sales and the US$1.4 million owed by EGG for oil sales.

(in thousands of US dollars)

A Court hearing date was set for November 1, 2016, however, EGG's legal representatives failed to appear and the hearing has been delayed.

*Kazakhstan work programmes*

The work programme commitments Kazakhstan businesses can be summarised as follows:

| | | Kazakhstan Work Programme Commitments | | |
|---|---|---|---|---|
| | Expiry date | Program 2016 | Spend to date 2016 | Program 2017 & later |
| **Akkulka Production Contract (Gas)** | 2018 | | | |
| Financial obligations, total | | 5,633 | 1,257 | 8,797 |
| Investments | | 2,440 | 481 | 3,788 |
| **Kyzyloi Production Contract (Gas)** | 2029 | | | |
| Financial obligations, total | | 8,407 | 1,218 | 46,957 |
| Investments | | 3,515 | 658 | 8,619 |
| **Akkulka Exploration Contract (Oil)** | 2019 | | | |
| Financial obligations, total | | 6,993 | 2,467 | 9,353 |
| Investments | | 5,497 | 1,019 | 7,044 |
| **Kul-Bas Exploration Contract** | 2015 | | | |
| Financial obligations, total | | - | 145 | - |
| Investments | | - | 100 | - |
| **Financial obligations, total** | | **21,033** | **5,087** | **65,107** |
| **Investments, total (subset of Financial obligations)** | | **11,452** | **2,258** | **19,451** |

Work programmes for exploration and production contracts agreed with the Kazakh State include a required level of “Investments” as defined in the contracts. “Investments” includes capital expenditure, operating expenses, social sphere, sub-soil monitoring and specialist training costs. It is this required level of Investments that forms the principal financial obligation of the Company in respect of its work programme commitments and against which the Company is mainly measured by the relevant Kazakh State authorities along with production volumes in the Production Contracts. Failure by the Company to meet the required level of Investments could put the Company’s licences at risk of forfeiture or give rise to penalties for non-fulfillment.

In addition, an assumed level of other costs forms part of the overall work programme (insurance, liquidation fund, indirect costs and taxes). Taken together with the Investments amount described above these form the Company’s “Financial obligations, total” as defined in the contracts and as set out in the table above.

In July 2016 the Company received a penalty notice from the authorities for under-fulfilment of its 2015 work programme commitments in relation to the Kyzyloi and Akkulka contracts in the amount of USD775,000. The Company does not agree with the basis of the penalty levied and is in discussions with the authorities to have the penalty withdrawn or reduced. The State could also seek to impose penalties on the Company for under-fulfilment of its 2015 work programme commitments in relation to the Kul-bas contract of up to USD1.4 million on the same basis as for the Kyzyloi and Akkulka contracts, however, no penalty notices have yet been received by the Company. At the end of Q2 2016 the Company (and Akkulka Exploration Contract) was behind the annual commitments in some of the categories that make up the annual work programme for the Kyzyloi and Akkulka Production Contracts mainly in “Investments” (comprising largely

CAPEX and OPEX) and in "Financial Obligations" (comprising Investments plus Indirect/Overhead costs and taxes), the reasons for this are mainly lack of funding of CAPEX in the year to date and also operational efficiency with respect to operations (OPEX and some overheads). For Kyzyloi the company is in the process of submitting a project to the State authorities to rationalize the forward production profile and hence the work programme commitments.

For Kul-Bas the company awaits the ratification of the extension before the draft work programme can be made final and expenditure offset against it. Apart from the Company's work programme commitments, other amounts may become payable to the Kazakh State in certain circumstances. These are described below.

*Akkulka Production Contract*

On December 23, 2009, the Company and the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan signed the Akkulka Production Contract giving the Company exclusive rights to produce gas from the Akkulka Block for a period of nine years. Contingent upon commencement of commercial production on the Akkulka contractual territory, an amount of USD3,500,000 was due to the Kazakh State as a reimbursement of historical costs previously incurred in relation to the contractual territory. For that part of the contractual territory from which production commenced in 2010, staged payments over a period of nine years totalling approximately USD933,997 are to be paid in equal quarterly instalments from the commencement of production until full reimbursement. To September 30, 2016, the Company had reimbursed the Kazakh State USD676,200 in respect of the Akkulka Field.

*Kul-Bas Exploration and Production Contract*

The Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of USD3,275,780. To date, the Company has paid two amounts of USD49,137 each in relation to this balance. If and when commercial production commences, USD80,666 is due in quarterly instalments until the remaining historical costs of USD3,177,506 have been paid in full. This contract expired on November 11, 2015 and on December 29, 2015 the Company announced it had been granted an extension subject to approval of an appraisal extension project and work programme and subsequent registration of a suitable addition to the contract.

*Tajikistan*

The Company has an effective 28.33% interest (33.33% interest via its 85% owned subsidiary) in Bokhtar Operating Company BV with partners Total and CNPC each having a 33.33% interest. Under the terms of the farm-out agreement entered into on September 18, 2013 with Total and CNPC the Company was only required to contribute 11.11% or USD9.0 million of the first USD80.0 million of the initial work programme. As at September 30, 2016, the joint venture partners had contributed in excess of USD100.0 million to the Bokhtar Operating Company of which the Company's share was USD16.3 million. At September 30, 2016, Bokhtar had contractual commitments not yet incurred or accrued relating to seismic acquisition of which Tethys share is 33.33%. The Company has not been provided with this information by the joint operating company since August 2015 as a result of being in default of cash calls in the amount of USD11.5 million.

The Company's indirectly held subsidiary, Kulob Petroleum Limited, ("KPL") the contracting partner in the Bokhtar Production Sharing Contract, has been informed by legal counsel representing Total and CNPC (the "Partners"), that on 19 May, 2016, the Partners had filed for arbitration proceedings at the International Court of Arbitration seeking to enforce KPL's withdrawal from the project and assignment of its interest to the Partners, as well as payment of outstanding cash calls of USD9 million plus an award of costs. KPL has submitted its answer to the request for arbitration to the court setting out its arguments against the Partners' claim and its counter-claim which is the first stage of the arbitration proceedings. The costs of the arbitration could be significant although KPL has actively sought to reach an amicable resolution with the Partners and will continue to do so. There is no guarantee in place of KPL's obligations by the Company.

Total informed the Company in May 2016 that it has been required to pay the equivalent of USD5.0 million to the tax authorities in Tajikistan in relation to the farm-out of the Company's interest to Total in 2013. Total is seeking to have the Company indemnify it for these taxes under the terms of the farm-out agreement. The Company does not agree with Total's interpretation of the farm-out agreement or that it is liable to indemnify Total for these taxes. No similar claim has been received from CNPC although the terms of the farm-out with CNPC were the same for Total and CNPC.

*Georgia*

The Company has a 49% interest in three blocks in Eastern Georgia and is responsible for funding its percentage interest share in the work programmes. During 2015 the Joint Venture completely redefined the work obligations and cost of exploration. The forward work programme has also been reduced and deferred on all 3 blocks: XIA, XIN and XIM. For 2016 this involves focused 2D seismic acquisition at a cost to Tethys of USD0.9m after which the Joint Venture will make an informed decision in 2017 whether to drill or cease further activity with contingent drilling of any wells in 2018.

*Uzbekistan*

Following the Company's withdrawal from Uzbekistan in December 2013 the tax authorities claimed additional taxes payable from the Company amounting to USD2.1 million. The Company, after taking professional advice, believes the claim is without foundation or merit and have disputed it. Also following withdrawal from the country, the Company was unable to recover payment for oil previously delivered to the Fergana refinery with an estimated value of USD1.6 million and this could potentially be used to settle any claim which is finally determined.

(in thousands of US dollars)

## 16 Operating leases

*Leases as a lessee:*

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

| | As at September 30, 2016 | December 31, 2015 |
|---|---|---|
| Less than 1 year | 137 | 611 |
| 1 – 3 years | 171 | 722 |
| Greater than 3 years | - | 75 |

## 17 Subsequent events

*Olisol Transaction*

On October 27, 2016 the Company announced that the private placement with Olisol had not closed by the October 27, 2016 outside date under the Investment Agreement.

Olisol claims that it is entitled to terminate the Investment Agreement and has also demanded immediate repayment, in full, of the outstanding USD5.7 million of working capital indebtedness under the terms of the Facility Agreement. Tethys disagrees with Olisol that it has the right to terminate the Investment Agreement and further disagrees that there has been an event of default under the Facility Agreement and that the amount is repayable.

*Claim against the Company by EGG*

Also, on October 27, 2016 the Company announced that on October 26, 2016 the Company was notified of a claim lodged by EGG in the Almaty City Court against the Company's subsidiary TAG. EGG is seeking an award equivalent to USD2.6 million at current exchange rates for the alleged failure by TAG to deliver certain minimum volumes of crude oil to EGG. EGG is a company whose principal is also a principal of Olisol.

The Company's view is that EGG's claim is without merit or substance as TAG has no contractual obligation to deliver minimum volumes of crude oil to EGG, nor is there any penalty clause in contracts entered into between TAG and EGG for failure to deliver minimum volumes of crude oil. The Company is also of the view that EGG has not followed correct legal process which requires it to notify the Company at least 30 days prior to filing a claim with the Court. As a consequence of EGG's Court claim the bank accounts of TAG have been blocked.

*Tethys gas sales contract*

On November 1, 2016 the Company announced that it had been notified of the cancellation of TAG's gas sales contract with Intergas Central Asia ("ICA"), the Kazakh State-owned gas transport company ("Gas Contract"). The Company contests the grounds for the cancellation of the receipt of gas by ICA and its right to terminate the Gas Contract, is in discussions with ICA and Kazakh

Government officials regarding such matters, and is hopeful that such matters will be resolved amicably and to the satisfaction of all parties in the near future.

*Proposals to Acquire Shares in Tethys Petroleum Limited*

On November 6, 2016, the Company announced that it had received non-binding proposals from two private investors which would result in each investor acquiring approximately 9.9% (when measured individually against the current number of shares outstanding) of the enlarged share capital of the Company. The price for the ordinary shares would be USD0.01593 per share and the total proceeds would amount to approximately USD1.4m. The investors would also be granted warrants giving them the right to acquire additional ordinary shares of Tethys with an exercise price of USD0.031 per share. Each of the investors would be appointed to the Board of the Company on closing of the placings.

*Allegations made against Tethys Aral Gas LLP employees. Searches and seizures at the office of Tethys Aral Gas LLP, Tethys Services Kazakhstan LLP and Kul-Bas LLP*

Also on November 6, 2016 the Company announced that on November 1, 2016 allegations of improper conduct were made against certain employees of TAG in an action initiated by the Company's former Chairman Mr. Abramov and searches and seizures at TAG's offices in Kazakhstan took place by law enforcement agencies. On November 15, 2016 the Company announced that the claims had since been dismissed.

# Tethys Petroleum Limited

Management's Discussion and Analysis
for the period ended September 30, 2016

## Content

The following Management's Discussion and Analysis ("MD&A") is dated November 15, 2016 and should be read in conjunction with the Company's unaudited Condensed Consolidated Interim Financial Statements and related notes for the period ended September 30, 2016 as well as the audited Consolidated Financial Statements and the MD&A for the year ended December 31, 2015. The accompanying unaudited Condensed Consolidated Interim Financial Statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. The 2015 annual audited Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The unaudited Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" and the requirements of the Disclosure and Transparency Rules ("DTR") of the Financial Conduct Authority ("FCA") in the United Kingdom as applicable to interim financial reporting. Additional information relating to the Company can be found on the SEDAR website at *www.sedar.com* and the Company's website at www.tethyspetroleum.com.

Readers should also read the "Forward-Looking Statements" legal advisory wording contained at the end of this MD&A and also the Company's Annual Information Form ("AIF").

## Nature of Business

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") is an oil and gas company operating within the Republic of Kazakhstan, Republic of Tajikistan and Georgia. Tethys' principal activity is the exploration and development of crude oil and natural gas fields. The address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. The domicile of Tethys is the Cayman Islands where it is incorporated.

## Financial highlights

**(All references to USD are United States dollars unless otherwise noted and tabular amounts are in thousands, unless otherwise stated)**

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Oil and gas sales and other revenues | 3,119 | 5,736 | (46%) | 10,103 | 18,528 | (45%) |
| Loss for the period: | | | | | | |
| – continuing operations | (4,036) | (3,698) | 9% | (14,647) | (31,010) | (53%) |
| – discontinued operations | - | (11) | (100%) | - | (88) | (100%) |
| | (4,036) | (3,709) | 9% | (14,647) | (31,098) | (53%) |
| Basic and diluted loss (USD) per share | | | | | | |
| – continuing operations | (0.01) | (0.01) | 0% | (0.04) | (0.09) | (56%) |
| – discontinued operations | - | - | 0% | - | - | 0% |
| EBITDA - adjusted for share based payments[1] | (838) | (637) | 32% | (2,160) | (6,321) | (66%) |
| Capital expenditure | 318 | 1,938 | (84%) | 1,054 | 7,919 | (87%) |

| | As at 30 September | | |
|---|---|---|---|
| | 2016 | 2015 | Change |
| Total assets | 187,323 | 225,170 | (17%) |
| Cash & cash equivalents | 1,800 | 4,286 | (58%) |
| Short & long term borrowings | 34,167 | 32,479 | 5% |
| Total non-current liabilities | 12,908 | 24,264 | (47%) |
| Net debt[1] | 32,367 | 28,193 | 15% |
| Number of common shares outstanding | 400,004,848[2] | 336,839,315 | 19% |

Note 1 EBITDA and net debt are non-GAAP Measures, refer to page 24 for details.

Note 2 Includes 63,044,461 shares issued during 2016 to Olisol Petroleum Limited.

## Third quarter 2016 versus third quarter 2015

- Oil and gas sales and other revenues decreased by 46% to USD3.1m from USD5.7m due to a natural decline in production volumes and price reductions in USD terms as a result of the devaluation of the Kazakh currency, the Tenge in August 2015;
- The loss of USD4.0m was higher than the loss of USD3.7m in 2015 due to the significantly lower revenue in the current quarter and provision of USD0.8m made for non-fulfilment of Kazakh work programmes penalties. The Company is working to have these withdrawn or reduced;
- EBITDA - adjusted for share based payments increased from negative USD0.6m to negative USD0.8m as a result of significantly lower revenue in the current quarter. This was offset by lower costs;
- Capital expenditure was lower due to lack of funds to develop the Company's assets with expenditure in the prior period relating to Kazakhstan exploration and development and Tajikistan exploration.

## Financial highlights

### First nine months 2016 versus first nine months in 2015

- Oil and gas sales and other revenues decreased by 45% to USD10.1m from USD18.5m due to a natural decline in production volumes and price reductions in USD terms as a result of the Tenge devaluation;
- The loss for the current period of USD14.6m is lower than the loss of USD31.1m in 2015 due to additional depletion in the prior period as a result of the reclassification of assets which were previously shown as held for sale;
- EBITDA adjusted for share based payments at negative USD2.2m decreased by 66% from negative USD6.3m for the prior period as a result of reduced costs which more than offset the reduction in revenue;
- Net debt increased as a result of interim finance obtained as part of larger strategic transactions which did not complete.

## Operational highlights

| | Units | Quarter ended September 30 2016 | 2015 | Change | Nine months ended September 30 2016 | 2015 | Change |
|---|---|---|---|---|---|---|---|
| **Kazakhstan** | | | | | | | |
| Oil | bopd | 742 | 1,702 | (56%) | 856 | 1,619 | (47%) |
| Gas | boe/d | 2,106 | 3,121 | (33%) | 2,286 | 3,181 | (28%) |
| **Total** | boe/d | **2,848** | **4,823** | **(41%)** | **3,142** | **4,800** | **(35%)** |
| ***Oil*** | | | | | | | |
| Net production | Bbls | 68,248 | 156,599 | (56%) | 234,454 | 441,913 | (47%) |
| Net revenue | USD'000 | 459 | 1,631 | (72%) | 1,591 | 4,884 | (67%) |
| Production costs | USD'000 | 603 | 980 | (38%) | 1,938 | 3,859 | (50%) |
| **Gross margin** | USD'000 | **(144)** | **651** | **(122%)** | **(347)** | **1,025** | **(134%)** |
| Gross sales price | USD/bbl | 7.81 | 12.24 | (36%) | 7.75 | 12.93 | (40%) |
| Cost | USD/bbl | 8.84 | 6.26 | 41% | 8.27 | 8.73 | (5%) |
| **Gross margin** | USD/bbl | **(1.03)** | **5.98** | **(117%)** | **(0.52)** | **4.20** | **(112%)** |
| ***Gas*** | | | | | | | |
| Gross production | Mcm | 32,917 | 48,784 | (33%) | 106,431 | 147,562 | (28%) |
| Revenue net of marketing commission | USD'000 | 1,994 | 2,921 | (32%) | 6,397 | 10,073 | (36%) |
| Production costs | USD'000 | 486 | 766 | (37%) | 1,589 | 2,959 | (46%) |
| **Gross margin** | USD'000 | **1,508** | **2,155** | **(30%)** | **4,808** | **7,114** | **(32%)** |
| Sales price net of marketing commission[1] | USD/Mcm | 61.53 | 63.40 | (3%) | 61.05 | 70.41 | (13%) |
| Cost | USD/Mcm | 14.76 | 15.70 | (6%) | 14.93 | 20.05 | (26%) |
| **Gross margin** | USD/Mcm | **46.77** | **47.70** | (2%) | **46.12** | **50.36** | (8%) |

Note 1 Using a 2016 average exchange rate of USD1 = Tenge 344.0 (2015: USD1 = Tenge 193.9) for the nine months and USD1 = Tenge 341.3 (2015: USD1 = Tenge 215.3) for the quarter.

## Oil

- Average oil production for the quarter decreased to 742 bopd (Q3 2015 : 1,702 bopd) and YTD Q3 2016 decreased to 856 bopd (YTD Q3 2015: 1,619) reflecting a natural decline in overall production;
- Oil production cost per barrel in Q3 2016 increased to USD8.84 compared with USD6.26 in Q3 2015. This was mainly due to the decrease in oil production and non-variable costs of production. There was a decrease in cost per barrel to USD8.27 in YTD Q3 2016 compared with USD8.73 in YTD Q3 2015 as a result of cost reduction initiatives and the Tenge devalution;
- Oil prices averaged USD7.81 in the quarter compared with USD12.24 bbl in Q3 2015, a reduction of 36% and USD7.75 in YTD Q3 2016 compared with USD12.93 in YTD Q3 2015, reflecting the fall in World oil price which impacted the domestic Kazakh price the Company receives and the devaluation of the Tenge.

## Gas

- Current quarter gas production averaged 2,106 boe/d compared with 3,121 boe/d in Q3 2015 and 2,286 boe/d in YTD Q3 2016 compared with 3,181 boe/d in YTD Q3 2015, reflecting a natural decline in overall production;
- Gas production cost per Mcm in the current quarter reduced to USD13.59 compared with USD15.70 in Q3 2015 and to USD14.93 in YTD Q3 2016 compared with USD20.05 in YTD Q3 2015 despite lower production volume as a result of improved efficiency, cost reduction initiatives and the Tenge devaluation;

## Operational Review

- An increase in gas price in local currency of over 50 percent was obtained from January 1, 2016, however, this was negatively affected in USD terms due to the Tenge devaluation and translates to a decrease for the quarter to USD61.53 per Mcm from USD63.40 per Mcm in Q3 2015 and to USD61.05 per Mcm in YTD Q3 2016 compared with USD70.41 per Mcm in YTD Q3 2015, net of marketing commission.

## Outlook

The information provided under this heading is considered as forward looking information; as such please refer to Forward Looking Statements on page 28 of this MD&A.

The Company's objective is to become the leading Independent E&P Company in Central Asia, by exercising capital discipline, by generating cash flow from existing discoveries and by maturing large exploration prospects within our highly-attractive frontier acreage. The Company produces both oil and natural gas in order to balance its product portfolio and currently operates in three separate jurisdictions in Central Asia and the Caspian Region, though the Board is looking to farm down or sell the Tajikistan and Georgian assets to focus on the assets in Kazakhstan. The Company was served with a withdrawal notice from its partners in Tajikistan during 2015 although is disputing this in arbitration proceedings.

The Company's long-term ambition is to achieve a significant role in the production and delivery of hydrocarbons from the Central Asian region to local and global markets, especially to the Chinese market. In common with many oil and gas companies, in implementing its strategies, the Company regularly considers farm-out/farm-in and joint venture opportunities and new projects which provide synergy with the Company's activities. Meanwhile, the specific focus of management in the short term is to:

- resolve the Company's current issues in Kazakhstan, including disputes with Eurasia Gas Group LLP ("EGG") and Olisol Petroleum Limited and Olisol Investments Limited (together "Olisol");
- work with the Company's new partner in Kazakhstan to market the Company's oil and gas for better pricing and obtain funding from a Kazakh bank to restructure loans and fund operations;
- seek drilling company partners, or other investors, to fund drilling in the Company's licence areas in Kazakhstan on a contingent on success production sharing basis. This would include shallow and deep gas targets, Akkulka enhanced oil recovery and the Klymene exploration well on the Kul-bas licence;
- continue to evaluate farm-out opportunities with respect to Tajikistan and Georgia;
- continue to review and implement further restructuring and cost optimisation across the business;
- maintain and increase shallow gas production in the near-term and drill for deep gas in the medium-term with the objective to supply gas to China through the newly built pipeline, once operational and additional funding is secured.

## Significant events and transactions for the nine months ended September 30, 2016

- *Olisol Transaction Updates*

On February 8, 2016, the Company announced that Olisol had informed the Company that due to the difficult business and banking environment in Kazakhstan they would like to renegotiate some of the key terms of the transactions envisaged in the letter of intent which would include changes to the facility agreement and the investment agreement which the Company announced entering into on December 8, 2015.

On February 22, 2016 the Company announced that it had entered into a non-binding and indicative term sheet (the "Term Sheet") with Olisol, setting out amended terms to the LOI entered into on November 9, 2015 ("Amended LOI") and consequently changes to the transaction documentation between the companies.

On March 2, 2016 the Company announced it had signed a legally binding amendment to the USD15 million convertible debt facility entered into on November 19, 2015 with Olisol the key terms of which are as follows:

- Olisol to convert approximately USD6.25 million of the interim facility into ordinary shares at a price of USD0.10 per share;
- Olisol would work with a bank in Kazakhstan to secure a loan for the Company's subsidiary, Tethys Aral Gas LLP ("TAG"), in the amount of USD10 million within 60 days which, together with the conversion, would satisfy the outstanding obligations of Olisol under the interim facility;
- Olisol to provide additional working capital reasonably required by Tethys, until completion of a placement under an amended investment agreement;
- Olisol committed to purchasing 181,240,793 new shares at a price to be agreed by Tethys and Olisol. This purchase, together with the conversion of the amounts outstanding under the interim facility would result in Olisol owning approximately 42% of the Company's shares;
- Upon successful first draw down of the Kazakh loan and conversion of the circa USD6.25 million under the interim facility into equity, the Board would be reconstituted and comprise the following five directors:
    - Adeola Ogunsemi, non-executive director and Chairman of the Audit Committee;
    - William Paul Wells, non-executive director;
    - Alexander Abramov, non-executive director;
    - One additional non-executive independent director designated by Olisol; and
    - The one remaining Board seat to be filled by a candidate who satisfies the legal and regulatory requirements of the Company and whose appointment is agreed by Tethys and Olisol.

On March 21, 2016, Olisol converted USD3.7 million of the outstanding amount into 37,440,042 shares. On April 15, 2016, Olisol converted a further USD2.6 million of the outstanding amount into 25,604,419 shares.

On April 28, 2016 the Company entered into a binding investment agreement (the "Investment Agreement") with Olisol setting out the terms and conditions upon which it agreed to purchase

181,240,793 new ordinary shares in Tethys at a price of CAD0.054 per Share, for total proceeds of CAD9.8 million, by way of a private placement and to commit to backstop a further equity fundraising of 50 million Shares at CAD0.054 per share. The further equity fundraising would generate proceeds of CAD2.7 million for a total of CAD12.5 million. The Investment Agreement amended and restated the investment agreement that was signed by the Parties on December 7, 2015.

On September 2, 2016 the Company announced that the Investment Agreement requires a closing date two business days after all closing conditions have been satisfied or waived by the parties and the Company was therefore prepared to complete the private placement with Olisol on September 2, 2016 as originally scheduled or to agree a short extension with Olisol if Olisol met certain funding commitments. As Olisol has not done so the Company considered Olisol to be in breach of the Investment Agreement. The Company announced it would continue to work with Olisol to complete the private placement.

- *Director changes*

On March 14, 2016 the Company announced that in connection with the transactions with Olisol, John Bell had moved from Executive Chairman to co-Non-Executive Chairman along with Mr. Alexander Abramov, who also became co-Non-Executive Chairman.

In addition, the Company announced that it had set the Annual General Meeting ("AGM") date for May 31, 2016. John Bell, David Henderson, David Roberts and Jim Rawls all informed the Company that they would not stand for re-election at the AGM.

- *Gas Contract*

On March 24, 2016 the Company entered into a 2016 Gas Supply Contract, effective from January 1, 2016 through to December 31, 2016 with Inter Gas Central Asia for the supply of 150 million cubic meters of gas, at a gross price of KZT28,000/Mcm (USD81.16/Mcm (USD2.30/Mcf) at the exchange rate of KZT345 = USD1), effective from January 1, 2016 through to December 31, 2016. The associated gas marketing contract has been renewed covering the same period with a fee of KZT7,000/Mcm (USD20.29/Mcm (USD0.58/Mcf) at the exchange rate of KZT345 = USD1).

- *Results of Annual General and Special Meeting*

On May 31, 2016 the Company announced that all resolutions put to shareholders at the AGM were passed on a poll at the meeting including the transactions with Olisol. The closing of the Olisol transaction was conditional on, inter alia, the reduction in the par value of the Company's ordinary shares.

- *USD10 million loan facility in Kazakhstan*

On June 20, 2016 the Company announced that on June 7, 2016, the Company received the first USD1 million drawdown of a USD10 million loan facility from a leading Kazakhstan bank. The loan interest on the initial USD1 million is 11%, maturing in July 2017 and also includes a 6-month principal grace period.

Under the Investment Agreement Olisol undertook to work with Tethys and a Kazakh bank to obtain a bank loan of not less than USD10 million for TAG ("TAG Loan") and to date Olisol has not been able to complete the TAG Loan and the Company has not received any further drawdowns.

- *Tajikistan update*

  On June 20, 2016 the Company announced that its indirectly held subsidiary, Kulob Petroleum Limited, ("KPL") the contracting partner in the Bokhtar Production Sharing Contract, has been informed by legal counsel representing Total and CNPC (the "Partners"), that on May 19, 2016, the Partners had filed for arbitration proceedings at the International Court of Arbitration. The filed arbitration request is in relation to the Notice of Dispute received by KPL on January 8, 2016, which is in connection to the previously announced Notice to Withdraw issued by the Partners on October 11, 2015, following the Company's cash call default of September 2015. The Notice to Withdraw was rejected by KPL, which lead to the Partners issuing a Notice of Dispute. Tethys has tried to engage with the Partners to reach an amicable resolution. The arbitration has been initiated but hearings have not yet commenced.

- *Chief Commercial Officer Appointment*

  On July 13, 2016, the Company announced the appointment of Alexander Skripka as Chief Commercial Officer responsible for the commercial activities of the company including gas sales, existing and new contract or license negotiations, and negotiations on financing, divestments and acquisitions.

  On October 14, 2016, his position as Chief Commercial Officer was terminated.

- *Management Changes*

  On August 2, 2016, the Company announced the appointment of Kenneth J. May as interim Chief Executive Officer replacing Julian Hammond in the transitional period until the appointment of two new members to the existing three person Board of Directors when his position would be reviewed.

- *Par value reduction of ordinary shares from USD0.10 to USD0.01 per share*

  On August 23, 2016 the Grand Court in the Cayman Islands approved a motion by Tethys to reduce the par value of the Company's ordinary shares. Accordingly, on August 31, 2016, the Company reduced the par value of its ordinary shares from USD0.10 per share to USD0.01 per share. The par value reduction exercise was performed to facilitate the Investment Agreement between Tethys and Olisol.

- *Cost Optimisation*

  Also on August 23, 2016 the Company announced a new cost optimisation programme, that once fully implemented, should save the company an estimated USD2.5 million a year. The programme followed an extensive review into costs and operations that was started after the Company's May 31, 2016 AGM.

- *Kazakhstan legal proceedings*

  Also on August 23, 2016 the Company provided an update to the Q2, 2016 financial statements where it was reported that the assets of one of the Company's Kazakhstan subsidiaries remained frozen after the first Court hearing of a claim brought against the Company by a private individual in relation to the USD 7.5 million debenture due June 30, 2017 originally issued to AGR. The Court was scheduled to hold further hearings on Tuesday, August 23 and Tethys expected a release of its assets and dismissal of all claims. Tethys had been working tirelessly to resolve what it believed to be an unfounded claim.

On September 2, 2016 the Company provided an update that on August 24, 2016 the Court dismissed the claim and ordered the lifting of the seizure order over the Company's assets. The claimant lodged an appeal on August 29, 2016 and until the appeal was heard restrictions remained in place over the operation of the Company's bank accounts in Kazakhstan.

On September 30, 2016 the Company announced that the Almaty City Court's Board of Appeals found in favour of Tethys by dismissing the previously announced appeal of the claimant and upholding the earlier Court decision on August 24, 2016 to lift the seizure order over the Company's assets. The Court's decision was effective immediately, there is no right of further appeal and restrictions over the operation of the Company's bank accounts in Kazakhstan were lifted.

## Significant events and transactions subsequent to the period end

- *Olisol Transaction Updates*

On October 20, 2016 the Company announced that it acknowledged Olisols Press Release dated October 12, 2016 ("Release") whilst wishing to clarify certain matters pertaining to Olisol's Release.

Olisol stated in its Release that it intended to direct Tethys to apply all funds to be repaid to Olisol in connection with outstanding working capital advances, plus accrued interest thereon, to its obligation to subscribe for 181,240,793 ordinary shares at CAD0.054 per share.

Tethys clarified that under the Amended and Restated Investment Agreement Olisol was required to transfer the full purchase price of CAD9.8 million for 181,240,793 ordinary shares to Tethys prior to the closing date.

In addition to this, under the Investment Agreement, Olisol has the right to convert any amounts outstanding under the facility agreement and any amounts of working capital indebtedness, in each case with accrued but unpaid interest thereon, into Tethys ordinary shares at the placing price of CAD0.054 per share.

On October 27, 2016 the Company announced that the private placement with Olisol had not closed by the October 27, 2016 outside date under the Investment Agreement. Tethys took all steps required to close the private placement and was ready, willing and able to do so, however, Olisol failed to provide Tethys with any of the CAD9.8 million purchase price required to purchase the subscription shares under the Investment Agreement. Therefore, Tethys considers Olisol to be in breach of the Investment Agreement and reserves all of its legal rights.

Olisol sent a letter to the Company claiming that it is entitled to terminate the Investment Agreement as a result of a Material Adverse Change (as defined in the Investment Agreement) having occurred. In addition, Olisol has also demanded immediate repayment, in full, of the outstanding USD5.7 million of working capital indebtedness under the terms of the Facility Agreement as Olisol is alleging an event of default under the Facility Agreement. Tethys disagrees with Olisol that it has the right to terminate the Investment Agreement and further disagrees that there has been an event of default under the Facility Agreement and that the amount is repayable.

- *Claim against the Company by EGG*

Also, on October 27, 2016 the Company announced that on October 26, 2016 the Company was notified of a claim lodged by EGG in the Almaty City Court against the Company's subsidiary TAG. EGG is seeking an award equivalent to USD2.6 million at current exchange rates for the alleged failure by TAG to deliver certain minimum volumes of crude oil to EGG. EGG is a company whose principal is also a principal of Olisol. EGG's claim follows TAG's recent formal notification to EGG requiring it to settle long overdue unpaid oil sales debts of USD1.3 million within 10 days or TAG would take Court action against EGG to recover those debts.

The Company's view is that EGG's claim is without merit or substance as TAG has no contractual obligation to deliver minimum volumes of crude oil to EGG, nor is there any penalty clause in contracts entered into between TAG and EGG for failure to deliver minimum volumes of crude oil. The Company is also of the view that EGG has not followed correct legal process which requires it to notify the Company at least 30 days prior to filing a claim with the Court. As a consequence of EGG's Court claim the bank accounts of TAG have been blocked.

- *Tethys gas sales contract*

On November 1, 2016 the Company announced that it acknowledged the press release by Olisol on October 28, 2016 relating to TAG's gas sales contract with Intergas Central Asia ("ICA"), the Kazakh State-owned gas transport company ("Gas Contract"). Olisol's unauthorized release of confidential information contained factual inaccuracies and Tethys issued a clarification.

Prior to Olisol's press release, Tethys had filed a confidential material change report (the "Report") with the relevant Canadian securities regulator as it is permitted to do under applicable Canadian securities laws. Tethys filed such Report confidentially as the Company contests the grounds for the cancellation of the receipt of gas by ICA and its right to terminate the Gas Contract, is in discussions with ICA and Kazakh Government officials regarding such matters, and is hopeful that such matters will be resolved amicably and to the satisfaction of all parties in the near future.

As such, the Company believed that disclosure of the cancellation of receipt of gas and the termination of the Gas Contract would be unduly detrimental to the interests of Tethys, and potentially be misleading or confusing to investors, in the event that the Company is successful in having the Gas Contract reinstated.

Contrary to Olisol's assertion that the cancellation of the Gas Contract is irrevocable, the Company continues to be in discussions with ICA and Governmental officials, and believes that there remains a reasonable prospect that ICA will reinstate the Gas Contract. Further, the Company does not believe that the loss of the gas sales to date have been material to the Company.

- *Board and Management Changes*

On November 3, 2016, The Company announced that Alexander Abramov had been removed from the Board of Directors of the Company by a majority vote of the Board and in accordance with the Company's Articles of Association. Alexander Abramov was replaced as Chairman of the

Board by William P. Wells. In addition to the board changes, Kenneth J. May was confirmed as the Company's permanent Chief Executive Officer.

- *Proposals to Acquire Shares in Tethys Petroleum Limited*

  On November 6, 2016, the Company announced that it had received non-binding proposals from two private investors which would result in each investor acquiring approximately 9.9% (when measured individually against the current number of shares outstanding) of the enlarged share capital of the Company. The price for the ordinary shares would be USD0.01593 per share and the total proceeds would amount to approximately USD1.4m. The investors would also be granted warrants giving them the right to acquire additional ordinary shares of Tethys with an exercise price of USD0.031 per share. Each of the investors would be appointed to the Board of the Company on closing of the placings which the parties are working to complete as soon as possible. If completed, the placements will bring much needed funding to the Company as well as provide it with strong in-country partners in Kazakhstan and internationally.

- *Allegations made against Tethys Aral Gas LLP employees. Searches and seizures at the office of Tethys Aral Gas LLP, Tethys Services Kazakhstan LLP and Kul-Bas LLP*

  Also on November 6, 2016 the Company announced that on November 1, 2016 allegations of improper conduct were made against certain employees of TAG in an action initiated by the Company's former Chairman Mr. Abramov and searches and seizures at TAG's offices in Kazakhstan took place by law enforcement agencies.

  On November 15, 2016 the Company announced that the claims have since been dismissed. Tethys wishes to acknowledge the assistance of the Office of the Almaty City Prosecutor in quickly reviewing the claims and dismissing the case. Property taken during the investigation has been returned to the Company and we work to have the Court imposed freezing order over TAG's bank accounts lifted and restore normal business operations as soon as possible.

## **Operational Review** - continued

## Results of Operations and Operational Review - Kazakhstan

### Oil production – Akkulka Contract

| | 2016 | | | | | 2015 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Gross fluid | | Net | Net production | | Gross fluid | | Net | Net production | |
| | m3 | barrels | barrels | days | bopd | m3 | barrels | barrels | days | bopd |
| Q1 | 16,851 | 105,988 | 78,366 | 91 | 861 | 19,666 | 123,683 | 107,529 | 90 | 1,195 |
| Q2 | 20,987 | 132,002 | 87,840 | 91 | 965 | 31,745 | 199,682 | 177,785 | 91 | 1,954 |
| Q3 | 17,532 | 110,274 | 68,248 | 92 | 742 | 31,159 | 195,986 | 156,599 | 92 | 1,702 |
| **Total** | **55,370** | **348,264** | **234,454** | **274** | **856** | **82,570** | **519,351** | **441,913** | **273** | **1,619** |

The Company produces oil from up to three wells under a pilot production license: AKD01, AKD05 and AKD06. AKD01 has been performing to expectation and AKD06 has been shut in since late Q4 2014 due to the lower oil price received and the increased operating costs of a high water-cut well. AKD05 has been off production since November 2015. The option of using enhanced oil recovery techniques for this well is currently being evaluated by technical personnel. A large volume Electrical Submersible Pump (“ESP”) has been delivered and is expected to be operational in December 2016 to support the AKD01 well.

### *Oil operations update*

*General*

Oil production averaged 742 barrels per day in Q3 from AKD01 only. The well is currently on a 12mm choke with a Flowing Tubing Head Pressure (“FTHP”) of 206 psi and an approximate 42% water-cut. The water-cut has been on an increasing trend over the past 16 months and it is expected at some point to require the use of artificial lift (ESP).

AKD05 is currently offline since November 2015 and is expected on in 2017 and possibly AKD06, both depending on the oil price. The current oil price is the equivalent of USD7.80 per barrel following the fall in World oil prices and the significant devaluation of the Kazakhstan currency, the Tenge, in August 2015, however it should be noted that operating costs in USD terms have also reduced.

Due to the low prices currently being received for oil the Company is considering shutting in oil production once the effectiveness of the ESP has been determined. If successful, and subject to funding, the Company would then invest in the required gas utilisation facilities and apply for oil export consent which would enable higher export prices to be achieved.

*Joint Venture – Aral Oil Terminal (“AOT”)*

In 2013, the construction of Phase 2 of the AOT facility was completed, which provides for an increase in throughput capacity from 4,200 bopd to 6,300 bopd with the installation of two 1,000 $m^3$ storage tanks (12,500 bbls) and associated pumping equipment. Current levels of oil production have meant AOT throughput has been insufficient and the AOT has operated at a loss, however, the AOT joint venture has continued to operate since 2013 without recourse to additional loan funding from the JV partners including Tethys. Repayments on an external loan have been rescheduled with the agreement of the lender. The Company is considering options to divest its interest in the AOT.

## Operational Review - continued

### Gas production – Kyzyloi and Akkulka Contracts

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Mcm | Mcf | Mcm/d | Boe/d | Mcm | Mcf | Mcm/d | Boe/d |
| **Kyzyloi** | | | | | | | | |
| Q1 | 16,113 | 578,531 | 177 | 1,042 | 9,283 | 327,835 | 103 | 607 |
| Q2 | 17,039 | 568,923 | 187 | 1,102 | 10,700 | 377,817 | 118 | 692 |
| Q3 | 16,384 | 601,656 | 178 | 1,048 | 15,836 | 559,152 | 172 | 1,013 |
| **Total** | **49,536** | **1,749,110** | **181** | **1,064** | **35,819** | **1,264,804** | **131** | **772** |
| **Akkulka** | | | | | | | | |
| Q1 | 21,647 | 764,340 | 238 | 1,400 | 39,239 | 1,385,735 | 436 | 2,566 |
| Q2 | 18,716 | 660,855 | 206 | 1,210 | 39,556 | 1,396,930 | 435 | 2,558 |
| Q3 | 16,532 | 583,766 | 180 | 1,058 | 32,948 | 1,163,406 | 358 | 2,108 |
| **Total** | **56,895** | **2,008,961** | **207** | **1,222** | **111,743** | **3,946,071** | **409** | **2,409** |
| **Grand total** | **106,431** | **3,758,071** | **388** | **2,286** | **147,562** | **5,210,875** | **541** | **3,181** |

Production commenced from the Kyzyloi field in 2007, following the construction of a 56 km, 325mm outside diameter (“OD”) export pipeline from the Kyzyloi field gathering station to the main Bukhara–Urals gas trunkline, where a compressor station was constructed at 910 km on that trunkline. The gas flows into the main trunkline which is owned by IntergasCentralAsia (“ICA”), a division of the Kazakh State natural gas company KazTransGas (“KTG”);

Production commenced from the Akkulka field on October 6, 2010.

Gas production decreased by 33% or 172 Mcm per day in the current quarter compared with the same quarter in the prior year primarily as a result of natural decline in the fields, although compressor #2 being offline for the entirety of Q3 2016 affected the rate.

*Gas operations update*

Currently, the Company produces dry gas from a total of 17 wells at a depth of approximately 480-600m below surface, comprising nine producing wells in the Kyzyloi field and eight in the Akkulka field with combined current average production for September being 345 Mcm/d (12.18 Mcf/d). Gas production is current shut in pending the resolution of the gas sales contract dispute.

In late December 2015 the engine for compressor #2 went offline and needs capital repairs amounting to an estimated USD191,000, with a lead time of approximately 20 weeks, it is also still required to overhaul the engine for Compressor #3 and replace compression cylinders on units #1, #2 and #3 when funding allows. If any of the current three working compressors went offline in the interim, then it would have a negative impact on production.

The completed Bozoi-Shymkent-China gas pipeline means that Tethys now has two potential gas export routes that provide alternatives to sell its gas; the route taking gas to the more populous south eastern part of Kazakhstan and, ultimately to China, and the Bukhara Urals trunk line that transports gas from Central Asia into Russia. Currently, the Chinese pipeline is only taking domestic gas within Kazakhstan to Shymkent and it is not known when exports to China will commence. The Company expects to realise a higher net sales price to China should exports commence but it is unknown at this time what the price will be. The Company believes that the long term price for gas will rise in the region, in particular dry gas imported via pipeline from Central Asia and that Chinese demand will increase over the medium to long term, especially with the substitution in China of a greater percentage of energy use from gas instead of coal.

During Q1 2015, the Company signed a Memorandum of Understanding (“MOU”) with PetroChina with respect to co-operation in potential future gas sales.

## Operational Review - continued

It is currently planned to conduct 3D seismic acquisition starting in Q4 2016. The goal of the survey is to identify shallow gas targets for drilling in 2017 in an area of prospective interest in the south-eastern part of the Akkulka Exploration Contract, previously only covered by exploration 2D seismic. The survey covers an area that includes the AKK16 well which is currently the best producing well in the combined Kyzyloi and Akkulka Fields. The tender incorporates the acquisition of 150 sq.km of full-fold coverage 3D seismic with a planned initial phase of 80 sq.km; in addition 25 line kilometres of 2D seismic is planned in the west-central part of the block to target a shallow gas prospect there.

Shallow gas drilling is planned to restart, subject to funding, with the drilling of KYZ110 targeting the Kyzyloi sandstone horizon in a partially developed sector of the Kyzyloi Field up dip of the producing AKK05 well. A further planned well (AKK23) is to be located in the Akkulka Production Contract targeting the Tasaran sandstone horizon. More wells are planned based on existing modern seismic however the exact order is in part dependent on the results of the new seismic acquisition. Wells are typically 650m and take up to 14 days to drill with testing usually taking up to 10 days post completion.

*Exploration - update*

The KBD02 ("Klymene") prospect is planned to be drilled to a total depth of 2,750 metres targeting a large structure in the south west of the Kul-Bas block, and will target three horizons in the Lower Cretaceous and Upper Jurassic. State approval for the Klymene exploration well drill project and associated emissions are now in place. The Klymene prospect has the potential to be an order of magnitude bigger than the Doris oil discovery and surrounding prospects (the geographical area of the prospect is up to ten times the areal extent of the Doris oil field). It appears to have good four-way structural closure and positive amplitude effects which may be indicative of enhanced porosity on the recently acquired and interpreted seismic. Currently this well is planned for 2017 under the draft minimum work programme, subject to State approvals and funding but some preparation could start in Q4 2016.

The necessary State permission to extend the Kul-Bas Exploration and Production Contract for a further two years to November 11, 2017 was received in December 2015 subject to submittal of relevant projects, amended work programmes and signing amendments to the Contract. On September 22, 2016 the company passed the TsCR meeting and received approval on the appraisal extension project for the Kul-Bas area.

## Results of Operations and Operational Review - Tajikistan

Since completion of the farm-out to Total and CNPC in 2013, the joint operating company has focused on the completion of a full regional 2D seismic acquisition programme across the PSC area, particularly targeted at deeper exploration potential. In Q4 2013, the joint operating company went out to tender for the acquisition of seismic data which was awarded to BGP of China in April 2014 and commenced field acquisition in late October 2014. This new wide line 2D survey is specially designed to image the deep targets described in an independent resource report and consists of a first phase of 826 kms completed in 2015 with an option for an additional 200 kms. As well as 2D acquisition and processing, a concurrent low cost passive seismic survey was planned and commenced in March 2015 whilst a Magnetotellurics survey was also being acquired along the dip lines. Due to the default situation under the JOA, the Company has been unable to receive any of the new data and is unable to comment on the status of the operations and prospectivity potential.

The Company's indirectly held subsidiary, Kulob Petroleum Limited, ("KPL") the contracting partner in the Bokhtar Production Sharing Contract, has been informed by legal counsel representing Total and CNPC (the "Partners"), that on May 19, 2016, the Partners had filed for arbitration proceedings at the International Court of Arbitration seeking to enforce KPL's withdrawal from the project and assignment of its interest to the Partners, as well as payment of outstanding cash calls of USD9 million (and continuing) plus an award of costs. Tethys has submitted its answer to the request for arbitration to the court setting out its arguments against the Partners claim which is the first stage of the arbitration proceedings. The costs of the arbitration could be significant although Tethys has actively sought to reach an amicable resolution with the Partners and will continue to do so. The arbitration hearings have not yet commenced.

## Results of Operations and Operational Review - Georgia

Following completion, in early January 2014, of the acquisition of a 56% interest in the Georgian license areas (49% since Q1 2015): Blocks XIA, XIM and XIN, activities performed since the 2013 2D seismic acquisition have focused on the collation, preparation, processing and interpretation of seismic and well data across blocks XIA and XIM with some geochemical and structural geology work having been completed across all three blocks with ground gravity data acquisition in 2015.

During Q2 and early Q3 2015 the operator Norio Operating Company Limited oversaw ground gravity acquisition on all three blocks and field acquisition was completed in late July 2015 where a total of 187.4 sq.km of XIA phase III obligation gravity, 197.5 sq.km of XIM phase II obligation and 721.1 sq.km of XIN phase II obligation gravity were completed. In parallel, approvals to the changes in the work programme were passed successfully through several State entities and the final Government ratification was achieved in October 2015 and stipulates the main capital expenditure item to be a minimum of 50km of 2D seismic to be finished and evaluated by July 1, 2017 in XIN, at an estimated net to Tethys cost of USD1.1m whilst the potential block non-compliance fine is set as USD2m net to Tethys. Currently the operator is evaluating the feasibility of seismic lines for 2016-2017 in conjunction with Tethys staff, however this programme is subject to funding.

Final drill or drop decision points are June 1, 2017 for XIA and July 1, 2017 for XIM and XIN respectively, with any chosen well drilling needing to be complete 12 months later, in 2018.

On November 3, 2016, representatives of the Company and its partner met with the Ministry of Energy of Georgia and requested a two-year extension on the XIN PSA area. The Ministry has agreed to this extension subject to the Ministry of Justice approving not to impose any non-compliance penalty and final approval of the Cabinet.

## Financial Review

### Summary of Quarterly Results

| | Q3, 2016 | Q2, 2016 | Q1, 2016 | Q4, 2015 | Q3, 2015 | Q2, 2015 | Q1, 2015 | Q4, 2014 |
|---|---|---|---|---|---|---|---|---|
| Oil & gas sales and other revenues | 3,119 | 3,529 | 3,455 | 3,606 | 5,736 | 6,838 | 5,954 | 6,224 |
| Loss for the period | | | | | | | | |
| – continuing operations | (4,036) | (4,934) | (5,677) | (43,593) | (3,698) | (25,278) | (2,034) | (5,034) |
| – discontinued operations | - | - | - | 60 | (11) | (36) | (41) | (210) |
| Basic & diluted loss ($) per share: | | | | | | | | |
| – continuing operations | (0.01) | (0.01) | (0.02) | (0.13) | (0.01) | (0.08) | (0.01) | (0.02) |
| – discontinued operations | - | - | - | - | - | - | - | - |
| EBITDA – adjusted for share based payments[1] | (838) | (338) | (934) | (4,249) | (637) | (4,425) | (1,259) | (3,806) |
| Capital expenditure | 318 | 342 | 394 | 374 | 1,938 | 4,034 | 1,947 | 7,752 |
| Total assets | 187,323 | 185,634 | 189,103 | 190,595 | 225,170 | 226,024 | 243,560 | 238,695 |
| Cash & cash equivalents | 1,800 | 700 | 1,133 | 3,272 | 4,286 | 4,942 | 5,280 | 3,112 |
| Cash & cash equivalents – held in a disposal group | - | - | - | - | - | - | 1,707 | 757 |
| Short & long term borrowings | (34,167) | (30,502) | (30,532) | (32,032) | (32,479) | (26,719) | (16,637) | (10,628) |
| Short & long term borrowings – held in a disposal group | - | - | - | - | - | - | (4,641) | (4,871) |
| Total non-current liabilities | (12,908) | (13,447) | (31,628) | (34,644) | (24,264) | (23,197) | (11,468) | (5,489) |
| Total non-current liabilities – held in a disposal group | | - | - | - | - | - | (814) | (7,937) |
| Net debt[1] | (32,367) | (29,802) | (29,399) | (28,760) | (28,193) | (21,777) | (14,291) | (11,630) |
| Number of common shares outstanding | 400,004,848[2] | 400,004,848[2] | 374,400,429 | 336,960,387 | 336,839,315 | 336,712,385 | 336,543,145 | 336,452,667 |

Note 1 EBITDA and net debt are non-GAAP Measures, refer to page 24 for details

Note 2 Includes 63,044,461 shares to Olisol Petroleum Limited

## **Financial Review** – continued

### Loss for the period

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| Sales and other revenue | 3,119 | 5,736 | (46%) | 10,103 | 18,528 | (45%) |
| Sales expenses | (665) | (1,182) | (44%) | (2,132) | (3,563) | (40%) |
| Production expenses | (1,979) | (1,811) | 9% | (4,503) | (8,578) | (48%) |
| Depreciation, depletion & amortisation | (2,473) | (3,716) | (33%) | (8,256) | (25,004) | (67%) |
| Administrative expenses | (1,354) | (2,073) | (35%) | (4,379) | (7,608) | (42%) |
| Restructuring costs | 23 | (586) | (104%) | (1,400) | (2,907) | (52%) |
| Transaction costs of assets held for sale | - | - | 0% | - | (1,065) | (100%) |
| Share based payments | (20) | (93) | (78%) | (183) | (358) | (49%) |
| Profit on sale of fixed assets | - | 10 | (100%) | 10 | 53 | (81%) |
| Foreign exchange loss | 18 | (716) | (103%) | 141 | (931) | (115%) |
| Fair value gain on derivative financial instruments | 6 | 236 | (97%) | 275 | (233) | (218%) |
| Loss from jointly controlled entity | - | (15) | (100%) | - | (250) | (100%) |
| Finance costs | (893) | (321) | 178% | (4,835) | (2,848) | 70% |
| **Loss before taxation** | **(4,218)** | **(4,531)** | **(7%)** | **(15,159)** | **(34,764)** | **(56%)** |
| Taxation | 182 | 833 | (78%) | 512 | 3,754 | (86%) |
| **Loss for the period from continuing operations** | **(4,036)** | (3,698) | **9%** | **(14,647)** | (31,010) | **(53%)** |
| Loss for the period from discontinued operations | - | (11) | (100%) | - | (88) | (100%) |
| **Loss for the period** | **(4,036)** | **(3,709)** | **9%** | **(14,647)** | **(31,098)** | **(53%)** |

The Company recorded a net loss after taxation of USD4.0m for the current quarter compared with USD3.7m in Q3 2015 and USD14.6m for YTD Q3 2016 (2015: USD31.1m), the principal variances being:

- Lower sales revenue in 2016 due to natural decline in production volumes of oil and gas and price reduction in USD terms as a result of the devaluation of the Kazakh currency, the Tenge;
- Non-recurring costs in 2015, cost reduction initiatives and also the Tenge devaluation;
- Higher DD&A charge in 2015 calculated on the Kazakh assets following their reclassification from Assets Held for Sale.

Further variances between the two periods are summarised below together with a discussion of significant variances between the two periods.

## **Financial Review** – continued

### Sales & other revenue

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| *Summary* | | | | | | |
| Oil | 459 | 1,631 | (72%) | 1,591 | 4,884 | (67%) |
| Gas | 2,659 | 4,103 | (35%) | 8,529 | 13,636 | (37%) |
| Other | 1 | 2 | (50%) | (17) | 8 | (313%) |
| **Total** | **3,119** | **5,736** | **(46%)** | **10,103** | **18,528** | **(45%)** |
| *By region* | | | | | | |
| Kazakhstan - Oil | 459 | 1,631 | (72%) | 1,591 | 4,884 | (67%) |
| Kazakhstan - Gas | 2,659 | 4,103 | (35%) | 8,529 | 13,636 | (37%) |
| Kazakhstan - Other | 1 | 2 | (50%) | (17) | 8 | (313%) |
| Other | - | - | 0% | - | - | 0% |
| **Total** | **3,119** | **5,736** | **(46%)** | **10,103** | **18,528** | **(45%)** |

### Kazakhstan – Oil revenue and price

| | Gross sales bbls | Revenue $000 | Realized price at wellhead $/bbl | Compensation $000 | VAT $000 | Net sales $000 |
|---|---|---|---|---|---|---|
| **2016** | | | | | | |
| Q1 | 79,251 | 593 | 7.47 | 12 | 64 | 517 |
| Q2 | 88,417 | 702 | 7.94 | 14 | 73 | 615 |
| Q3 | 67,119 | 524 | 7.81 | 10 | 55 | 459 |
| **Total** | **234,787** | **1,819** | **7.75** | **36** | **192** | **1,591** |
| **2015** | | | | | | |
| Q1 | 100,773 | 1,424 | 13.00 | 30 | 149 | 1,245 |
| Q2 | 177,178 | 2,275 | 13.00 | 26 | 241 | 2,008 |
| Q3 | 152,267 | 1,863 | 12.24 | 38 | 194 | 1,631 |
| **Total** | **430,218** | **5,562** | **12.93** | **113** | **584** | **4,884** |

- Under the pilot production licence oil can only be sold in the domestic Kazakhstan market;
- Net figures exclude the compensation for water content plus compensation for natural wastage and transportation costs of water from the well head to the AOT terminal at Shalkar. The compensation for water content is due to the small amount of water in the crude that remains after the field separation;
- Sale price is determined at the wellhead where the oil is sold and therefore the Company incurs no transportation or marketing costs. Whilst some other oil companies report higher oil prices they report their transportation and marketing costs separately, however Tethys' oil is trucked 230 kilometres and then railed hundreds of kilometres and if the price was determined at the refinery it would be significantly higher;
- Current quarter and year to date revenue, have been affected by natural decline in production volumes and the significant devaluation of the Kazakh Tenge against the US Dollar from late August 2015, which has affected realised US Dollar prices, although operating costs have also come down in US Dollar terms.

## **Financial Review** – continued

### Kazakhstan - Gas revenue and price

- Gas revenue decreased in the current quarter and YTD Q3 compared with the same periods in the prior year as a result of lower production volumes and a lower gas price in USD terms following the Tenge devaluation from August 2015;
- The 2015 gas sales contract was for minimum of 100 million cubic metres at a fixed Tenge price of KZT 13,650 per 1,000 cubic metres, net of VAT and sales expenses, (USD70.41 at an average YTD Q3 2015 exchange rate of 193.9 Tenge);
- A new contract was signed with respect to 2016 production for a minimum metres at a fixed Tenge price of KZT 21,000 per 1,000 cubic metres, net of VAT and sales expenses, (USD61.05 at an average YTD Q3 2016 exchange rate of 344.0 Tenge);
- Gas contracts are subject to exchange rate risk – refer to page 26 – Sensitivities.

### Sales expenses

Sales expenses represent Kazakh marketing agent commissions paid in relation to the gas sale contracts. Commission is payable at KZT7,000 per Mcm, net of 12% VAT, (USD20.35 at a 2016 period to date average exchange rate of 344.0 Tenge), (2015: KZT 4,550 per Mcm, net of 12% VAT, (USD23.47 at a 2015 period to date average exchange rate of 193.9 Tenge).

### Production expenses

| | | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|---|
| | **Units** | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| **Kazakhstan** | | | | | | | |
| Oil production | USD000's | 603 | 980 | (38%) | 1,938 | 3,859 | (50%) |
| Gas production | USD000's | 486 | 766 | (37%) | 1,589 | 2,959 | (46%) |
| Other | USD000's | 890 | 65 | 1269% | 976 | 1,760 | (45%) |
| **Total** | **USD000's** | **1,979** | **1,811** | **9%** | **4,503** | **8,578** | **(48%)** |
| ***Oil*** | | | | | | | |
| Net production | bbls | 68,248 | 156,599 | (56%) | 234,454 | 441,913 | (47%) |
| Cost | USD/bbl | 8.84 | 6.26 | 41% | 8.27 | 8.73 | (5%) |
| ***Gas*** | | | | | | | |
| Production | boe | 193,729 | 287,111 | (33%) | 626,385 | 868,457 | (28%) |
| Cost | USD/boe | 2.51 | 2.67 | (6%) | 2.54 | 3.41 | (26%) |
| Weighted average cost per boe | USD/boe | 4.16 | 3.94 | 6% | 4.10 | 5.20 | (21%) |

### Kazakhstan – oil production

A significant proportion of costs associated with oil production are fixed, so costs would not generally be expected to reduce in the same proportion as a decline in production. The reduction in oil production costs reduced in the quarter but cost per barrel of oil produced increased due to the decline in production and non-variable or fixed costs. For the nine months production costs reduced significantly and marginally on a per barrel basis as a result of management's cost reduction initiatives from middle of 2015 onwards as well as the devaluation of the Kazakh Tenge from August 2015.

## **Financial Review** – continued

### Kazakhstan – gas production

Gas production costs decreased significantly in the current quarter and nine months as a result of cost reduction initiatives such as placing staff on unpaid leave, as well as the effect of devaluation of the Tenge from August 2015. Costs per barrel of oil equivalent also reduced but not to the same extent due to an element of fixed costs. Gas production, more so than the oil generally, has a significant fixed cost element which includes compressor supplies denominated in US dollar and consequently, as production declines, the production cost per Mcm (or boe) generally increases.

### Depreciation, depletion and amortization (DD&A)

DD&A for Q3 2016 was USD2.5m (Q3 2015: USD3.7m) and for the YTD Q3 2016 was USD8.3m (YTD Q3 2015: USD25.0m). The significantly higher charge in 2015 was due to the reclassification of assets from Assets Held for Sale in May 2015 giving rise to a "catch up" depletion charge needing to be booked as Assets Held for Sale are not depreciated.

### Administrative expenses

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| Staff | 738 | 1,100 | (33%) | 2,316 | 3,606 | (36%) |
| Travel | 87 | 177 | (51%) | 303 | 648 | (53%) |
| Office | 56 | 224 | (75%) | 322 | 708 | (55%) |
| Professional fees | 238 | 125 | 90% | 666 | 1,127 | (41%) |
| Regulatory | 45 | 123 | (63%) | 201 | 405 | (50%) |
| Marketing costs | 31 | 190 | (84%) | 184 | 414 | (56%) |
| Non-executive director fees | 120 | 78 | 54% | 294 | 372 | (21%) |
| Other costs | 39 | 56 | (30%) | 93 | 328 | (72%) |
| **Total** | **1,354** | **2,073** | **(35%)** | **4,379** | **7,608** | **(42%)** |
| G&A expenses per boe (USD) | 5.17 | 4.67 | 11% | 5.09 | 5.81 | (12%) |

- Staff costs have reduced significantly in Q3 2016 and YTD Q3 2016 as a result of reductions in staff levels, staff placed on unpaid leave and salary reductions as well as from the Kazakhstan Tenge devaluation from August 2015;
- Reductions in travel expenses reflect management's focus to reduce costs in this area and are also lower due to closure of a number of international offices and reductions in staff levels across the business;
- Office costs reduced in Q3 2016 and YTD Q3 2016 following the closure of nine of the Company's fourteen offices in 2015. Where there were ongoing rental commitments with respect to these offices these have been fully provided for and included within Restructuring costs;
- Professional and regulatory fees were higher in Q3 2016 due to timing of expense recognition although significantly lower for YTD Q3 2016 reflecting lower legal and audit fees. Fees in connection with strategic transactions and legacy issues have been included in Restructuring costs;
- Marketing costs include mandatory corporate social responsibility obligations in Kazakhstan and also investor relations costs;
- Non-executive director fees were higher in Q3 2016 due to booking of some Q2 2016 and earlier costs in the quarter and higher in YTD Q3 2015 as a result of fees paid to certain directors for additional work undertaken;

- Other costs, which include bank charges, vehicles costs and insurance are lower in Q3 2016 and YTD Q3 2016 due to lower activity levels and cost reduction initiatives.

### Restructuring costs

Costs associated with the restructuring programme undertaken in 2015 and continuing into 2016 have been shown separately from administrative expenses. These include legal and financial advisory fees associated with the Olisol strategic transaction as well as staff termination and office closure costs.

### Transaction costs of assets held for sale

Transaction costs of assets held for sale in the prior period relate to the SinoHan transaction which failed to complete by the longstop date of May 1, 2015.

### Share based payments

Share based payments were higher in the prior period quarter and six months reflecting the issuance of options at the beginning of 2015 and shares issued in connection with the former Executive Chairman's remuneration package whereby 30% of base salary was paid in shares.

### Foreign exchange loss - net

Foreign exchange gains and losses arise from the revaluation of monetary assets and liabilities denominated in currencies other than the reporting currency and the receipt or settlement of foreign currency denominated amounts at a different amount than the originally recorded transaction amount.

### Fair value gain on derivative financial instruments

The fair value gain of USD4,000 arising in the current quarter (2015: USD236,000) and gain of USD275,000 for the six months (2015: USD233,000 loss) was due to the revaluation of the warrants issued in connection with corporate loans and also loans with conversion features.

### Loss from jointly controlled entity

The Company's share of loss from the Aral Oil Terminal joint venture was nil for the current quarter and nine months. The terminal has generated losses as a result of low oil volume throughput and the value of the Company's investment in the joint venture was previously written down to nil.

### Finance costs - net

Finance costs comprise interest expense net of interest income and are higher in the current quarter and nine months due to higher effective interest charges on interim finance obtained in 2015 and 2016 as part of proposed strategic financings which did not complete.

### Taxation

A reconciliation of the loss before income tax to the current tax expense is provided in note 5 of the Condensed Consolidated Interim Financial Statements.

## Liquidity and Capital Resources

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objective when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its capital expenditures from existing cash and cash equivalent balances, primarily received from issuances of shareholders' equity and debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

### Net debt

Net debt (refer to Non-GAAP measures) is calculated as total borrowings (which includes 'current and non-current borrowings') less cash and cash equivalents. Total capital is calculated as 'equity' plus net debt. All figures are as stated in the Condensed Consolidated Interim Financial Statements.

| | **As at September 30** | | |
|---|---|---|---|
| | **2016** | **2015** | **Change** |
| Total financial liabilities - borrowings | 34,167 | 32,479 | 5% |
| Less: cash and cash equivalents | (1,800) | (4,286) | (58%) |
| **Net debt** | **32,367** | **28,193** | **15%** |
| Total equity | 123,410 | 225,170 | (45%) |
| **Total capital** | **155,777** | **253,363** | **(39%)** |

Should the Company be in a net debt position, it will assess whether the projected cash flow is sufficient to service this debt and support ongoing operations. Consideration will be given to reducing the total debt or raising funds through alternative methods such as the issue of equity, farm-down of assets or sale of the Company.

### Financing and Going Concern

Details of the Company's financing and going concern assessment are provided in note 2 of the Condensed Consolidated Interim Financial Statements.

## **Financial Review** – continued

### Cash Flow

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| **Net cash used in operating activities** | **(1,717)** | **(5,123)** | **(66%)** | **(5,278)** | **(10,675)** | **(51%)** |
| Capital expenditure | (318) | (1,938) | (84%) | (1,054) | (7,919) | (87%) |
| Net changes in working capital | (883) | (3,085) | (71%) | (1,099) | (970) | 13% |
| Other investing cash flows | 1,405 | 3,978 | (65%) | 2,070 | 1,303 | 59% |
| **Net cash generated/(used) in investing activities** | **204** | **(1,045)** | **(120%)** | **(83)** | **(7,586)** | **(99%)** |
| Proceeds from loan financing | 4,430 | 5,000 | (11%) | 7,930 | 23,235 | (66%) |
| Loan principal and interest payments | (1,618) | (599) | 170% | (3,905) | (6,172) | (37%) |
| Proceeds from equity, net of costs | - | - | 0% | - | - | 0% |
| Other financing cash flows | (22) | (27) | **(19%)** | (90) | (83) | **8%** |
| **Net cash generated from financing activities** | **2,790** | **4,374** | **(36%)** | **3,935** | **16,980** | **(77%)** |
| Effect of exchange rates | (177) | 1,138 | (116%) | (46) | 1,699 | (103%) |
| **Net increase/(decrease) in cash** | **1,100** | **(656)** | **(268%)** | **(1,472)** | **418** | **(452%)** |
| Cash & cash equivalents at beginning of period | 700 | 4,942 | **(86%)** | 3,272 | 3,868 | **(15%)** |
| **Cash & cash equivalents at end of period** | **1,800** | **4,286** | **(58%)** | **1,800** | **4,286** | **(58%)** |

### Operating activities

The decrease in cash used in operating activities in Q3 2016 and YTD Q3 2016 is primarily due to lower production, administrative, restructuring and transaction cost payments which more than offset the decrease in revenue receipts.

### Investing activities

Investing activities relate mainly to capital expenditure on oil and gas properties and exploration, details of which are given on the "Capital expenditure" section below.

### Financing activities

Proceeds from loan financing in the current quarter comprises USD4.5m from Olisol for working capital under an investment agreement. Further details of dates and amounts of new loans taken out in 2015 and 2016 are given in note 10 of the September 30, 2016 Condensed Consolidated Interim Financial Statements. Loan repayments includes scheduled repayments on the Company's rig loans and interest payments due on other borrowings.

### Capital expenditure

Significant spend was as follows:

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| Kazakhstan – exploration and production | 251 | 359 | (30%) | 654 | 2,563 | (74%) |
| Tajikistan - exploration | 22 | 1,353 | (98%) | 103 | 4,561 | (98%) |
| Georgia - exploration | 45 | 226 | (80%) | 283 | 795 | (64%) |
| Corporate and other | - | - | 0% | 14 | - | 0% |
| **Total** | **318** | **1,938** | **(84%)** | **1,054** | **7,919** | **(87%)** |

## Financial Review – continued

### Accounting policies, changes to accounting standards and critical estimates

The Company's significant accounting policies and discussion of changes to accounting standards are disclosed in note 2 of the September 30, 2016 Condensed Consolidated Interim Financial Statements. Refer to note 4 of the 2015 Consolidated Financial Statements for information on the Company's significant judgments and assumptions and critical estimates.

### Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

### Non-GAAP Measures

*EBITDA adjusted for share based payments*

EBITDA adjusted for share based payments is defined as "Loss or Profit before Interest, Tax, Depreciation, Amortization, Impairment, Fair value gains or losses and Share Based Payments" and is calculated on the results of continuing operations. It provides an indication of the results generated by the Company's principal business activities prior to how these activities are financed, assets are depreciated and amortized, or how results are taxed in various jurisdictions.

The reconciliation of EBITDA adjusted for share based payment to Loss for the Period is as follows:

| | Quarter ended September 30 | | | Nine months ended September 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| EBITDA - adjusted for share based payments | (838) | (637) | 32% | (2,160) | (6,321) | (66%) |
| Depreciation, depletion and amortization | (2,473) | (3,716) | (33%) | (8,256) | (25,004) | (67%) |
| Share based payments | (20) | (93) | (78%) | (183) | (358) | (49%) |
| Fair value gain on derivative financial instrument - net | 6 | 236 | (97%) | 275 | (233) | (218%) |
| Finance costs - net | (893) | (321) | 178% | (4,835) | (2,848) | 70% |
| **Loss before taxation** | **(4,218)** | **(4,531)** | **(7%)** | **(15,159)** | **(34,764)** | **(56%)** |

*Net debt*

Net debt is calculated as total borrowings (which includes current and non-current borrowings) less cash and cash equivalents. Total capital is calculated as equity plus net debt. All figures are as stated in the September 30, 2016 Condensed Consolidated Interim Financial Statements.

EBITDA adjusted for share based payments and Net debt shown in this MD&A do not have any standardized meaning as prescribed under IFRS and, therefore, are considered non-GAAP measures. These measures have been described and presented to provide shareholders and potential investors with additional information regarding the Company's financial results. These measures may not be comparable to similar measures presented by other entities.

### Stockholder Equity

As at September 30, 2016 the Company had authorised share capital of 1,450,000,000 ordinary shares of which 400,004,848 (Q3 2015: 336,839,315) had been issued and 50,000,000 preference shares of which none had yet been issued. The preference shares have the rights as set out in the Memorandum and Articles of Association of the Company.

As at September 30, 2016, a total of 40,374,320 (2015: 40,374,320) ordinary shares were reserved under the Company's Long Term Stock Incentive Plan. The number of options outstanding as at September 30, 2016 is 19,798,500 and the number of warrants outstanding is 25,423,333. Loan facilities are in place which are convertible into a total of 122,757,140 ordinary shares, excluding accrued interest.

## Dividends

There were no dividends paid or declared in the period.

## Transactions with Related Parties

Disclosure of the Company's transactions with related parties are provided in note 13 of the Condensed Consolidated Interim Financial Statements.

## Commitments and contingencies

Details of the Company's commitments and contingencies including litigation, claims and assessments, work programme commitments and operating leases are provided in notes 15 and 16 of the Condensed Consolidated Interim Financial Statements.

A summary of the Company's contractual obligations for the next five years and thereafter is shown in the table below:

| | | Payments due by period | | | |
|---|---|---|---|---|---|
| **Contractual obligations** | **Total** | **Less than 1 year** | **1 – 3 years** | **4 – 5 years** | **After 5 years** |
| Borrowings | 36,871 | 34,141 | 2,730 | - | - |
| Operating leases | 308 | 137 | 171 | - | - |
| Kazakhstan work programme commitments | 72,114 | 5,258 | 36,435 | 8,892 | 21,528 |
| Georgia work programme commitments | 816 | 789 | 27 | - | - |
| Trade and other payables | 18,203 | 18,133 | 70 | - | - |
| **Total contractual obligations** | **128,312** | **58,458** | **39,433** | **8,892** | **21,528** |

## Risks, uncertainties and other information

Readers are encouraged to read and consider the risk factors and additional information regarding the Company, included in its 2015 AIF filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com

Risk management is carried out by senior management, in particular the CEO and the CFO as well as the Board of Directors. The Company has identified its principal risks for 2016 to include:

(1) Liquidity;

(2) Retention and extension of existing licences and development thereof with respect to success rates;

(3) Production volume – both oil and gas;

(4) Political, fiscal and related risks.

## Financial Risk Management

The Company's activities expose it to a variety of financial risks including: market risk, credit risk, liquidity risk, interest rate, commodity price and foreign exchange risk. Details of the Company's exposure to these risks and how this is managed is given in note 3 to the Consolidated Financial Statements for the year ended December 31, 2015. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

The Board of Directors of the Company has overall responsibility for the Company's management of risk, including the identification and analysis of risks faced by the Company and the consideration of controls that monitor changes in risk and minimise risk wherever possible.

## Sensitivities

The price of gas sales from gas produced from both the Kyzyloi and Akkulka gas fields under Gas Supply Contracts is fixed in Tenge until December 31, 2016 and is sensitive to a fluctuation in exchange rates. A 20% devaluation of the Tenge, from 335 to the USD to 402 for example, would result in a net price reduction of USD10.45 per Mcm (i.e. USD52.24 from USD62.69). Based on a sales volume of 150,000 Mcm per annum, this would result in a reduction of USD1.6m in gas revenue.

The price of oil sales from the Doris discovery is sensitive to movements in the market price. On a production level of 1,000 bopd, a movement of USD1 per barrel on the price received by the Company would result in a plus or minus movement in oil sales revenue of USD0.4m per annum.

## Critical Accounting Policies and Estimates

The annual and Condensed Consolidated Interim Financial Statements of the Company are prepared in accordance with IFRS and IFRIC Interpretations issued by the IFRS Interpretations Committee, refer to 2015 Consolidated Financial Statements - note 2 *Summary of Significant Accounting Policies* and Note 4 – *Critical Judgements and Accounting Estimates* – for further details.

## Derivative Financial Instruments

The Company has a derivative financial liability relating to share warrants where the shares are denominated in a currency that is not the Company's functional currency and also convertible loans where the conversion option is treated as a derivative financial liability. Details are disclosed in note 11 of the Condensed Consolidated Interim Financial Statements.

## Disclosure and Internal Controls

### Disclosure and Internal Controls Over Financial Reporting

As at September 30, 2016, an evaluation of the effectiveness of the Company's disclosure controls and procedures as defined under the rules adopted by the Canadian securities regulatory authorities was carried out under the supervision and with the participation of management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on this evaluation, the CEO and the CFO concluded that, as at September 30, 2016, the design and operation of the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Corporation in reports filed with, or submitted to, securities regulatory authorities were reported within the time periods specified under Canadian securities laws.

Internal control over financial reporting is a process designed by or under the supervision of management and effected by the Board, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and preparation of consolidated financial statements for external purposes in accordance with IFRS. Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting, no matter how well designed, has inherent limitations and can provide only reasonable assurance with respect to the preparation and fair presentation of published financial statements.

Management has designed and implemented, under the supervision of the CEO and CFO, a system of internal controls over financial reporting which it believes is effective for a company of its size. Management has not identified any material weaknesses relating to the design of these internal controls and consequently, the CEO and CFO have concluded that internal control over financial reporting was effective as at September 30, 2016, and provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes.

The Company's CEO and CFO have filed certifications with the Canadian securities regulators regarding the quality of the Company's public disclosures relating to the period ending September 30, 2016.

## Significant equity investees

Details of significant equity investees are discussed in note 26 of Consolidated Financial Statements for the year ended December 31, 2015.

## Forward-looking statements

In the interest of providing Tethys' shareholders and potential investors with information regarding the Company and its subsidiaries, including management's assessment of Tethys' and its subsidiaries' future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project" or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements in this MD&A include, but are not limited to, statements with respect to: the projected 2016 capital investments projections, and the potential source of funding therefore. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other things: volatility of and assumptions regarding oil and gas prices; fluctuations in currency and interest rates; ability to successfully complete proposed equity financings; product supply and demand; market competition; ability to realise current market gas prices; risks inherent in the Company's and its subsidiaries' marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil and natural gas and other sources not currently classified as proved; the Company's and its subsidiaries' ability to replace and expand oil and gas reserves; the ability of the Company to farm out or sell its Georgian or Tajikistan assets; unexpected cost increases or technical difficulties in constructing pipeline or other facilities; unexpected delays in its drilling operations; delays in the delivery of its drilling rigs; unexpected difficulties in, transporting oil or natural gas; risks associated with technology; the significant uncertainty over the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations and continue as a going concern; the timing and the costs of well and pipeline construction; the Company's and its subsidiaries' ability to secure adequate product transportation; the Company will not be successful in negotiating binding terms for the export of gas and oil to China at prices significantly higher than prices currently realized; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; political and economic conditions in the countries in which the Company and its subsidiaries operate; the risk associated with the uncertainties, inconsistencies and contradictions in local laws and their interpretation and application in local jurisdictions in which the Company operates; the risk of international war, hostilities and terrorist threats, civil insurrection and instability affecting countries in which the Company and its subsidiaries operate; risks associated with existing and potential future lawsuits and regulatory actions made against the Company and its subsidiaries; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Tethys.

**Forward-looking statements** - continued

With regard to forward looking information contained in this MD&A, the Company has made assumptions regarding, amongst other things, the continued existence and operation of existing pipelines; the proposed increase in the selling price for the delivery of gas and crude oil to China; future prices for natural gas; future currency and exchange rates; the Company's ability to generate sufficient cash flow from operations and access to capital markets to meet its future obligations and ability to continue as a going concern; the regulatory framework representing mineral extraction taxes, royalties, taxes and environmental matters in the countries in which the Company conducts its business, gas production levels; that it will be able to farm out or sell its Georgian and Tajikistan assets; and the Company's ability to obtain qualified staff and equipment in a timely and cost effective manner to meet the Company's demands. Statements relating to "reserves" or "resources" or "resource potential" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although Tethys believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A and, except as required by law, Tethys 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. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## Glossary

| | |
|---|---|
| **AGM** | Annual General Meeting |
| **AIF** | Annual Information Form |
| **AOT** | Aral Oil Terminal LLP |
| **Bbls** | Barrels of oil |
| **boe/d** | Barrel of oil equivalent per day |
| **bopd** | Barrels of oil per day |
| **CAD** | Canadian Dollar |
| **CEO** | Chief Executive Officer |
| **CAPEX** | Capital expenditure |
| **CFO** | Chief Financial Officer |
| **DTR** | Disclosure and Transparency Rules |
| **E&P** | Exploration and production |
| **EBITDA** | Earnings before interest, taxes, depreciation and amortisation |
| **EGG** | Eurasia Gas Group LLP |
| **ESP** | Electrical submersible pump |
| **FCA** | Financial Conduct Authority |
| **FTHP** | Flowing tubing head pressure |
| **GAAP** | Generally accepted accounting principles |
| **ICA** | Intergas Central Asia |
| **IFRS** | International Financial Reporting Standards |
| **JOA** | Joint operating agreement |
| **JV** | Joint venture |
| **KPL** | Kulob Petroleum Limited |
| **KTG** | Kaz Trans Gas |
| **KZT** | Kazakhstani Tenge |
| **$m^3$** | Cubic metre |
| **Mcf** | Thousand cubic feet |
| **Mcf/d** | Thousand cubic feet per day |
| **Mcm** | Thousand cubic metres |
| **Mcm/d** | Thousand cubic metres per day |
| **MD&A** | Management's Discussion & Analysis |
| **MOU** | Memorandum of Understanding |
| **OPEX** | Operating expenditure or production costs |
| **OD** | Outside diameter |
| **Olisol** | Olisol Investments Limited and Olisol Petroleum Limited |
| **PSC** | Production sharing contract |
| **psi** | Pounds per square inch |
| **sq.km** | Square kilometre |
| **TAG** | Tethys Aral Gas LLP |
| **USD** | United States Dollar |
| **USD/bbl** | USD per barrel |
| **USD/Mcm** | USD per thousand cubic metre |
| **VAT** | Value added tax |
| **YTD** | Year to date cumulative |