

# **Zenith Energy Ltd.**

Condensed Interim Consolidated Financial Statements

As at and for the three and nine months ended December 31, 2016

(Unaudited)

# **Zenith Energy Ltd.**

## **Condensed Interim Consolidated Statements of Changes in Equity**

**(Unaudited)** (Expressed in Canadian dollars)

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### **Managements' Responsibility**

To the Shareholders of Zenith Energy Ltd.:

The accompanying unaudited condensed interim consolidated financial statements of Zenith Energy Ltd. (the "Company") as at and for the three and nine months ended December 31, 2016 have been prepared by and are the responsibility of the management of the Company and are approved by the board of directors of the Company. The unaudited condensed interim consolidated financial statements are prepared in accordance with International Financial Reporting Standards and reflect management's best estimates and judgments based on currently available information.

#### **Notice of No Auditor Review of Interim Consolidated Financial Statements**

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed these unaudited condensed interim consolidated financial statements as at and for the nine months ended December 31, 2016.

(signed) "Andrea Cattaneo"  
President and Chief Executive Officer

(signed) "Alan Hume"  
Chief Financial Officer

February 28, 2017

Calgary, Alberta

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

As at		December 31, 2016	March 31, 2016
	Note	\$	\$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash		18,476	137,982
Marketable securities	3	-	7,632
Trade and other receivables	18	1,956,334	787,477
Inventory	20	321,678	173,457
Prepaid expenses		296,177	385,504
		2,592,665	1,492,052
<b>Non-current assets</b>			
Property and equipment	4	1,066,398,243	14,598,089
Prepaid property and equipment insurance		160,761	207,000
<b>Total assets</b>		<b>1,069,151,669</b>	<b>16,297,141</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables	18	4,892,846	3,266,503
Oil share agreement		1,063,629	1,027,504
Deferred consideration payable	4	501,836	-
Loans payable	6	1,946,338	3,210,114
Convertible notes	7	-	697,046
Notes payable	8	213,608	-
		8,618,257	8,201,167
<b>Non-current liabilities</b>			
Loans payable	6	2,376,388	673,647
Convertible notes	7	525,992	-
Derivative liability	7	398,892	357,936
Deferred consideration payable	4	287,044,416	-
Bonds	8	383,090	563,103
Decommissioning obligation	9	9,703,775	7,896,671
Deferred taxes	18	153,927,334	883,567
		454,359,887	10,374,924
<b>Total liabilities</b>		<b>462,978,144</b>	<b>18,576,091</b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	10	11,455,930	9,578,270
Warrants	11	1,509,537	1,509,537
Options		290,200	-
Contributed surplus		2,231,583	2,231,583
Accumulated other comprehensive loss		(10,381,178)	(1,952,414)
Surplus / (Deficit)		601,067,453	(13,645,926)
<b>Total shareholders' equity</b>		<b>606,173,525</b>	<b>(2,278,950)</b>
<b>Total liabilities and shareholders' equity</b>		<b>1,069,151,669</b>	<b>16,297,141</b>

Going concern (Note 1)

Subsequent events (Note 19)

Segmented information (Note 20)

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

	Note	Three months ended		Nine months ended	
		December 31		December 31	
		2016	2015	2016	2015
		\$	\$	\$	\$
<b>Revenue</b>					
Oil and gas revenue		1,676,663	271,262	2,503,961	1,803,172
Electricity revenue		240,582	-	479,995	-
Royalties		-	(7,521)	(7,211)	(115,408)
		1,917,245	263,741	2,976,745	1,687,764
<b>Expenses</b>					
Operating		1,017,487	459,763	1,802,019	1,272,597
Transportation		-	2,890	1,725	56,875
General and administrative (1)		1,901,148	641,112	3,696,671	1,981,875
Transaction costs		-	35,536	-	35,536
(Gain) on sale of marketable securities		-	-	(3,720)	-
Foreign exchange		(129,957)	(292,365)	(220,697)	(389,463)
Fair value adjustment on marketable securities	3	-	5,058	-	21,552
Fair value adjustment on derivative liability	7	39,531	(26,686)	39,531	(209,652)
Depletion and depreciation		319,197	55,598	523,012	249,202
		3,147,406	880,906	5,838,541	3,018,522
<b>Loss from operations</b>		(1,230,161)	(617,165)	(2,861,796)	(1,330,758)
Gain on business combination	4	-	-	771,189,297	-
Finance expense	14	(325,531)	(272,305)	(570,354)	(775,424)
<b>Net income (loss) before tax</b>		(1,555,692)	(889,470)	767,757,147	(2,106,182)
Income tax (provision) reduction	18	-	-	(153,043,767)	
<b>Net (loss)/profit</b>		(1,555,692)	(889,470)	614,713,380	(2,106,182)
Exchange differences on translation on foreign operations		(233,589)	721,337	(8,428,763)	(88,046)
<b>Comprehensive (loss)/profit</b>		(1,789,281)	(1,761,125)	606,284,617	(2,194,228)
<b>Net Profit (loss) per share</b>					
Basic	13	(0.03)	(0.03)	10.59	(0.07)
Diluted		(0.02)	(0.03)	5.90	(0.07)
<b>Weighted average shares outstanding</b>					
Basic	13	63,284,344	33,623,814	58,619,309	30,859,060
Diluted	13	108,912,461	57,774,291	104,247,426	55,009,357

- (1) Included in the General and Administrative expenses for three and nine months ended December 31, 2016 are approximately CAD\$600,000 and CAD\$1,600,000 non-recurrent expenses related to the January 11th 2017 admission to the London Stock Exchange as well as a non-cash charge of C\$290,000 in relation to the award of the 6,000,000 options.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

For the nine months ended December 31	Note	2016 \$	2015 \$
<b>Operating activities</b>			
Net profit/(loss)		614,713,380	(2,106,182)
Items not involving cash:			
Shares issued for services		130,810	-
Gain on sale of marketable securities		(3,720)	-
Fair value adjustment on marketable securities		-	21,552
Fair value adjustment on derivative liability		39,531	(209,652)
Gain on business combination	4	(771,189,297)	-
Deferred taxation	18	-	-
Depletion and depreciation		523,012	249,202
Impairment of property and equipment		2,142	-
Options issued		290,200	-
Finance expense		194,016	383,514
Income tax expense		153,043,767	-
		(2,256,160)	(1,661,566)
Foreign exchange on translation		62,053	(398,404)
Change in non-cash working capital	16	285,031	89,666
		(1,909,076)	(1,970,304)
<b>Financing activities</b>			
Proceeds from issuance of bonds		191,183	517,731
Net proceeds from loans		359,894	594,554
Repayment of notes payable		-	(204,315)
Proceeds from issue of share capital, net of share issue costs		1,325,139	637,130
Change in non-cash working capital	16	-	(30,660)
		1,876,216	1,514,440
<b>Investing activities</b>			
Proceeds on sale of marketable securities		10,818	361,926
Purchase of marketable securities		-	(136,568)
Expenditures on property and equipment		(103,850)	(517,993)
Change in non-cash working capital	16	11,388	71,772
		(81,644)	(220,863)
Change in cash		(114,504)	(676,727)
Foreign exchange effect on cash held in foreign currencies		(5,002)	(90,711)
Cash, beginning of period		137,982	936,499
<b>Cash, end of period</b>		<b>18,476</b>	<b>169,061</b>

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

For the nine months ended December 31	Note	2016 \$	2015 \$
<b>Share capital</b>			
Balance - beginning of period		9,578,270	8,686,556
Unit private placement	10	1,577,360	637,130
Fair value of warrants		-	(87,200)
Conversion of convertible notes	10	300,300	-
Balance - end of period		11,455,930	9,236,486
<b>Warrants</b>			
	11		
Balance - beginning of period		1,509,537	1,245,708
Fair value of warrants		-	138,100
Expiry of warrants		-	(93,000)
Balance - end of period		1,509,537	1,290,808
<b>Options</b>			
	12		
Balance - beginning of period		-	-
Fair value of options issued		290,200	-
Balance - end of period		290,200	-
<b>Contributed surplus</b>			
Balance - beginning of period		2,231,583	2,138,583
Expiry of warrants		-	93,000
Balance - end of period		2,231,583	2,231,583
<b>Accumulated other comprehensive loss</b>			
Balance - beginning of period		(1,952,414)	(1,810,281)
Exchange differences on translation of foreign operations		(8,428,764)	(88,046)
Balance - end of period		(10,381,178)	(1,898,327)
<b>Surplus / (Deficit)</b>			
Balance - beginning of period		(13,645,926)	(5,971,478)
Net profit /(loss)		614,713,380	(2,106,182)
Balance - end of period		601,067,453	(8,077,660)
<b>Total equity</b>		<b>606,173,525</b>	<b>2,782,890</b>

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity (Unaudited) (Expressed in Canadian dollars)

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### 1. Nature of operations and going concern

Zenith Energy Ltd. ("Zenith" or the "Company") was incorporated pursuant to the provisions of the British Columbia Business Corporations Act on September 20, 2007. The address of the Company's registered office is 15th Floor, 850 - 2nd Street S.W., Calgary, Alberta T2P 0R8, Canada. The Company is primarily involved in the exploration for, development of and production of oil and natural gas properties primarily in Argentina (until February 19, 2017), Azerbaijan and Italy.

As at December 31, 2016, the Company has a working capital deficit of \$5,782,125 (March 31, 2016 – \$6,709,115), negative cash flows from operating activities of \$1,909,076 (March 31, 2016 - \$2,473,767) and an accumulated surplus of \$601,067,453 (March 31, 2016 deficit – \$13,645,926) since its inception, and may incur future losses in the development of its business. Current cash resources will not be sufficient to continue the exploration and development activities. These conditions indicate the existence of material uncertainties that may cast doubt on the Company's ability to continue as a going concern. Continuing operations are dependent on the ability to obtain adequate funding to finance existing operations, and attain future profitable operations in Azerbaijan and Italy. Additional financing is subject to the global financial markets and economic conditions, and volatility in the debt and equity markets. These factors have made, and will likely continue to make it challenging to obtain cost effective funding. There is no assurance this capital will be available and if it is not, the Company may be forced to curtail or suspend planned activity.

These condensed interim consolidated financial statements have been prepared on the basis of the going concern assumption that the Company will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in these consolidated financial statements, and that the Company will be able to continue its business activities. Realization values may be substantially different from carrying values as shown and these consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these consolidated financial statements, then the adjustments would be necessary in the carrying value of assets and liabilities, the reported revenues and expenses, and the classifications used in the consolidated statements of financial position. These adjustments could be material.

### Critical Accounting Estimates and Judgements

The Group makes estimates and assumptions concerning the future. The resulting estimates will, by definition, seldom equal the related achieved amounts. The estimates and assumptions that have significant risk of causing material adjustments and assumptions to the carrying amounts of assets and liabilities are disclosed below.

Valuation of the assets and liabilities associated with the Azerbaijan acquisition this assessment involves:

- Future revenues and estimated development and exploration costs;
- The discount rate to be applied for the purposes of deriving a recoverable value;
- The expected tax rate; and
- The expected oil price.

During the nine months ended December 31, 2016 the Company recognised a value of assets and associated liabilities for its Azerbaijan Assets acquired after the combination of the business, including the payments due in respect of the acquisition relating to royalties, work and exploration programmes and taxation. The valuations of the assets and of the liabilities have been based on the Net Present Value ("NPV") of future cash flows included in the Competent Persons Report prepared on behalf of the Company by Champan Petroleum Engineering Ltd. ("Chapman") and published on 15 June 2016 ("Original CPR"). The NPV of future cashflows was discounted at a rate of 10%. The Board considers 10% an appropriate rate of discount for the following reasons:

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

- The Asset has a verified producing history as well as current production;
- The asset is production & development with 2P reserves (made by way of a National Instrument 51-101) based over an acreage of 642 square kilometres comprised of different structures;
- The Asset is low cost and onshore presenting a low operational risk;
- Azerbaijan has one of the world's oldest established Oil & Gas industries;
- Azerbaijan has a stable political environment with a government that has guaranteed and supported the licence rights of companies operating in the Oil & Gas industry since its independence in 1992
- Crude oil is exported via two different pipelines, one delivering oil to the Mediterranean Sea and the other in the Black Sea, thereby derisking routes to market from both a political and logistical perspective.

Any changes to the estimates may result in a material impact to the carrying value of both the assets and liabilities, arising in respect of the acquisition.

## 2. Basis of presentation

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, including International Accounting Standard 34 – Interim Financial Reporting. The Company has consistently applied the same accounting policies throughout all periods presented. These condensed interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual filings for the year ended March 31, 2016.

The following entities have been consolidated within the Company's financial statements:

<u>Entity</u>	<u>Registered</u>	<u>Holding</u>
Zenith Energy Ltd.	Canada	Parent
Ingenieria Petrolera del Rio de la Plata SRL	Argentina	100%
Ingenieria Petrolera Patagonia Ltd ("IPP")	US	100%
Canoel Italia SRL	Italy	100%
Zenith Aran Oil Company Limited	BVI	100%
Aran Oil Operating Company Ltd.	BVI	80%
Petrolera Patagonia Corporation ("PPC")	US	100% owned subsidiary of IPP
PP Holding Inc. ("PPH")	US	100% owned subsidiary of IPP
Petrolera Patagonia SRL	Argentina	95% owned subsidiary of PPC and 5% held by PPH

The functional currency of the Company is the Canadian dollar ("CAD"); the functional currency Company's Argentine subsidiaries is the Argentine Peso; the functional currency of the Company's Italian subsidiary is the Euro; the functional currency of the Company's Azerbaijan subsidiary and of the Company's United States subsidiaries is the United States dollar. The Company's presentation currency is the CAD. In Financial Statements, unless otherwise noted, all dollar amounts are expressed in CAD. References to "US\$" are to United States dollars, references to "GBP" are to Great Britain Pounds, references to "AZN" are to Azerbaijan Manat.

### b) Basis of measurement

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies.



# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and assumptions are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. The significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended March 31, 2016 and the following additional critical judgements:

Determination that the acquisition of the Azerbaijan oil assets is a business combination rather than an asset acquisition and the functional currency of the acquired business is New Manat.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the year of the change, if the change affects that year only, or in the year of the change and future years, if the change affects both. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are discussed in Note 5 of the Company's audited consolidated financial statements for the year ended March 31, 2016. These unaudited condensed consolidated interim financial statements have been prepared on a historical cost basis, and are presented in Canadian dollars, unless otherwise indicated.

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on February 28, 2017.

### 3. Marketable securities

	December 31 2016	March 31 2016
GRIT shares (a)	\$ –	\$ 7,632
	\$ –	\$ 7,632

#### (a) GRIT shares

As at December 31, 2016, the Company held no GRIT shares (2015 – 116,913 GRIT shares with a fair value of GBP 18,122 (\$34,130)).

The Company sold all of the GRIT shares for gross cash proceeds of \$10,840 in July 2016 recognized a \$3,720 gain on the sale of marketable securities and a \$745 loss on foreign exchange in the Q2-2017 consolidated statements of loss and comprehensive loss.

### 4. Business combination

#### Azerbaijan

On January 26, 2016 the Company registered a branch of Zenith Aran Oil Company Ltd. ("Zenith Aran"), a wholly owned subsidiary of the Company, in Baku, Azerbaijan, to have an operating entity in Azerbaijan for the ownership and management of the Azerbaijan oil properties.

Zenith Aran was incorporated in the British Virgin Islands under the BVI Business Companies Act, 2004, on the 27th of November 2015.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

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On March 16, 2016, the Company's wholly-owned subsidiary, Zenith Aran, entered into a Rehabilitation, Exploration, Development and Production Sharing Agreement ("REDPSA") with SOCAR (State Oil Company of Azerbaijan Republic) and SOA (Socar Oil Affiliate). The REDPSA covers 642 square kilometres which include the active Muradkhanli, Jafarli and Zardab oil fields located in the Lower Kura Region, about 300 kilometres inland from the city of Baku, in Azerbaijan (the "Azerbaijani Operations"). Pursuant to the terms of the REDPSA, the Company and SOA have the exclusive right to conduct petroleum operations from the Azerbaijani Operations, through a newly incorporated operating company, Aran Oil Operating Company Limited (the "Aran Oil"). Aran Oil, in which Zenith has an 80% interest, is the operator of the concession, with the remaining 20% interest being held by SOA.

On June 24, 2016, the President of the Republic of Azerbaijan signed the REDPSA into law, following approval by Parliament on June 14, 2016. The delivery of the capital assets previously used in respect of the petroleum operations at the Azerbaijani Operations, from the previous operating company to Aran Oil, physically completed in June 2016, was formally completed on August 11, 2016 with the necessary signatures on related documents.

Aran Oil now has operational control of the Azerbaijani Operations. The transfer of operational control did not involve any interruption of petroleum production operations at the Azerbaijani Operations.

As a part of the Handover, an inventory of equipment and material was prepared and the volumes of oil in the pipelines and tanks were recorded. Any revenues related to the existing oil as at the date of Handover were allocated to SOCAR. At the time of the formal finalization of the transaction the production in Azerbaijan was about 275 barrels per day of oil, they have generated revenues for the Company since the completion of the transfer to Aran Oil.

The Handover involved the transfer of certain individuals employed by the current operator of the Azerbaijani Operations to Aran Oil. In accordance with the laws of Azerbaijan, the transfer process involved the relevant employees being dismissed by their previous employer (the outgoing operator of the Azerbaijani Operations) and entering into new employment contracts with Aran Oil. Any payments to the relevant employees arising as a result of their dismissal by the previous operating company were for the account of the previous operating company. In accordance with the laws of Azerbaijan, the relevant employees have been employed by Aran Oil with effect from the Effective Date. The form of employment agreement follows the template prescribed by the Azerbaijani labour code.

The capital assets which transferred to Aran Oil as part of the Handover include production equipment, vehicles, wells, pumps, storage facilities, tools, generators, compressors, pipelines, offices, warehouses, buildings, rigs, yards, roads, infrastructure, radios, tubular goods, supplies, materials and facilities. The Company appointed a consultant in Azerbaijan to review and report on the availability and the state of the assets prior to Handover.

The term of the Contract Exploration Area portion of the REDPSA is 25 years from the date of SOCAR's approval of the contractor's development program. The term of each Area may be extended by an additional five years at SOCAR's discretion.

The valuations of the Asset and of the liabilities have been based on the Net Present Value ("NPV") of future cash flows included in the Competent Persons Report prepared on behalf of the Company by Chapman Petroleum Engineering Ltd. ("Chapman") and published on June 15, 2016 ("Original CPR"), and in particular the financial and economic data from page 93 to page 128.

The acquisition of Assets has been brought to account as a business combination using the acquisition method of accounting and resulted in a bargain purchase arising as follows:

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

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Fair value of net assets acquired CAD\$

D&P assets	1,052,765,084
Compensatory Oil*	(1,997,357)
Capital Costs*	(285,548,895)
Foreign Currency Translation	7,913,703
Decommissioning Obligations*	<u>(1,943,339)</u>

<b>Gain on business combination</b>	<b>771,189,197</b>
Taxation	<u>(153,043,767)</u>

<b>Net NPV of the assets</b>	<b>618,145,430</b>
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\* Amounts required to be paid under the terms of the REDPSA and therefore in accordance with FRS3 ("Business Combinations") form part of the acquisition amount.

### D&P assets

The estimated value of the D&P assets acquired was determined using both estimates and an independent reserve evaluation based on oil and gas reserves discounted at 10%.

### Decommissioning provisions

The fair value of decommissioning obligation assumed was determined using the timing and estimated costs associated with the abandonment, restoration, and reclamation of the wells and facilities acquired, discounted at a credit adjusted rate.

On 15 June 2016, the day immediately following the acquisition date, the decommissioning obligation assumed was remeasured using a long term risk free rate based on the expected timing of cash flows, in accordance with IAS 37 ("Provisions, Contingent Liabilities and Contingent Assets"). The result was a CAD \$1,943,339 increase in the decommissioning obligation associated with the acquired assets and the net result of the acquisition and recognition of decommissioning liability recognition being a gain of CAD \$711,189,197 measurement adjustment in the first quarter of year 2017 consolidated statement of income and comprehensive income using prevailing exchange rates.

### Compensatory oil

The Company have an obligation, in force of the contract, to:

1. within one year following the Effective Date, deliver at no charge to SOCAR 5% of the total production of petroleum produced from the contract rehabilitation area in each calendar quarter; and
2. commencing on the first anniversary of the Effective Date, start delivering, at no charge to SOCAR, 15% of the total production of petroleum produced from the contract rehabilitation area in each calendar quarter, until the amount delivered is the equivalent of 45,000 tons of "compensatory" crude oil to SOCAR.

The amount, stated as a liability, reflect this part of production that has to be delivered to Socar, valued at the estimated production price of US\$20 per barrel.

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## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

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### Capital Costs

At the time of the formal finalization of the transaction the production in Azerbaijan was about 275 barrels per day of oil, although they have produced much larger quantities previously (Source: SOCAR). Gas is also produced, but in low quantities and is used at the sites.

The Company, which is free to sell/export oil without restrictions, sells its oil through the Marketing and Operations Department of SOCAR ("SOCARMO"). A commission of 1% of total sales is payable to SOCARMO.

Between 2017 and 2019, the Company plans to workover a total of 44 existing wells in Azerbaijan which are currently inactive or produce at low rates (< 5 STB/d) to bring rates up to 10 to 15 STB/d per well using improved technology, non damaging fluids and optimised treatments. It is estimated that 10 wells will be worked over in 2017, 16 wells in 2018 and 18 wells in 2019. This programme has commenced using the existing workover rig in the field and the Company intends to purchase an additional modern workover rig to optimise the workover of the wells, within the next four years.

In addition to the marginal producing wells, five non-producing wells in the Maykop zone in the Zardab field in Azerbaijan are expected to be worked over in 2017 and to be returned to production once the existing wellbore and sand production issues have been resolved.

The Company intends to acquire one modern drilling rig capable of drilling 4,500m to carry out a fifteen year drilling programme. It is anticipated that five new wells will be drilled in 2018 and ten wells in each year thereafter until the anticipated drilling programme is complete in 2032.

During the first four years of the REDPSA it is estimated that US\$2,500,000 will be spent upgrading the gathering system and central facilities in Azerbaijan to improve safety, efficiency and handle higher production rates. During the same period, 39 active wells currently producing at marginal rates will be worked over at an estimated cost averaging \$50,000 per well, using the existing workover rig.

It is anticipated that in 2017 five shut-in wells completed in the Maykop formation will be worked over to control sand production, at an estimated cost of US\$100,000 per well, and returning to an increase of production at a total of 200STB/d.

It is envisaged that development drilling will commence in 2018 and continue until 2032. It has been estimated that each well with proved reserves will cost approximately US\$4,300,000. This cost will include the direct cost of materials, fuel, salaries, etc. to drill the well and an allocation for the purchase of one drilling rig, well completion and tie-in.

Proved reserves are those reserves that can be estimated, by competent professional, with a high degree of certainty to be recoverable. The estimate of the reserves are related to a given date, based on analysis of drilling, geological, geophysical and engineering data; the use of established technology, and; specified economic conditions, which are generally accepted and being reasonable, and shall be disclosed.

Each well in the proved plus probable category is expected to cost approximately US\$5,000,000. This category of reserves includes those additional reserves that are less certain to be recovered than proved reserves.

In addition to the costs anticipated for the wells with proved reserve, wells in the proved plus probable category have an additional allocation of US\$700,000 for the purchase and maintenance of a second drilling rig and expansion and modernisation of the field facilities.

In all 145 wells are expected to be drilled over 16 years, of which 58 of these are anticipated to be horizontal wells.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

DEFERRED CONSIDERATION PAYABLE		
	December 31, 2016	March 31, 2016
<b>Compensatory Oil</b>		
Current portion	27,780	-
Non-Current portion	1,969,577	-
<b>Capital costs</b>		
Current portion	474,056	-
Non-Current portion	285,074,839	-
As of 31 December	287,546,252	-
Deferred Consideration payable current	501,836	-
Deferred Consideration payable non-current	287,044,416	-
Total	287,546,252	-

### 5. Property and equipment

	D&P assets	Furniture & Fixtures	Total
<b>Cost</b>			
Balance – March 31, 2016	\$ 21,612,271	\$ 51,921	\$ 21,664,192
Acquisition	1,052,765,084	-	1,052,765,084
Additions	84,313	19,537	103,850
Decommissioning obligations	(2,142)	-	(2,142)
Foreign currency translation	(822,905)	(2,080)	(824,985)
Balance – December 31, 2016	\$ 1,073,636,621	\$ 69,378	\$ 1,073,705,999
<b>Accumulated depletion and depreciation</b>			
Balance – March 31, 2016	\$ (7,027,156)	\$ (38,947)	\$ (7,066,103)
Depletion and depreciation	(519,762)	(3,250)	(523,012)
Foreign currency translation	279,695	1,664	281,359
Balance – December 31, 2016	\$ (7,267,223)	\$ (40,533)	\$ (7,307,756)
<b>Carrying amount</b>			
March 31, 2016	\$ 14,585,115	\$ 12,974	\$ 14,598,089
December 31, 2016	\$ 1,066,369,398	\$ 28,845	\$ 1,066,398,243

The depletion calculation for the nine months ended December 31, 2016 included estimated future development costs of \$2.7 million for proved and probable reserves (March 31, 2016 – \$2.7 million).

The Company did not identify any indicators of impairment at December 31, 2016.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

### 6. Loans payable

	December 31 2016	March 31 2016
USD loan payable (a)	\$ 2,934,252	\$ 2,834,600
Euro bank debt (b)	234,143	288,422
Euro bank debt (c)	213,411	282,457
Euro loan payable (d)	309,312	478,282
First Credit Agreement (e)	215,650	-
Second Credit Agreement (f)	267,696	-
Third Credit Agreement (g)	74,131	-
Fourth Credit Agreement (h)	74,131	-
	4,322,726	3,883,761
Current portion of loans payable	(1,946,338)	(3,210,114)
<b>Long-term portion of loans payable</b>	<b>\$ 2,376,387</b>	<b>\$ 673,647</b>

#### a) USD loan payable

As at March 31, 2016, the Company was indebted to a third party lender for a USD 2,185,337 (\$2,866,506) loan payable secured by the shares of its wholly owned subsidiary, IPP, and bearing fixed interest at 10% per annum.

The loan maturity date is March 31, 2018 and the repayment scheduled was amended in December 2016 to require a USD 700,000 (CAD\$943,467) payment on January 2017 and a final payment of approximately USD 1,485,337 on March 31, 2018.

As at December 31, 2016, \$943,467 (March 31, 2016 – \$2,834,600) of principal is classified as a current liability; \$2,001,952 (March 31, 2016 – \$nil) of principal is classified as long-term and \$292,061 (March 31, 2016 – \$156,874) of accrued interest is included in trades and other payables.

In January 2017 the Company paid the USD 700,000 (CAD\$943,467) of the USD loan, utilising part of the proceeds from the fundraising aligned with the listing on the London Stock Exchange of January 11, 2017. The President, CEO and Director of the Company, has provided a personal guarantee to the lender in respect of the repayment of the USD Loan by the Company.

#### b) Euro bank debt

On August 6, 2015, the Company obtained a €220,000 loan (CAD\$315,986) from the GBM Banca of Rome. The loan is unsecured, bears fixed interest at 7% per annum and is repayable in 60 monthly payments of principal and interest until August 6, 2020.

As at December 31, 2016, the principal balance of the loan was €165,250 (CAD\$234,143) of which \$59,587 is classified as a current liability and \$174,556 is classified as long-term.

#### c) Euro bank debt

On December 17, 2015, the Company obtained a €200,000 loan (CAD\$301,880) from Credito Valtellinese Bank of Tortona. The loan is unsecured, bears fixed interest at 4.5% per annum and is repayable in 42 monthly payments of principal and interest until July 17, 2019.

As at December 31, 2016, the principal balance of the loan was €150,610 (CAD\$213,411) of which \$80,336 is classified as a current liability and \$133,075 is classified as long-term.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

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### d) Euro loan payable

On October 1, 2015, the Company acquired a co-generation plant from a third party of which €401,148 (CAD\$594,943) of the purchase price was in the form of a loan from the seller. The loan is secured by the co-generation plant and bears interest at 3.5% and is repayable in 30 monthly payments of principal and interest until March 31, 2018.

As at December 31, 2016, the principal balance of the loan was €218,302 (CAD\$309,312) of which \$231,341 is classified as a current liability and \$77,971 is classified as long-term.

### e) USD \$320,000 General Line of Credit Agreement

On August 9, 2016, the Company's wholly-owned subsidiary, Zenith Aran, entered into a general line of credit agreement with Rabitabank Open Joint Stock Company ("Rabitabank") (the "First Credit Agreement") up to an amount of USD \$320,000, for industrial and production purposes. The loan could be drawn down in tranches and as at 30 September 2016 it was fully drawn down. Rabitabank can postpone or suspend the facility if there is a decline in oil production under the REDPSA of more than 30% from production levels as at the date of first drawdown or if the REDPSA is terminated. The First Credit Agreement bears interest at a rate of 12% per annum. The loan is guaranteed by the Company. In November 2016 the Company repaid the first tranche of the loan for the amount of USD160,000, and as at December 31, 2016, the balance of the loan outstanding was USD \$160,000 (plus accrued interest) (CAD\$215,650) that is classified as a current liability. The loan is repayable on February 22, 2017.

On February 22, 2017 the terms of the repayment of the First Credit Agreement were amended and the amount of USD \$160,000 (plus accrued interest)(CAD \$215,650) will be paid on March 27, 2017

### f) USD \$200,000 General Line of Credit Agreement

On September 30, 2016, Zenith Aran entered into a second general line of credit agreement with Rabitabank (the "Second Credit Agreement") up to an amount of USD \$200,000. The Second Credit Agreement bears interest at a rate of 12% per annum. The loan is repayable in two tranches; USD \$100,000 (plus accrued interest) (CAD\$133,848) is payable on January 3, 2017 and the remaining USD \$100,000 (plus accrued interest) (CAD\$133,848) is payable on April 3, 2017. The loan is guaranteed by the Company. As at December 31, 2016, the full balance of the loan was outstanding and it is all classified as a current liability.

At the date of this document the first tranche of the repayment of the Second Credit Agreement was totally paid.

### g) USD \$55,000 General Line of Credit Agreement

On November 21, 2016, Zenith Aran entered into a third general line of credit agreement with Rabitabank (the "Third Credit Agreement") up to an amount of USD \$55,000 (CAD\$74,131). The Third Credit Agreement bears interest at a rate of 12% per annum and is repayable on February 21, 2017. The loan is guaranteed by the Company. As at December 31, 2016, the full balance of the loan was outstanding and it is classified as a current liability.

On February 21, 2017 the terms of the repayment of the Third Credit Agreement were amended and the amount of USD \$55,000 (plus accrued interest)(CAD \$74,130) will be paid on March 27, 2017.

### h) Second USD \$55,000 General Line of Credit Agreement

On November 22, 2016, Zenith Aran entered into a fourth general line of credit agreement with Rabitabank (the "Fourth Credit Agreement") up to an amount of USD \$55,000 (CAD\$74,131). The Fourth Credit Agreement bears interest at a rate of 12% per annum and is repayable on February 21, 2017. The loan is guaranteed by the Company. As at December 31, 2016, the full balance of the loan was outstanding and it is classified as a current liability.

On February 22, 2017 the terms of the repayment of the Fourth Credit Agreement were amended and the amount of USD \$55,000 (plus accrued interest)(CAD \$74,130) will be paid on March 27, 2017

# Zenith Energy Ltd.

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(Unaudited) (Expressed in Canadian dollars)

### i) Cayman loan payable

On November 13, 2015, the Company secured a £20,000,000 (CAD\$40,250,000) unsecured loan facility (the "Loan") for general corporate purposes with a Cayman Islands based Fund (the "Lender"). The Loan can be drawn by written notice given by the Company. Subject to a satisfaction of certain conditions precedent and the approval of the Lender, a minimum sum of £100,000 and up to a maximum sum of £2,000,000 for each tranche can be drawn at any time from the date of the Loan agreement for a period of 18 months after such date. The Loan accrues interest at the rate of 12% per annum on the amount drawn and is payable quarterly in arrears. Each outstanding draw down is repayable on the third anniversary of the first draw down date. The Company may prepay the loan, in whole or in part, at any time and without penalty. A one-time fee of £25,000 is payable in cash or by issuing the Lender common shares of the Company.

As at December 31, 2016 the Company had not made any draws on the Loan.

### 7. Convertible notes

	Face value \$	Debt component \$	Derivative liability \$
<b>Balance – March 31, 2016</b>	730,915	697,046	357,936
Conversion	(300,300)	(275,000)	(25,300)
New Subscriptions	167,030	140,305	26,725
Change in fair value	-	-	39,531
Accretion	-	419	-
Foreign exchange	(18,954)	(36,778)	-
<b>Balance – December 31, 2016</b>	<b>578,691</b>	<b>525,992</b>	<b>398,892</b>

### Swiss Franc Convertible Note

As at December 31, 2016, the Company held CHF312,586 Swiss Francs (\$413,051) (March 31, 2016 – CHF540,000 Swiss Francs (\$730,915)) principal amount of unsecured convertible notes bearing interest at 1% per annum, payable in arrears in equal quarterly installments on January 11, 2019. At any time prior to maturity and at the option of the note holder, the principal and any unpaid interest of a note may be converted into common shares of the Company at a price of \$0.11 per share.

Interest is accrued and presented in the amount of \$337,345 as at December 31, 2016 (March 31, 2016 – \$314,597).

In June 2016, the Company issued 2,730,000 common shares on the conversion of 225,047 Swiss Francs (\$300,300) principal amount of convertible notes (Note 10).

On November 28, 2016, the Company formalized the previously reached agreement for the amendments of the terms of its 5% convertible notes. The proposed amendments to the notes included an extension of two years to the maturity date from January 11, 2017 to January 11, 2019, a reduction to the conversion price from \$0.125 per common share to \$0.11 per common shares and a reduction to the interest rate payable by the Company from 5% to 1% for the remainder of the term. The proposed extension to the notes, and the reduction in the conversion price and interest rate remains subject to approval of the TSX Venture Exchange.



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## Condensed Interim Consolidated Statements of Changes in Equity

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On January 25, 2017 the Company issued 3,700,000 shares on the conversion of 311,067 Swiss Francs (CAD\$407,000) principal amount of convertible notes.

<b>Outstanding debt As of January 25, 2017</b>	<b>CHF</b>	<b>CAD\$</b>
Principal	CHF 314,953	\$ 412,084
Accrued Interest	CHF 249,758	\$ 327,730
<b>Total to be paid</b>	<b>CHF 564,711</b>	<b>\$ 739,814</b>

<b>Conversion of notes</b>	<b>Shares</b>	<b>CHF</b>	<b>CAD\$</b>
<b>Outstanding principal As of January 25, 2017</b>		CHF 314,953	\$ 412,084
Issued January 2017	3,700,000	-CHF 311,067	\$ -407,000
<b>Remaining</b>		<b>CHF 3,886</b>	<b>\$ 5,084</b>

*Changes calculated using the following current change rate conversion  
(January 25, 2017)*

### Change Rate

CAD\$/CHF	1.3084
CHF/CAD\$	0.7643

The outstanding amount of convertible note, at the date of this document, is CHF3,886 Swiss Francs (\$5,084) of principal, and CHF249,758 (CAD\$327,730) of accrued interest.

### **Pound Convertible Note**

On November 22, 2016, Gunsynd Plc ("Gunsynd"), a company listed on the London Stock Exchange's AIM market for listed securities, invested GBP£100,000 (CAD\$165,640) by way of subscription for convertible unsecured loan notes bearing interest of 3% per annum (the "GBP Convertible Notes"). The GBP Convertible Notes are payable in arrears in quarterly instalments. At the option of Gunsynd, the principal of the GBP Convertible Notes may be converted into Common Shares of the Company at any time prior to the expiry of 36 months from issuance at a price equal to CAD \$0.10 per Common Share (or the initial listing price of the Common Shares if the Company is listed on another senior stock exchange at the time of such conversion). Subject to the GBP Convertible Notes not having been converted, the GBP Convertible Notes mature 36 months from the date of issuance. Unless permitted under Canadian securities legislation, the GBP Convertible Notes cannot be traded before the date that is four months and a day after the date of issuance.

Interest is accrued and presented in the amount of \$531 as at December 31, 2016 (March 31, 2016 – \$nil).

## **8. Bonds and notes payable**

### BONDS

<b>Balance – March 31, 2016</b>	<b>\$ 563,103</b>
Fair value of warrants	-
Finder's warrants	-
Finder's fees	-
<b>Liability portion</b>	<b>563,103</b>

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

Interest	49,694
Accretion	7,668
Conversion	(121,411)
Repayments	(43,624)
Foreign currency translation	(72,341)
<b>Balance – December 31, 2016</b>	<b>\$ 383,090</b>

The bonds are secured by 99% of the oil and gas properties owned by the Company's subsidiary, Canoe Italia SRL. The bonds bear interest at 12% per annum, payable quarterly, until the maturity date 36 months from the date of issuance at which time the principal amount of bonds is repayable in full.

Each common share purchase warrant entitles the holder thereof to purchase, subject to adjustment, one additional common share at an exercise price of \$0.25 per share for a period of 36 months from the date of issuance. In connection with the private placement, the Company paid a finder's fees of GBP 11,250 (\$21,169) and granted 67,500 finder's warrants exercisable at \$0.25 until for a period of 36 months from the date of issuance.

The grant date weighted average fair value of warrants was \$0.03 per warrant (\$50,900) estimated using the Black-Scholes pricing model calculations based on the following significant assumptions:

Risk-free interest rate	0.50% - 0.70%
Expected volatility	75%
Expected life	3 years
Dividends	nil

On November 2016 the bond was partially repaid for CAD\$121,411 (with related accrued interest), and within December 31, 2016 all the outstanding accrued bond interests were paid for CAD\$70,641.

### NOTES PAYABLE

On July 16, 2016, the Company's wholly owned subsidiary in Argentina, Petrolera Patagonia S.r.l. ("PPSRL"), entered into a loan agreement with Arpenta Sociedad de Bolsa S.A. ("Arpenta"), pursuant to which PPSRL borrowed USD \$154,000 of Bonar 2017 Argentine sovereign bonds (the "Bonds") (the "Arpenta Bond Loan"). PPSRL subsequently sold the Bonds in the market (for Argentine pesos) to address cashflow requirements. Interest is payable on the Arpenta Bond Loan at a rate of 4% per annum. The Arpenta Bond Loan had a bullet repayment date of 15 December 2016, although management at PPSRL has taken steps for the Arpenta Bond Loan to be rolled-over (in whole) for an additional 180 day period. Repayment of the Arpenta Bond Loan is required to be made to Arpenta in the same Bonar 2017 Argentine sovereign bonds as were borrowed.

As at December 31, 2016, the Company had US\$154,000 (CAD\$207,563) (March 31, 2016 – US\$nil) of notes payable.

As at December 31, 2016, the balance of notes payable is \$211,384 including accrued interest (March 31, 2016 – \$nil).

<b>Balance – March 31, 2016</b>	<b>\$ nil</b>
Liability portion	198,787
Interest	3,821
Foreign currency translation	9,226
<b>Balance – December 31, 2016</b>	<b>\$ 213,608</b>

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

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### 9. Decommissioning obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the reclamation and abandonment of the Company's oil and gas properties:

<b>Balance – March 31, 2016</b>	\$	7,896,671
Acquisition		1,943,339
Accretion		128,030
Foreign currency translation		(264,265)
<b>Balance – December 31, 2016</b>	\$	9,703,775

The following significant weighted average assumptions were used to estimate the decommissioning obligation:

Undiscounted cash flows – uninflated	\$17 million
Undiscounted cash flows - inflated	\$1,223 million
Risk free rate	35.2%
Inflation rate	25.4%
Expected timing of cash flows	16 – 20 years

### 10. Share capital

	Number of shares	Amount
<b>Balance – March 31, 2016</b>	43,594,406	\$ 9,578,270
Unit private placement proceeds	20,979,747	1,877,660
Fair value of warrants	–	–
<b>Balance – December 31, 2016</b>	64,574,153	\$ 11,455,930

- (a) On April 11, 2016 the Company completed the private placement of 6,674,775 shares at CAD\$0.08 per unit for gross proceeds of CAD\$533,982. Of the 6,674,775 shares, 5,000,000 shares were issued forming part of a unit comprising one common share and one common share purchase warrant. Each whole common share purchase warrant entitles the holder to acquire one common share at CAD\$0.15 per common share for a period of 24 months from the date of issuance. The remaining 1,674,775 shares were not issued with accompanying warrants. The Company also paid aggregate finders' fees of CAD\$26,000.
- (b) On April 21, 2016, the Company completed the private placement of 3,892,875 shares at CAD\$0.08 per unit for gross proceeds of CAD\$311,430. Each unit is comprised of one common share and one common share purchase warrant. Each whole common share purchase warrant entitles the holder to acquire one common share at CAD\$0.15 per common share for a period of 24 months from the date of issuance. The Company also paid aggregate finders' fees of CAD\$14,181.95 and issued 179,712 warrants to certain arm's-length parties in the connection with the Private Placement.
- (c) On June 9, 2016, the Company issued 2,730,000 shares at a deemed price of \$0.11 per share in partial conversion of convertible notes \$300,300 (Note 7), and 312,500 shares at a price of \$0.10 per share creditors of the Corporation to settle debts owing by the Company totalling \$31,250.
- (d) On June 16, 2016 the Company has closed a non-brokered private placement of 1,519,250 shares of the Company at a price of \$0.08 per Unit for aggregate gross proceeds of \$121,540. Each unit is comprised of one

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

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common share and one common share purchase warrant. Each Warrant will be exercisable for one Common Share at a price of \$0.15 per share for a period of 24 months from the date of closing of the offering.

- (e) On 10 October 2016 the Company closed a non-brokered private placement of 1,906,050 Common Shares at a price of CAD \$0.10 per unit for aggregate gross proceeds of CAD \$190,605. Each unit is comprised of one Common Share and one common share purchase warrant. Each common share purchase warrant will be exercisable for one Common Share at a price of CAD \$0.20 per share for a period of 24 months from the date of closing of the offering.
- (f) On 19 October 2016, the Company issued 724,235 Common Shares at a deemed price of CAD \$0.085 per Common Share to certain debtholders and creditors of the Company to settle debts owing by the Company, representing an aggregate of CAD \$61,585.48.
- (g) On November 7, 2016, the Company closed a non-brokered private placement of 2,745,062 Common Shares at a price of CAD \$0.12 per unit for aggregate gross proceeds of CAD \$329,407.44. Insiders of the Company subscribed for an aggregate of 2,195,475 units for aggregate subscription proceeds of CAD \$263,457. Each common share purchase warrant will be exercisable for one Common Share at a price of CAD \$0.20 per share for a period of 24 months from the date of closing of the offering.
- (h) On November 30, 2016, the Company issued 150,000 Common Shares to certain debtholders and creditors of the Company (based on a price of CAD\$ \$0.08 per share Common Share) in settlement of a debt of GBP £7,000 (inclusive of accrued interest) owed by the Company in respect of services.

### 11. Warrants

	Number of warrants	Amount \$	Weighted average exercise price
<b>Balance – March 31, 2016</b>	29,638,898	1,509,537	\$ 0.23
Unit private placements (Note 10)	17,242,724	-	0.16
<b>Balance – December 31, 2016</b>	46,881,622	1,509,537	\$ 0.21

As at December 31, 2016 the Company had 46,881,622 warrants outstanding and exercisable at a weighted average exercise price of \$0.21 per share with a weighted average life remaining of 2 years.

### 12. Stock options

The Company has a stock option plan (the "Plan") for the benefit of directors, employees and consultants. The maximum number of shares available under the Plan is limited to 10% of the issued and outstanding common shares at the time of granting options. Granted options are fully vested on the date of grant, at which time all related share-based payment expense is recognized in the consolidated statements of loss and comprehensive loss. Stock options expire five years from the date of grant.

On November 18, 2016 the Company granted Options to certain of its Directors and employees to acquire a total of 6,000,000 Common Shares pursuant to its Stock Option Plan. Each Option granted entitles the relevant holder to acquire one Common Share for an exercise price of CAD \$0.10 per Common Share. The expiry date of the Options is the date falling five years from the date of grant, being 18 November 2021.

The following table summarizes information about the Company's stock options outstanding as at December 31, 2016:

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Number of options	outstanding and exercisable	Weighted average exercise price (\$)
Balance - March 31, 2016	-	-
Granted	6,000,000	0.10
<b>Balance - December 31, 2016</b>	<b>6,000,000</b>	<b>0.10</b>

The Stock Options Plan was approved by shareholders of the Company at the Annual General Meeting held on January 20, 2017

On February 22, 2017 the Company announced that a Director of the Company has exercised his stock options to purchase 1,000,000 common shares in the capital of the Company at a price of CAD\$0.10 per Common Share and a total cost of CAD\$100,000.

### 13. Per share amounts

	Three months ended December 31		Nine months ended December 31	
	2016	2015	2016	2015
	\$	\$	\$	\$
Net Profit (loss)	(1,789,281)	(889,470)	606,284,617	(2,106,182)
Weighted average number of shares – basic:				
Issued common shares as at April 1	43,594,406	29,292,081	43,594,406	29,292,081
Effect of common shares issued during the year	19,689,938	4,331,733	15,024,903	1,566,979
	63,284,344	33,623,814	58,619,309	30,859,060
Basic weighted average number of shares	63,284,344	33,623,814	58,619,309	30,859,060
Potential dilutive effect on shares issuable under warrants	45,628,117	24,150,477	45,628,117	24,150,477
Potential diluted weighted average number of shares	108,912,461	57,774,291	104,247,426	55,009,537
Net Profit (loss) per share – basic <sup>(1)</sup>	(0.03)	(0.03)	10.59	(0.07)
Net Profit (loss) per share – diluted	(0.02)	(0.02)	5.90	(0.04)

<sup>(1)</sup> The Company did not have any in-the-money convertible notes, warrants and stock options during the three and nine months ended December 31, 2016 and 2015. The effect of convertible notes, warrants and stock options is anti-dilutive in loss periods.

### 14. Finance expense

	Three months ended December 31		Nine months ended December 31	
	2016	2015	2016	2015
	\$	\$	\$	\$
Interest expense	194,535	129,046	434,237	372,961
Accretion of convertible notes (Note 7)	419	74,469	419	181,757
Accretion of bonds (Note 8)	2,547	6,049	7,668	17,228
Accretion of decommissioning obligation (Note 9)	128,030	62,741	128,030	203,478
	325,531	272,305	570,354	775,424

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

### 15. Supplemental disclosure

The condensed interim consolidated statements of profit and comprehensive profit are prepared primarily by nature of expense with the exception of employee compensation cost which is included in operating and general and administrative expenses. As at December 31, 2016 the Company and its subsidiaries had 15 full time employees and three part time employees or consultants based in its offices in Buenos Aires and Comodoro Rivadavia in Argentina and in Genoa, Italy. Subsequently the handover dated August 11, 2016 the Company hired additional 201 full time employees and one part time employees or consultants all based in Baku in Azerbaijan.

The following table details the amounts of total employee compensation:

	Three months ended December 31		Nine months ended December 31	
	2016	2015	2016	2015
	\$	\$	\$	\$
Operating	366,342	309,635	642,617	820,415
General and administrative	150,886	76,563	449,423	323,747
<b>Total employee compensation cost</b>	<b>517,228</b>	<b>386,198</b>	<b>1,092,041</b>	<b>1,144,162</b>

### 16. Change in non-cash working capital

For the nine months ended December 31	2016	2015
Trade and other receivables	\$ (1,284,754)	\$ (209,466)
Inventory	(288,088)	(154,207)
Prepaid expenses	80,355	(137,243)
Prepaid property and equipment insurance	38,635	133,973
Trade and other payables	1,750,271	497,721
<b>Total change in non-cash working capital</b>	<b>\$ 296,419</b>	<b>\$ 130,778</b>

The change in non-cash working capital has been allocated to the following activities:

	2016	2015
Operating	\$ 285,031	\$ 89,666
Financing	-	(30,660)
Investing	11,388	71,772
<b>Total change in non-cash working capital</b>	<b>\$ 296,419</b>	<b>\$ 130,778</b>

### 17. Related party transactions

- Included in general and administrative expenses for the three and nine months ended December 31, 2016 is \$41,983 and \$121,445 (three and nine months ended December 31, 2015 – \$34,902 and \$147,645), respectively, charged by a company controlled by an officer and director of the Company for administrative services. As at December 31, 2016, \$22,961 (March 31, 2016 – \$nil) was included in trade and other payables in respect of these charges.
- Included in trade and other payables is \$nil (March 31, 2016 – \$8,966) due to officers and directors of the Company in respect of general and administrative expenditures made on behalf of the Company for which the officers and directors will be reimbursed.

# Zenith Energy Ltd.

## Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in Canadian dollars)

### 18. Taxation

	December 31, 2016 CAD\$	March 31, 2016 CAD\$
Current tax	-	-
Deferred tax	153,927,334	883,567
Total tax	153,927,334	883,568

The deferred tax charge for the period has arise as a result of the acquistion of the assets in Azerbaijan. No tax charge or credit arises on the loss for the period.

The difference between tax expense for the year and expected income taxes based on the statutory tax rate arises as follows:

TAXATION	December 31, 2016 CAD\$	March 31, 2016 CAD\$
Initial Balance	883,567	2,397,623
Deferred tax reduction	-	(1,516,046)
Expected tax provision on business combination	153,043,767	-
As of 31 December	153,927,334	883,567

The provision for the nine months ended December 31, 2016 is related to the expected taxation of the profitability of the assets that the Company acquired in Azerbaijan (see note 4).

The tax (reduction) provision for the year ended March 31, 2016 is comprised of \$nil of current tax expense and a \$1,514,056 deferred tax reduction.

As at March 31, 2016, the Company has accumulated non-capital losses in Canada totaling \$15.2 million (2015 – \$11.6 million) which expire in varying amounts between 2028 and 2036 and \$0.4 million (2015 – \$0.5 million) of non-capital losses in Italy.

### 19. Financial risk management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as credit risk, liquidity risk and market risk. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

#### a) Credit risk

Credit risk is the risk of an unexpected loss if a customer or counter party to a financial instrument fails to meet its commercial obligations. The Company's maximum credit risk exposure is limited to the carrying amount cash of \$18,476 (March 31, 2016 – \$137,982) and trade and other receivables of \$1,956,334 (March 31, 2016 – \$787,477).

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The composition of trade and other receivables is summarized in the following table:

	December 31 2016	March 31 2016
Oil and natural gas sales	\$ 1,025,306	\$ 475,219
Stamp tax and other tax withholdings	731,179	216,926
Goods and services tax	96,357	12,261
Other	103,492	83,071
	<b>\$ 1,956,334</b>	<b>\$ 787,477</b>

The receivables related to the sale of oil and natural gas are due from large companies who participate in the oil and natural gas industry in Argentina, Azerbaijan and Italy. Oil and natural gas sales receivables are typically collected in the month following the sales month.

The Company considers its receivables to be aged as follows:

	December 31 2016	March 31 2016
Current	\$ 1,749,136	\$ 542,962
90 + days	207,198	244,515
	<b>\$ 1,956,334</b>	<b>\$ 787,477</b>

### b) Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and distressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

As at December 31, 2016, the Company had \$8,618,257 (March 31, 2016 – \$8,201,167) of current liabilities for which the Company's \$18,476 (March 31, 2016 – \$137,982) cash balance is insufficient to settle the current liabilities. It is expected that further debt and equity financings will be required in order to settle existing current liabilities, continue development of the Company's assets and meet future obligations. There can be no assurance that such financings will be available to the Company.

As of December 31, 2016, the contractual cash flows, including estimated future interest, of current and non-current financial liabilities mature as follows:

	Carrying amount	Contractual cash flows	Due on or before December 31, 2017	Due on or before December 31, 2018	Due between January 2018 and November 2020
Trade and other payables	\$ 4,892,846	4,892,846	4,892,846	–	–
Oil share agreement	1,063,629	1,063,629	1,063,629	–	–
Loans payable	4,322,726	5,264,699	1,973,367	3,123,648	167,684
Convertible notes	525,992	940,058	6,313	7,035	926,710
Notes payable	213,608	213,608	213,608	–	–
Bonds payable	383,090	443,511	55,995	387,516	–
	<b>\$ 11,401,891</b>	<b>12,818,351</b>	<b>8,205,758</b>	<b>3,518,199</b>	<b>1,094,394</b>



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### c) Market risk

Market risk is the risk that changes in foreign exchange rates, commodity prices, and interest rates will affect the Company's net income (loss) or the value of financial instruments.

#### i) Currency risk

Foreign currency exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Foreign exchange rates to Canadian dollars for the noted dates and periods are as follows:

	<u>Closing rate</u> <u>December 31</u>		<u>Average rate Nine months</u> <u>ended December 31</u>	
	2016	2015	2016	2015
Argentine Peso	0.0853	0.1069	0.0881	0.1375
US dollar	1.3427	1.3840	1.3087	1.2908
Euro	1.4169	1.5029	1.4502	1.4256
Swiss Franc	1.3214	1.3805	1.3328	1.3365
British Pound	1.6564	2.0407	1.74064	1.9790
Azerbaijani New Manat	0.7586	-	0.8201	-

The following represents the estimated impact on net income (loss) of a 10% change in the closing rates as at December 31, 2016 and 2015 on foreign denominated financial instruments held by the Company, with other variables such as interest rates and commodity prices held constant:

<u>For the nine months ended December 31</u>	<u>2016</u>	<u>2015</u>
Argentine Peso	88,700	\$ 57,150
US dollar	417,600	294,090
Euro	117,700	108,760
Swiss Franc	75,000	116,350
British Pound	53,800	55,720
Azerbaijani New Manat	(53,100)	-
	699,700	\$ 632,070

#### i) Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices.

As at December 31, 2016, a 5% change in the price of natural gas produced in Italy would represent a change in net profit (loss) for the nine months ended December 31, 2016 of approximately \$2,700 (2015 loss – (\$23,800)) and a 5% change in the price of electricity produced in Italy would represent a change of net profit for the nine months ended December 31, 2016 of approximately \$24,000 (2015 – not applicable).

Oil prices in Argentina are set by the international market, with certain variation for logistical problems and delivery date. As at December 31, 2016, a 5% change in the price of oil would represent a change in net income (loss) for the nine months ended December 31, 2016 of approximately \$4,000 (2015 – loss (\$64,300)).

As at December 31, 2016, a 5% change in the price of crude oil produced in Azerbaijan would represent a change in net profit (loss) for the nine months ended December 31, 2016 of approximately \$118,600 (2015 – not applicable).

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### ii) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company has fixed interest convertible notes (Note 7) and bonds payable (Note 8) and therefore is not exposed to interest rate risk.

### 20. Inventory

As at December 31, 2016, there were 2,462 bbls of unsold oil production in Argentina held in inventory, and there were 189 bbls of unsold oil production in Azerbaijan held in inventory which were sold in subsequent months, valued at the lower of cost or net realizable value based on the selling prices.

The Company also have materials for maintenance in inventory in Azerbaijan, for an amount of CAD\$132,231, valued at the purchase cost.

As at March 31, 2016, inventory was comprised of 2,267 barrels of oil valued at the lower of cost or net realizable value based on a selling price of USD 59 (2015 – USD 60) per barrel.

INVENTORY	December 31, 2016		March 31, 2016	
	Barrels	Inventory CAD\$	Barrels	Inventory CAD\$
Argentina	2,462	183,852	2,267	173,547
Azerbaijan oil in stock	189	5,595	-	-
Azerbaijan materials in stock	-	132,231		
Balance	2,651	321,678	2,267	173,547

### 21. Subsequent events

- (a) On February 22, 2017 the terms of the repayment of the First Credit Agreement were amended and the amount of USD \$160,000 (plus accrued interest)(CAD \$215,650) will be paid on March 27, 2017
- (b) On February 21, 2017 the terms of the repayment of the Third Credit Agreement were amended and the amount of USD \$55,000 (plus accrued interest)(CAD \$74,130) will be paid on March 27, 2017
- (c) On February 22, 2017 the terms of the repayment of the Fourth Credit Agreement were amended and the amount of USD \$55,000 (plus accrued interest)(CAD \$74,130) will be paid on March 27, 2017
- (d) On January 5, 2017 - The Company announced that the Prospectus dated January 5, 2017 has been approved by the UK Listing Authority (the "Prospectus"). The Prospectus relates to admission of the Company's Common Shares to the standard listing segment of the Official List and to trading on the London Stock Exchange's Main Market ("Admission"). Admission and commencement of dealings in the Company's Common Shares did occur on 11 January 2017.

In connection with Admission, the Company successfully placed 33,322,143 Common Shares (the "UK Placing"). Following its book-building process, in which Common Shares were placed at £0.07 (CAD\$0.11) per Common Share, on completion of the UK Placing the gross proceeds available to the Company were approximately £2,332,550 (CAD\$3,823,848) and the net proceeds were approximately £2,015,922 (CAD\$3,304,786). The Company paid finder's fees of GBP 113,500 and issued 1,114,286 broker warrants exercisable for 24 months

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from closing at a price of GBP 0.07 per common share to certain arm's-length parties under the private placement undertaken as part of the dual listing on the London Stock Exchange on 11 January 2017.

- (e) On January 11, 2017 – The Company announced that its entire Common Share capital, consisting of 98,564,867 Common Shares, were admitted to the standard listing segment of the Official List of the FCA and to trading on the London Stock Exchange's Main Market under the ticker symbol "ZEN".

Admission became effective and dealings commenced at 8.00 a.m. on January 11, 2017.

The net proceeds of the UK Placing will be used by the Company to provide additional funding for debt repayment, to provide additional funding for the Company's development and appraisal activities in Azerbaijan, Italy and Argentina and to provide additional working capital.

- (f) On January 24, 2017 the Company announced the signing of a well workover contract and engagement of highly experienced local drilling company to initiate and execute the workover of first two wells in the programme (M-195 and M-45).
- (g) In January 2017 the Company paid the USD 700,000 (CAD\$943,467) of the USD loan, utilising part of the proceeds from the fundraising aligned with the listing on the London Stock Exchange of January 11, 2017.
- (h) In January 2017 the Company issued 668,571 shares, at a deemed price of £0.07 per share, for the settlement of a debt for services of a senior manager of the Company, for an amount of £46,800.
- (i) In January 2017 the Company incurred in expenses for a total amount of £306,628 (CAD\$505,476), related to the admission to the London Stock Exchange listing, as follow:

Role	Cost (£)	Cost (CAD\$)
<i>UK Legal Counsel to the Company</i>	£ 100,000	\$ 164,850
<i>TSX - V share issue costs</i>	£ 18,000	\$ 29,673
<i>Auditors &amp; Reporting Accountants</i>	£ 70,000	\$ 115,395
<i>Registrar</i>	£ 1,300	\$ 2,143
<i>Legal opinion Crest</i>	£ 5,000	\$ 8,243
<i>Prospectus Printers</i>	£ 8,000	\$ 13,188
<i>placings payable</i>	£ 96,128	\$ 158,467
<i>LSE Admission Fees</i>	£ 8,200	\$ 13,518
<b>Total</b>	<b>£ 306,628</b>	<b>\$ 505,476</b>

- (j) In January 2017 the Company entered into an agreement to proceed with a brokered private placement (the "Private Placement") to raise gross proceeds of GBP 855,000 (approximately CAD\$ 1,408,000) through the issue of nine million (9,000,000) new common shares of the Company ("New Common Shares") at a price of GBP 0.095 (approximately CAD\$ 0.1565) per share.

In addition to the New Common Shares, under the Private Placement each subscriber received one warrant (the "Warrant") for every New Common Share purchased. Each Warrant shall entitle the Warrant holder to subscribe for new Common Shares in the Company at a price of GBP 0.15 per common share (approximately CAD\$ 0.247), exercisable at any time until 1 February 2019. The proceeds of the Private Placement will be used to accelerate the Company's field rehabilitation activities in Azerbaijan and increase the number of well workovers scheduled for completion by 31 March 2018.

- (k) On January 25, 2017 the Company issued 3,700,000 shares on the conversion of 311,067 Swiss Francs

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(CAD\$407,000) principal amount of convertible notes.

<b>Outstanding debt As of January 25, 2017</b>	<b>CHF</b>	<b>CAD\$</b>
Principal	CHF 314,953	\$ 412,084
Accrued Interest	CHF 249,758	\$ 327,730
<b>Total to be paid</b>	<b>CHF 564,711</b>	<b>\$ 739,814</b>

<b>Conversion of notes</b>	<b>Shares</b>	<b>CHF</b>	<b>CAD\$</b>
<b>Outstanding principal As of January 25, 2017</b>		CHF 314,953	\$ 412,084
Issued January 2017	3,700,000	-CHF 311,067	\$ -407,000
<b>Remaining</b>		<b>CHF 3,886</b>	<b>\$ 5,084</b>

*Changes calculated using the following current change rate conversion  
(January 25, 2017)*

**Change Rate**

CAD\$/CHF	1.3084
CHF/CAD\$	0.7643

The outstanding amount of convertible note, at the date of this document, is CHF3,886 Swiss Francs (\$5,084) of principal, and CHF249,758 (CAD\$327,730) of accrued interest.

- (l) On February 20, 2017 the Company announced the sale of its operations in Argentina to a group of local energy investors.

Due to a series of circumstances beyond the Company's control, caused by the collapse of a major storage tank owned by the Argentina's national oil company production, Zenith's Argentine operations was still suspended and its oil production could no longer be transported through YPF pipelines.

To date, the issues affecting the transportation of oil have not been fully resolved and a persisting uncertainty on the recommencement of operations has led Zenith to reconsider its operational involvement in Argentina.

The sale of the Company's Argentina subsidiary has been fixed at a nominal sum in recognition of the costs the new owner is expected to incur to return these fields to production. In addition, Zenith will no longer be liable for any environmental responsibilities or future well abandonment obligations for the Don Alberto and Don Ernesto fields.

Termination of activities in Argentina will enable Zenith's management to more effectively direct its focus on its Italian operations and especially towards Azerbaijan, where the Company's most important assets are located, and where a systematic programme of field rehabilitation has begun. This re-alignment reflects the Board's aversion to operational overstretch and the Company's preference for a strong, concentrated focus towards the achievement of its production objectives in Azerbaijan.

- (m) The Stock Options Plan (note 12) has been approved by shareholders of the Company at the Annual General Meeting held on January 20, 2017
- (n) On February 22, 2017 the Company announced that a Director of the Company has exercised his stock

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options to purchase 1,000,000 common shares in the capital of the Company at a price of CAD\$0.10 per Common Share and a total cost of CAD\$100,000.

### 22. Operating segments

The Company's operations are conducted in one business sector, the oil and natural gas industry. Geographical areas are used to identify Company's reportable segments. A geographic segment is considered a reportable segment once its activities are regularly reviewed by the Company's management. The Company has four reportable segments which are as follows:

- Argentina (until February 19, 2017);
- Azerbaijan;
- Italy; and,
- Other, which includes corporate assets and the operations in the Canadian and US entities. None of these individual segments meet the quantitative thresholds for determining reportable segments in 2016 or 2015.

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	December 31, 2016					March 31, 2016				
	Argentina	Azerbaijan	Italy	Other	Total	Argentina	Azerbaijan	Italy	Other	Total
Property and equipment	\$ 3,060,005	1,052,488,882	10,849,356	-	1,066,398,243	3,177,155	-	11,420,934	-	14,598,089
Other assets	\$ 408,794	1,190,239	905,063	249,330	2,753,426	504,125	-	958,825	236,102	1,699,052
Total liabilities	\$ 4,350,857	443,662,115	7,419,521	7,545,651	462,978,144	5,377,969	-	7,134,198	6,063,924	18,576,091
Capital expenditures	\$ -	19,537	84,313	-	103,850	(236,515)	-	(178,406)	-	(414,921)

	Three months ended December 31									
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	Argentina		Azerbaijan		Italy		Other		Total	
Revenue	-	83,904	1,713,838	-	203,490	187,358	-	-	1,917,328	271,262
Royalties	-	7,521	-	-	-	-	-	-	-	7,521
Operating and transportation	278,335	441,855	650,645	-	216,557	20,798	-	-	1,145,537	462,653
General and administrative	122,570	90,960	518,648	-	199,003	159,046	1,058,848	391,106	1,899,069	641,112
Depletion and depreciation	3,261	1,325	210,170	-	107,908	54,273	-	-	321,339	55,598
Transaction costs	-	-	-	-	-	35,536	-	-	-	35,536
Finance and other (income) expenses	(2,822)	(319,900)	(7,599)	-	11,667	51,340	105,829	226,872	107,075	(41,688)
Segment income (loss)	(401,344)	(137,857)	341,974	-	(331,645)	(133,635)	(1,164,677)	(617,978)	(1,555,692)	(889,470)

	Nine months ended December 31									
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	Argentina		Azerbaijan		Italy		Other		Total	
Revenue	78,527	1,283,940	2,372,160	-	533,352	519,232	-	-	2,984,039	1,803,172
Royalties	7,521	115,408	-	-	-	-	-	-	7,521	115,408
Operating and transportation	546,837	1,111,690	1,021,712	-	363,018	217,782	-	-	1,931,567	1,329,472
General and administrative	301,714	501,223	790,649	-	416,572	360,136	2,185,551	1,120,516	3,694,486	1,981,875
Depletion and depreciation	13,459	58,204	319,715	-	191,980	190,998	-	-	525,154	249,202
Transaction costs	-	-	-	-	-	35,536	-	-	-	35,536
Finance and other (income) expenses	(7,260)	(391,070)	(618,153,818)	-	36,157	87,746	236,851	501,185	(617,888,070)	197,861
Segment income (loss)	(783,744)	(111,515)	618,393,902	-	(474,376)	(372,966)	(2,422,402)	(1,621,701)	614,713,380	(2,106,182)