



**ZENITH ENERGY LTD.  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
SIX MONTHS ENDED SEPTEMBER 30, 2018**

This management's discussion and analysis (the "MD&A") dated November 14, 2018 of Zenith Energy Ltd. ("Zenith" or the "Company") is presented in Canadian dollars and should be read in conjunction with the Company's unaudited consolidated financial statements dated September 30, 2018.

The consolidated financial statements have been prepared by management and approved by Zenith's Board of Directors on the recommendation of the Audit Committee. These statements are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may differ materially. The financial data included in this MD&A is in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC") that are effective as at April 1, 2015. The Company has presented its financial statements on a going concern assumption, which assumes that the Company will be able to continue to finance its operations for the foreseeable future and will be able to realise its assets and discharge its liabilities in the normal course of business. Refer to the Business Risks and Uncertainties section of this MD&A for additional information related to identified risks, estimates and uncertainties.

The functional currency of the Company is the Canadian dollar ("CAD\$"); the functional currency of the Company's subsidiaries in Argentina 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 is the Manat; the functional currency of the Company's Swiss subsidiary is the Swiss Franc and the functional currency of the Company's United States subsidiaries is the United States dollar. The Company's presentation currency is the CAD\$. In this MD&A, unless otherwise noted, all dollar amounts are expressed in CAD. References to "US" are to United States dollars, references to "€" are to Euros and references to "GBP" are to British Pounds, references to "AZN" are to Azerbaijan Manats, and references to "CHF" are to Swiss Francs.

The amounts are shown in thousands Canadian dollars (CAD\$'000), British Pounds (£'000) and US Dollars (US\$'000), where not disposed differently.

Additional information related to the Company's business and activities can be found on SEDAR at: [www.sedar.com](http://www.sedar.com).

**BOE Presentation** – Production information is commonly reported in units of barrels of oil equivalent ("boe"). For the purposes of computing such units, natural gas is converted to equivalent barrels of oil using a conversion factor of six thousand cubic feet ("MCF") to one barrel of oil ("bbl"). The conversion ratio of 6:1 is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Such disclosure of boe may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

**Special Note Regarding Non-IFRS Measures** – This MD&A may include references to certain financial measures, as described below, which do not have standardized meanings prescribed by IFRS, however, as these measures are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors and they are measures that the Company uses to evaluate its performance. Investors are cautioned that these non-IFRS measures should not be construed as an alternative to the measures calculated in accordance with IFRS, given their

non-standardized meanings; they may not be comparable to similar measures presented by other issuers. The term “funds from (used in) operations”, defined as the cash flow from operating activities, before the change in non-cash working capital and abandonment expenditures, should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income (loss) as determined in accordance with IFRS as an indicator of performance. The Company’s determination of funds from operations may not be comparable to that reported by other companies.

#### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

Certain information contained in this MD&A is forward-looking relating but not limited to anticipated financial performance, events and strategies. When used in this context, words such as “will”, “anticipate”, “believe”, “plan”, “intend”, “target” and “expect” or similar words suggest future outcomes. By their nature, such statements are subject to significant risks, assumptions and uncertainties, which could cause the Company’s actual results and experience to be materially different than the anticipated results. In particular, forward-looking information and statements include, but are not limited to: (i) expectations related to crude oil and petroleum products prices and demand; (ii) the state of capital markets; (iii) expectations related to operating costs in Azerbaijan and Italy; (iv) variations in the US dollar, Euro, Manat, and Canadian dollar exchange rates; (v) expectations related to regulatory approvals; (vi) management’s analysis of applicable tax legislation; (vii) expectations that the currently applicable and proposed tax laws will not change and will be implemented; (viii) expectation that management will continue to focus its efforts towards acquiring large exploration permits, which offer high exploration potential and the opportunity to act as operator at least for the initial exploration period; (ix) expectation that management will consider acquiring additional producing assets; (x) the capital expenditures required in order to re-commence production on both the Torrente Vulgano and Canaldente concessions; (xi) the ability of the Company to re-commence production on both the Torrente Vulgano and Canaldente concessions by late 2017; (xii) the price of natural gas and of the electricity in Italy; (xiii) the ability of the Company to comply with certain regulatory requirements in Italy; (xiv) the Company’s ability to increase its oil and gas production in the year 2017; (xv) expectations related to the assets producing oil in Azerbaijan named Muradkhanli, Jafarli and Zardab, operated by Zenith Aran Oil Company Limited and (xvi) business strategy and outlook.

These statements are based on certain assumptions and analysis made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments and other factors it believes are appropriate. The material factors and assumptions used to develop these forward-looking statements include, but are not limited to: (i) increased competition; (ii) assumption that operating costs in Azerbaijan and Italy may be reduced in future months and that the oil price in the international markets will continue to improve; (iii) additional financing of the Company is subject to the global financial markets and economic conditions; (iv) the Company will evaluate certain assets located within Azerbaijan and will focus on managing the assets acquired in 2016 with the intention to increase production and cash flows; (v) assumptions related to international oil and natural gas prices; (vi) ability to obtain regulatory approvals; (vii) costs of exploration and development; (viii) availability and cost of labour and management resources; (ix) performance of contractors and suppliers; (x) availability and cost of financing; and (xi) the Company’s business strategy and outlook.

Whether actual results, performance or achievements will conform to the Company’s expectations and predictions is subject to a number of known and unknown risks and uncertainties which could cause actual results to differ materially from the Company’s expectations. Such risks and uncertainties include, but are not limited to risks and uncertainties relating to: (i) volatility of and assumptions regarding commodity prices; (ii) product supply and demand; (iii) market competition; (iv) risks inherent in the Company’s operations; (v) potential disruption or unexpected technical difficulties in developing or maintaining facilities; (vi) risks associated with technology; (vii) Company’s ability to generate sufficient cash flow from operations to meet its current and future obligations; (viii) the Company’s ability to secure external sources of debt and equity as needed; (ix) changes in royalty, tax, environmental, greenhouse gas, carbon, accounting and other laws or regulations or the interpretation of such laws or regulations; (x) political and economic conditions in the countries in which the Company operates; (xi) terrorist threats; (xii) risks associated with potential future lawsuits and regulatory actions made against the Company; (xiii) the performance of counterparties in meeting their obligations under agreements; (xiv) economic conditions; (xv) equipment and labour shortages and inflationary costs; (xvi) fluctuations in foreign exchange rates; (xvii) the effect of weather conditions on operations and facilities; and (xviii) stock market volatility.

Readers are cautioned not to place undue reliance on forward-looking statements as actual results could differ materially from the plans, expectations, estimates or intentions expressed in the forward-looking statements. Forward-looking statements are provided for the purpose of presenting information about management's current expectations and plans relating to the future. Readers are cautioned that such statements may not be appropriate for other purposes.

Except as required by law, the Company disclaims any intention and assumes no obligation to update any forward-looking statement(s) contained in this document.

### **CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

The Company 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.

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.

The Development and Production assets in Azerbaijan are valued using discount factors of 15% and 10% respectively.

The assets acquired in the business combination were acquired in conjunction with capital commitments represented by the deferred consideration payable. The details of these capital commitments are included within the 'Capital costs'.

As at September 30, 2018 and 2017, the Group identified certain business risks related to its Italian and Azerbaijan CGUs, such as a decrease in forecast prices from those in prior years and the deferral of future capital investment, as indicators of impairment. As a result, the Group performed impairment tests at September 30, 2018 and 2017 and estimated the recoverable amount of the above CGUs, based on the higher of the fair value less costs to sell and its value in use.

The estimated fair value less costs to sell the Italian CGU was based on 15% (June 30, 2017 – 15%) discounted cash flows expected to be derived from proved plus probable reserves based on the externally prepared reserve reports at 31 March 2018 and 2017. The estimated recoverable amount of the Italian CGU at September 30, 2018 was higher than its carrying amount, therefore, no impairment was recognized in the six months ended September 30, 2018 (September 30, 2017 – nil) in the consolidated statement of comprehensive income.

The estimated fair value less costs to sell the Azerbaijan CGU was based on 10% (2017 – 10%) discounted cash flows expected to be derived from proved plus probable reserves based on the externally prepared reserve reports at 31 March 2018. The estimated recoverable amount of the Azerbaijan CGU at September 30, 2018 was higher than its carrying amount, therefore, no impairment was recognised in the six months ended September 30, September 2018 (September 30, 2017 - CAD \$nil) in the consolidated statement of comprehensive income. The headroom between the calculated value in use and the carrying amount is sensitive to changes in the discount rate used. A 0.3% increase in the discount rate would eliminate the headroom and therefore any increase in the discount rate above 0.3% would result in an impairment.

### **NATURE OF OPERATIONS, ACQUISITION AND EXPLORATION ACTIVITIES**

Zenith is a public company listed on the TSX Venture Exchange under the ticker symbol, "ZEE", on the Main Market of the London Stock Exchange under the ticker "ZEN", and on the Merkur Market of the Oslo Børs under the ticker "ZEN-**ME**".

The Company was incorporated under the Business Corporations Act (British Columbia) ("BCBCA") on September 20, 2007. The Company's registered address is 250 Howe Street, 20<sup>th</sup> Floor, Vancouver, BC, V6CV 3R8, Canada and its website address is: [www.zenithenergy.ca](http://www.zenithenergy.ca). The Company's primary operational activities are the production and development of hydrocarbon reserves in Azerbaijan and Italy.

On March 10, 2010, Zenith established Ingenieria Petrolera del Rio de la Plata S.r.l. ("IPRP"), a wholly owned subsidiary of Zenith. IPRP was initially incorporated in Buenos Aires, Argentina, to operate producing assets in Argentina. However, as described in subsequent paragraphs, after Petrolera Patagonia S.r.l. was acquired, management saw no

immediate need for IPRP. The company was kept in a dormant state and held in trust by Zenith's trustees in Argentina until late 2011.

On July 20, 2010, Zenith incorporated a wholly owned US subsidiary, Ingenieria Petrolera Patagonia Ltd. ("**IPP**"), to act as the potential acquirer of two US based companies controlling Central Patagonia S.r.l., renamed as Petrolera Patagonia S.r.l., the owner of two producing oil fields in the Chubut Province in Argentina.

On July 22, 2010, Zenith acquired two US based companies, namely Central Patagonia Corporation (renamed Petrolera Patagonia Corporation or "**PPC**") and CPC Holdings (renamed PP Holdings Inc. or "**PPH**") owning respectively 95% and 5% of Central Patagonia S.r.l. (renamed Petrolera Patagonia S.r.l. or "**PPS**"), thereby acquiring two adjacent oil producing assets in Argentina.

On March 23, 2011, Zenith established Canoel Italia S.r.l. ("**Canoel**") an Italian subsidiary of the Company, in order to enable the Company to have an Italian operating entity and thereby have the possibility to be awarded oil and gas production and exploration assets posted for auction by the Italian Ministry for Economic Development.

On August 27, 2011, Canoel. was awarded two natural gas production assets, which were previously on production but are currently shut-in, in an auction by the Ministry of Economic Development. Zenith's bid was accepted on the basis of a comprehensive and detailed presentation outlining a clear programme to return both assets to production. The assets are Torrente Vulgano, located in the Puglia region, and Canaldente, located in the Basilicata region. Both regions are located in southern Italy, which is where the majority of Italian hydrocarbons are produced.

In mid-2012, in line with the Company's strategy to increase its involvement in Italy through its Italian subsidiary, Zenith commenced negotiations to purchase production and exploration permits from an established natural gas production company, Mediterranean Oil & Gas Plc, a British company with activities in Italy, France and Malta, listed on the AIM of the London Stock Exchange.

On June 6, 2013, the Company completed the acquisition of various working interests in 13 Italian production and exploration assets (the "**Assets**") from Medoilgas Italia S.P.A. and Medoilgas Civita Limited, each a subsidiary of Mediterranean Oil and Gas Plc (collectively, "**MOG**") after receiving final approval from the Italian Ministry for Economic Development for the change of ownership. The Assets are comprised of (i.) 6 operated onshore gas production concessions: Masseria Grottavecchia (20% working interest), San Teodoro (100% working interest), Torrente Cigno (45% working interest), Misano Adriatico (100% working interest), Sant'Andrea (40% working interest) and Masseria Petrilli (50% working interest); (ii.) 3 non-operated onshore gas production concessions: Masseria Acquasalsa (8.8% working interest), Lucera (13.6% working interest) and San Mauro (18% working interest) (collectively, the "**Gas Licenses**"); (iii.) an operated exploration permit: Montalbano (57.15% working interest) (the "**Exploration Permit**"); and (iv.) 3 exploration permit applications: Serra dei Gatti (100% working interest), Villa Carbone (50% working interest) and Colle dei Nidi (25% working interest) (the "**Exploration Applications**").

Most of the Gas Licenses are located onshore in southern Italy, in the regions of Puglia, Basilicata, Molise, Abruzzo and Marche. The Exploration Permit and Exploration Permit Applications are located in southern Italy and cover an area of 1,285 sq. kilometres.

On October 1, 2015, the Company acquired cogeneration equipment and infrastructure from the owner of the plant that treats gas from the Masseria Vincelli 1 well in the Torrente Cigno concession in Italy. The acquisition has enabled the Company to produce electricity using Torrente Cigno' sub-standard natural gas production from the Masseria Vincelli 1 well and sell it directly into the national grid.

In September 2015, the Company opened an office in Baku, the capital of Azerbaijan. In October 2015, the Republic of Azerbaijan issued a Presidential Decree which authorised the State Oil Company of the Azerbaijan Republic ("**SOCAR**") to negotiate a Rehabilitation, Exploration, Development and Production Sharing Agreement ("**REDPSA**") with Zenith pursuant to which Zenith would receive the rights and obligations to an 80% participating interest in current and future production from three producing onshore oil fields named Muradkhanli, Jafarli and Zardab, known as the Muradkhanli Area (the "**Area**"), covering 642.4 sq. kilometres.

The REDPSA was executed on March 16, 2016 between SOCAR, Zenith Aran and SOCAR Oil Affiliate ("**SOA**"), a 100% owned subsidiary of SOCAR. On June 20, 2016, upon ratification by the Parliament of the Republic of Azerbaijan, the REDPSA was enacted into Azerbaijan national law.

On August 11, 2016, the handover of the Azerbaijan assets was formally completed, with the necessary signatures on related documents, and the Company commenced crude oil production of approximately 275 bopd under Zenith's ownership. The REDPSA therefore became effective on August 11, 2016.

On February 20, 2017, Zenith announced the divestment of its operations in Argentina to a group of local energy investors. The divestment of the Company's oil production activities in Argentina has enabled Zenith's management to direct undistracted focus towards Zenith's operations in Azerbaijan, where a systematic programme of field rehabilitation is underway, as well as enabling the consolidation of its Italian energy production portfolio. The divestment reflects the Board's aversion to operational overstretch, and the Company's preference for a strong, undistracted focus towards the achievement of its operational goals in Azerbaijan.

On March 30, 2017, Zenith acquired a Swiss company, Altasol SA, a non-operating company, purchased with the intention of developing an oil trading subsidiary of Zenith.

On July 29, 2017, the Company established an oilfield services subsidiary company, Zena Drilling Limited ("**Zena**"), incorporated in the Ras Al Khaimah Free Trade Zone ("**RAKFTZ**"), in the United Arab Emirates ("**UAE**"). Zena is a 100% beneficially owned subsidiary of the Company. Zena was incorporated by, and the shares in Zena are currently registered in the name of, Mr Andrea Cattaneo as pro bono trustee of the Company. Due to the process of incorporation in RAKFTZ, this was the most efficient method of establishing Zena on account of the fact that the UAE is not a signatory to The Hague Convention Abolishing the Requirement of Legalisation for Foreign Public Documents and the process of transferring legal ownership to Zenith is lengthy and not expected to be completed before the close of 2018.

On November 2, 2017, Zenith was a founding party in a newly incorporated Italian entity named 'Leonardo Energy Consulting S.r.l.' ("**Leonardo**"). The Company holds a 48 percent interest in Leonardo. The primary purpose of this subsidiary is the identification of business development opportunities in Central Asia and in the Middle East.

On March 28, 2018, the Company announced that it had entered into a binding exclusivity and an option to purchase agreement (the "**Agreement**") for the possible acquisition of an oil production asset located in Indonesia (the "**Proposed Acquisition**").

The Proposed Acquisition envisaged the Company acquiring a 100% working interest in an oil production licence comprising two onshore blocks, with a combined total acreage covering approximately 65 sq. kilometres.

Existing production was reported as in excess of 1,000 barrels of oil per day transported by pipeline directly into the national oil sales system with a reported all-in average production cost of US\$18 per barrel.

The oilfields are located in a prolific oil and gas basin with a proven petroleum system. At the time of the Proposed Acquisition it was reported that only one of the two oilfields was producing. The second oilfield was reported to be capable of significant production by drilling new wells and performing workovers on existing wells. In addition, it was also reported that drilling activities could be performed at relatively low-cost and without significant delay. The average total depth of production wells in the licence area of the Proposed Acquisition was reported to be between 350 to 750 metres.

The approved development programme for the licence area of the Proposed Acquisition, involving the drilling of new wells and the introduction of new oil production technology, was reported to be able to achieve a doubling of production from the Proposed Acquisition by 2020.

The Chief Executive Officer and President of the Company made a down payment of US\$100,000 by April 15, 2018 (the "**Deposit**"). After completing the Due Diligence, the Company would have a period of 15 days to choose to exercise the binding option to complete the Proposed Acquisition (the "**Option**") for a total consideration of US\$6,600,000 (the "**Consideration**"). The Consideration shall be payable as to 50 per cent., (US\$3,300,000), within 7 business days of exercising the Option (the "**First Payment**"), and the balance, (US\$3,300,000), payable by the deadline of August 31, 2018.

On May 16, 2018 the Company announced that its due diligence of the Proposed Acquisition in Indonesia, encompassing an evaluation of the legal, accounting, petroleum and fiscal aspects of the Proposed Acquisition, was in progress and that the Company now expected to complete the Due Diligence by June 15, 2018. The extension enabled the Company to further examine certain areas of the Proposed Acquisition that required clarity to satisfy the Company's stringent Due Diligence requirements. The Company also announced that it had decided to defer a decision on whether to proceed with the Proposed Acquisition until the second half of 2018 in order to focus on implementing its operational strategy in Azerbaijan.

On 16 July 2018, the Company announced that the due diligence report of the Proposed Acquisition's financial statements of the entity in Indonesia evidenced a number of discrepancies. Management visited Indonesia during July 2018 to undertake further pricing negotiations with the ultimate vendor of the Proposed Acquisition based on the findings of the due diligence report. However, the ultimate vendor refused to accept the Company's offer which had been formulated on the basis of the findings of the aforementioned due diligence report.

Zenith's Board of Directors therefore decided not to proceed with the completion of the Proposed Acquisition due to the vendor's refusal to renegotiate the total consideration. As aforementioned, the accounting due diligence process had evidenced negative discrepancies exceeding 5% of the book values declared in the Proposed Acquisition's financial statements dated February 28, 2018.

In addition, the vendor and Zenith maintain different views regarding the return of the deposit advanced by Andrea Cattaneo, Chief Executive Officer & President of the Company, in good faith and support of the Proposed Acquisition. Zenith and Andrea Cattaneo consider the retention of the deposit by the vendor to be contrary to the mutually agreed terms and the parties' intentions. The Company and Mr. Andrea Cattaneo are evaluating which steps can be taken in order to recover the deposit.

### **DEVELOPMENT AND EXPLORATION ACTIVITIES**

The Company conducted the following development activities in Azerbaijan, Italy and in new subsidiary Zena Drilling as noted below:

|                      | <b>Six months ended<br/>September 30 (CAD\$'000)</b> |             |
|----------------------|--|-------------|
|                      | <b>2018</b>  | <b>2017</b> |
| Capital additions    |  |             |
| Azerbaijan           | <b>37</b>  | <b>876</b>  |
| Italy                | <b>28</b>  | <b>55</b>   |
| United Arab Emirates | <b>296</b>   | <b>-</b>    |
|                      | <b>361</b>   | <b>931</b>  |

### **HIGHLIGHTS FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2018 INCLUDE THE FOLLOWING:**

#### **OPERATIONAL:**

- During the three and six months ended September 30, 2018 the Company produced 22,133 and 45,523 bbls of oil from its assets in Azerbaijan, as compared to 23,095 and 47,954 bbls of oil produced in the 2017 similar period.
- During the three and six months ended September 30, 2018 the Company sold 18,813 and 38,695 bbls of oil from its assets in Azerbaijan, as compared to 19,292 and 42,682 bbls of oil sold in the 2017 similar period.

At the end of September 2018, there were 140 bbls of unsold oil production in Azerbaijan held in inventory which were sold in subsequent months.

- During three and six months ended September 30, 2018, the Company sold 2,641 and 3,978 mcf of natural gas from its Italian assets as compared to 4,831 and 9,621 mcf of natural gas in the 2017 similar period.
- During the three and six months ended September 30, 2018, the Company sold 182 and 610 bbls of condensate from its Italian assets as compared to 264 and 488 bbls of condensate in the 2017 similar period, with an increase of 25% in the six months ended 30 September 2018.
- During the three and six months ended September 30, 2018, the Company sold 1,883 and 4,566 MWh of electricity from its Italian electricity production assets as compared to 2,741 and 5,263 MWh for the corresponding period of 2017.
- On June 6, 2018, the Company's oilfield service subsidiary, Zena Drilling Limited, ("Zena"), signed a six-month rental agreement with B Robotics W S.r.l., ("Robotics"), a leading Italian drilling rig manufacturer, for a BD-260 type Robotics drilling rig.

Zena has contracted the BD-260 drilling rig in order to complete the Company's planned workover and drilling activities in the Zardab and Muradkhanli fields during the six-month period.

Transportation of the BD-260 rig from one operation site to the next one in the Zardab field is expected to be relatively fast on account of the proximity of the Z-21, Z-28 and Z-3 well locations.

- On June 25, 2018, the Company's oilfield service subsidiary, Zena Drilling Limited, ("**Zena**"), signed a revised commitment letter (the "**Revised Commitment Letter**") for the operating lease of a Genesis BQ500 onshore drilling rig ("**BQ500**") with Olieum Services WLL ("**Olieum**"), an integrated oilfield services and equipment joint venture based in Bahrain. The Revised Commitment Letter superseded the letter signed on November 1, 2017 and it includes more favourable terms for the Company in a number of areas.

The BQ500 is a 2,000hp automated hydraulic drilling rig built by Robotics.

- On July 16, 2018, the Company announced that the due diligence report of the Proposed Acquisition's financial statements of the entity in Indonesia uncovered certain discrepancies. Management visited Indonesia during July 2018 to undertake further pricing negotiations with the ultimate vendor of the Proposed Acquisition based on the findings of the due diligence report. However, the ultimate vendor refused to renegotiate the total consideration in reflection of the aforementioned discrepancies identified in the due diligence report.

Zenith's Board of Directors therefore decided not to proceed with the completion of the Proposed Acquisition due to the vendor's refusal to renegotiate the total consideration. As aforementioned, the accounting due diligence process evidenced negative discrepancies largely exceeding 5% of the book values declared in the Proposed Acquisition's financial statements dated February 28, 2018.

In addition, the vendor and Zenith maintained different positions regarding the return of the deposit advanced by Andrea Cattaneo, Chief Executive Officer & President of the Company, in good faith and support of the Proposed Acquisition. Zenith and Andrea Cattaneo consider the retention of the deposit by the vendor to be contrary to the mutually agreed terms and the parties' intentions.

- On August 13, 2018 the Company completed two comprehensive geological studies to optimise the selection of potential drilling locations and workover opportunities across the Muradkhanli, Jafarli and Zardab oilfields. The studies have provided a significantly enhanced understanding of the hydrocarbon production of the Company's operations in Azerbaijan which will have a direct influence in shaping the Company's operational activities going forward.
- On September 5, 2018, the fully owned subsidiary Zena Drilling Limited signed a purchase agreement for the acquisition of a BD-260 drilling rig assembled by B Robotics W S.r.l., for a total consideration of €2,250,200. The agreement supersedes the six-month rental agreement Zena had signed with Robotics for the BD-260 drilling rig dated June 6, 2018. In addition, Robotics confirmed it would provide its highly experienced drilling personnel for a minimum of 6 months as part of the aforementioned agreement. In addition, the Company announced that it was formalising a tender process in Azerbaijan for the leasing of a 180-ton truck-mounted workover and drilling rig for a period of four months.

#### **FINANCIAL:**

- The Group generated revenues from oil and natural gas of CAD\$3,803 (2017 – CAD\$2,465) and from electricity CAD\$321k (2017 – CAD\$317) in the six months ended September 30, 2018 representing an increase of 12.8% in revenues than the corresponding period of 2017.
- On April 18, 2018 the Company announced the extension of the maturity date of the Series A Bond (the "**Bond Extension**"). The Bond Extension extends the maturity date for the Series A Bond from May 4, 2018 by six months to November 4, 2018. For the duration of the Bond Extension the interest rate of the Series A Bond has been increased to fifteen per cent per annum (15% p.a.). No further material terms will be amended in the Series A Bond or in any other document related to the 2015 Private Placement.

Furthermore, in connection with the work undertaken on the Bond Extension, Optiva Securities Limited, the Company's joint broker, will be paid a fee consisting of (i) £10,125 in cash (CAD\$18,141 at an exchange rate of 1.79167); and (ii) 93,750 common share purchase warrants ("**Warrants**"). The Warrants entitle the holder to acquire one common share per warrant in the capital of Zenith at an exercise price of £0.12 (approximately CAD\$0.215) until the expiration date in May 2021.

- On May 2, 2018, the Group fully repaid the loan to acquire the Italian co-generation plant from a third party of which €401k (CAD\$637k) of the purchase price was in the form of a loan from the seller.

- On May 4, 2018 Mr. Cattaneo swapped part of his salary for the 2018 financial year for common shares in Zenith Energy Ltd. As a result, the Company issued Mr Andrea Cattaneo 1,123,068 common shares in the capital of the Company at an average price of CAD\$0.165 (approximately £0.094) for the period from April 1, 2017 until March 31, 2018. The amount of the Salary Sacrifice Shares was calculated based on Mr Cattaneo's salary as at April 1, 2017.
- On May 24, 2018 the Company signed a two-year non-convertible loan facility, (the "**Facility**"), for a total amount of up to US\$2,000,000.

The Facility will be used to provide additional funding for the Group's operations when required. It will be drawn down in tranches, with each tranche being payable four months from the drawdown date. It can be settled at any time without penalty and has no warrants attached.

- On June 21, 2018, the Company raised gross proceeds amounting to £2,166,898 through the successful Placing, Subscription and Primary Bid Offer.

As a result of the Placing, Subscription and Primary Bid Offer the Company issued a total of 54,172,451 new common shares, (the "**New Common Shares**").

The Company also paid finder's fees for CAD\$187k and issued 1,280,000 warrants, that could be exercised at a price of CAD\$0.07 per warrant that expire three years after the granting date.

- On September 5, 2018, the Company announced that it had entered into a US\$1,500,000 unsecured convertible loan facility (the "**Facility**") with a term of 18 months starting from August 30, 2018. Zenith shall pay interest on the outstanding amount of the Facility at the rate of 0% per annum. The Facility includes an initial immediate advance of US\$1,300,000 and a further advance of US\$200,000, to be provided at a later time and only at the discretion of the Lenders. Under the terms of the Facility the Company issued the lenders 6,977,988 share purchase warrants (the "**Warrants**") to subscribe for the equivalent number of common shares of no par value in the share capital of the Company at a price of £0.0505 per Common Share on subscription at any time from December 30, 2018 to February 28, 2020 subject to the articles of the Company and the terms and conditions of the Facility.

#### **CORPORATE AND ADMINISTRATIVE:**

- The Company continues to improve its accounting and administrative practices.
- In accordance with the Company's Stock Option Plan on April 5, 2018 the Board of Directors resolved to grant its directors, certain employees and consultants a total of 10,500,000 stock options (the "**Options**"). A total of 9,500,000 Options have been granted to directors and persons discharging managerial responsibility ("**PDMRs**"). Further details of the Options awarded to directors and PDMRs are outlined below. The exercise price of the Options is equivalent to the Company's TSXV closing price of March 26, 2018, being CAD\$0.12 (approximately £0.067). The Options are fully vested and expire five years from the date of granting.

#### **SUBSEQUENT EVENT HIGHLIGHTS:**

- a) On October 2, 2018, the Company's Chief Executive Officer & President, Mr. Andrea Cattaneo advised the Company that he had swapped his salary for the first two quarters of the 2019 financial year in exchange for common shares in the capital of Zenith ("**Salary Sacrifice Shares**"). As a result, on October 1, 2018, the Company issued Mr. Cattaneo 2,225,941 Salary Sacrifice Shares at an average price of CAD\$0.108 for the period from April 1, 2018 to June 30, 2018, and at an average price of CAD\$0.069 for the period from July 1, 2018 to September 30, 2018. The amount of Salary Sacrifice Shares was calculated on the basis of Mr. Cattaneo's salary as at October 1, 2018.
- b) On October 10, 2018 ARC Ratings, SA. ("**ARC Ratings**") assigned the Company a medium to long-term issuer credit rating of "B+" with Positive Outlook.
- c) On October 22, 2018, the Company announced that additional geological and reservoir investigations had enabled the Company to identify a new structure in the Middle Eocene and Upper Cretaceous formations of the Jafarli field.



- d) On November 7, 2018 the Company announced that it had received approval for admission to trading of its entire common share capital on the Merkur Market of the Oslo Børs (the "Merkur Market"). The Merkur Market is a multilateral trading facility owned and operated by the Oslo Børs. In addition, in order to satisfy the Merkur Market admission requirements the Company completed a private placement with Norwegian investors (the "Private Placement"). The Private Placement successfully raised gross proceeds of NOK 7,273,850 (approximately £668,300 or CAD\$1,141,600) through the placement of 20,782,429 common shares of no-par value (the "Placement Shares") at a subscription price of NOK 0.35 per share (approximately £0.032 or CAD\$0.055 per Placement Share). No Insider/Person Discharging Managerial Responsibility subscribed for Placement Shares. Following issuance of the Placement Shares, the Company will have a total of 237,102, 587 Common Shares in issue. 237,102,587 Common Shares will be admitted to trading on the Merkur Market and listed on the TSX Venture Exchange in Canada. The Company announced that an application for the Placement Shares to be listed on the standard segment of the UK Official List and to be admitted to trading to the Main Market of the London Stock Exchange will be made within 12 months of the issue of the Placement Shares; the number of Common Shares listed on the standard segment of the UK Official List and to be admitted to trading to the Main Market of the London Stock Exchange remains at 216,320,158.
- e) On November 12, 2018, the Company announced that it had successfully completed a private placement on the Merkur Market of the Oslo Børs with Norwegian investors raising gross proceeds of NOK 1,000,000 (approximately £91,700 or CAD\$157,000) through the placement of 2,857,143 common shares of no par value (the "Placement Shares") at a subscription price of NOK 0.35 per Placement Share (approximately £0.032 or CAD\$0.055).

## OPERATIONAL UPDATE

### ITALY

In August 2009, the Italian Ministry for Economic Development announced an auction for three previously producing natural gas production assets owned and operated by Eni, the Italian oil and gas major. Zenith's Italian subsidiary, Canoel Italia S.r.l ("Canoel"), participated in the auction process for two assets, was selected as a finalist in the auction process, and was subsequently awarded the two assets.

On August 30, 2011, the Company announced that the Italian "Ministero per lo Sviluppo Economico" (the Ministry for Economic Development) confirmed in writing that Zenith's technical submission and proposal to return these assets to production had been approved.

These two natural gas production assets are both located in southern Italy. The first asset, named "Torrente Vulgano", is located in the Puglia Region, whilst the second, named "Canaldente", is located in the Basilicata Region. Both assets are already connected to the Italian national gas distribution network and therefore do not require the installation of new infrastructure.

The Torrente Vulgano and Canaldente concessions were previously operated by Italian oil major ENI. In the four-year period prior to the assets being returned to the Ministry for Economic Development by ENI, (1997-2000), the Torrente Vulgano concession was producing an average of 7,900 standard cubic meters (m<sup>3</sup>) per day (278,949 standard cubic feet (MCF) per day, using a conversion rate of 1 m<sup>3</sup> = 35.31 MCF).

Canoel will have to comply with certain Italian regulatory obligations before field start-up. Production will commence once all the necessary approvals have been received. However, there can be no assurance that production of the Torrente Vulgano and Canaldente assets will be resume at past rates. It is worth noting that the Canaldente reservoir appears to be a good candidate for gas storage when the well will eventually be shut-in at the end of commercial production cycle.

On August 27, 2011, Canoel was approved in its role as operator by the relevant Italian authorities and is currently submitting environmental reports and conducting the final assessment of on-site equipment.

On June 6, 2013, the Company completed the acquisition of various working interests in 13 Italian producing and exploration assets from Medoilgas Italia S.P.A. and Medoilgas Civita Limited, each a subsidiary of Mediterranean Oil and Gas Plc after receiving the final approval from the Italian Government for the change of ownership.

On October 1, 2015, the Company acquired cogeneration equipment and facilities which has enabled the company to produce electricity from the natural gas produced from the Masseria Vincelli 1 well, and to sell its electricity production directly into the national energy grid.

The Company's share of estimated total proved plus probable natural gas net reserves were assessed at 16,400 Mmscf and condensate net reserves were assessed at 257 Mbbls as of March 31, 2018.

## **AZERBAIJAN**

On June 8, 2015, the Company and SOCAR (State Oil Company of the Azerbaijan Republic) signed a confidential memorandum of understanding ("**MOU**") for the Muradkhanli Area. Formal approval of the MOU was subsequently granted by the President of Azerbaijan through Decree No. 1439, dated October 7, 2015 ("**Presidential Decree**"). This authorised SOCAR to prepare and execute a Rehabilitation, Exploration, Development and Production Sharing Agreement ("**REDPSA**") for the Muradkhanli Area between the Company and SOCAR on behalf of the Republic of Azerbaijan.

The REDPSA was executed on March 16, 2016 between SOCAR, Zenith Aran and a SOCAR Oil Affiliate ("**SOA**"), a 100% owned subsidiary of SOCAR. The REDPSA became effective on June 20, 2016, upon ratification by the Parliament of the Republic of Azerbaijan, and the Company's rights and obligations under the REDPSA became enacted into Azerbaijan national law.

The REDPSA covers approximately 642.4 square kilometres and includes the active Muradkhanli, Jafarli and Zardab oilfields located in the Lower Kura Region, about 240 kilometres inland from the city of Baku, Azerbaijan.

Pursuant to the REDPSA, the Company holds an 80% participating interest both the Contract Rehabilitation Area and the Contract Exploration Area; SOA holds the remaining 20% participating interest. Together, the Company and a SOA form the contractor group.

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

On June 14, 2016, the REDPSA for the Area Including the Muradkhanli, Jafarli and Zardab oilfield in the Republic of Azerbaijan was ratified by the Parliament of Azerbaijan.

In June 2016, the Company established Aran Oil Operating Company Limited, an 80% owned subsidiary of Zenith Aran, to serve as operator of the REDPSA.

On June 24, 2016, the President of the Republic of Azerbaijan signed the REDPSA into law, following parliamentary ratification on June 14, 2016.

On August 11, 2016 the handover of the Azerbaijan assets was formally completed with the necessary signatures on related documents, and the Company commenced crude oil production at approximately 300 bopd.

The Company's share of estimated total proved plus probable natural oil net reserves was assessed at 32,103 MSTB as of March 31, 2017.

On August 21, 2017 the Company announced that it had signed a contract for the procurement of oil production materials with Kerui Petroleum, a leading Chinese manufacturer of oilfield equipment.

The total value of the procurement contract between Kerui Petroleum and Zenith is US\$1,706k (approximately £1,325k; CAD\$ 2,146k). The terms of payment have been defined in accordance with INCOTERMS 2010 and will take place within 1 year of the contract's effective date. Zenith will pay 15 percent of the total contract value in advance as deposit.

The procurement of this new equipment will enhance Zenith's operational capabilities, enable the Company's personnel to work in remote field locations, and replenish Zenith's stock of oil production materials.

The materials procured include: a blowout preventer (BOP); a full set of well control equipment; drill pipes to be used as a work string; tubing to be used in the installation of new electric submersible pumps and in old wells that have been returned to production; new oilfield infrastructure; lighting equipment; and a generator system to enable a workover rig to operate without the need for nearby infrastructure across Zenith's 642.4 sq. kilometres field area.

The procurement of these materials evidences Zenith's preference towards employing its own equipment and resources across its operational activities. This ensures lower costs, direct accountability, and comprehensive oversight of the Company's operations. The Company's stock of oilfield equipment will also avoid the risk of Zenith's

operations being affected by third-party delays in supplying equipment that the Company's systematic field rehabilitation activities require on an immediate basis.

The Company's share of estimated total proved plus probable oil net reserves were assessed at 31,735 MSTB as of March 31, 2018.

## OTHER ACTIVITIES

In addition to the activities discussed above, the Company is examining a number of opportunities for value-accretive expansion with the potential acquisition of additional oil and gas producing assets in established oil production regions.

- On March 30, 2017, the Company acquired a Swiss company, Altasol SA. Altasol SA does not hold any assets and was purchased with the intention of developing an oil trading subsidiary of Zenith Energy Ltd.
- On July 29, 2017, the Company established an oilfield services subsidiary company, Zena Drilling Limited ("**Zena**"), incorporated in the Ras Al Khaimah Free Trade Zone ("**RAKFTZ**"), in the United Arab Emirates ("**UAE**"). Zena is a 100% beneficially owned subsidiary of the Company. Zena was incorporated by and the shares in Zena are currently registered in the name of Mr Andrea Cattaneo as pro bono trustee for the Company. Due to the process of incorporation in RAKFTZ, this was the most efficient method of forming a new company since the UAE is not a signatory to The Hague Convention Abolishing the Requirement of Legalisation for Foreign Public Documents. The process of transferring legal ownership to Zenith could be quite lengthy and is not expected to be completed until later in 2018.
- On November 2, 2017, Zenith was a founding party in a newly incorporated Italian company named 'Leonardo Energy Consulting S.r.l.'. The Company holds a 48 percent interest in the entity. The primary purpose of the company is the identification of business development opportunities in Central Asia and the Middle East.
- On March 28, 2018 the Company announced that it had entered into a binding exclusivity and an option to purchase agreement (the "**Agreement**") for the possible acquisition of an oil production asset located in Indonesia (the "**Proposed Acquisition**").
- On March 28, 2018 the Company announced that Mr Andrea Cattaneo, the Chief Executive Officer and President of the Company, had agreed to make a down payment of US\$100,000 by April 15, 2018 (the "**Deposit**"). After completing the Due Diligence, the Company had a period of 15 days during which it could exercise the binding option to complete the Proposed Acquisition (the "**Option**") for a total consideration of US\$6,600,000 (the "**Consideration**"). The Consideration was to be payable as to 50 per cent., (US\$3,300,000), within 7 business days of exercising the Option (the "**First Payment**"), and the balance, (US\$3,300,000), payable by the deadline of August 31, 2018.
- On April 16, 2018 the Company announced that, in agreement with the vendor, it had extended the completion deadline for the due diligence until May 15, 2018. Zenith also announced that Mr. Cattaneo had advised the Company that the Deposit had been paid in full.
- On May 16, 2018 the Company announced that its due diligence of the Proposed Acquisition in Indonesia, encompassing an evaluation of the legal, accounting, petroleum and fiscal aspects of the Proposed Acquisition, was in progress and that the Company expected to complete the Due Diligence by June 15, 2018. The due diligence report of the Proposed Acquisition's financial statements of the entity in Indonesia uncovered certain discrepancies. Management visited Indonesia during July 2018 to undertake further pricing negotiations with the ultimate vendor of the Proposed Acquisition based on the findings of the due diligence report. However, the ultimate vendor decided not to accept the Company's proposal. Zenith's Board of Directors has therefore agreed not to proceed with the completion of the Proposed Acquisition due to the vendor's refusal to renegotiate the total consideration. As aforementioned, the accounting due diligence process evidenced negative discrepancies largely exceeding 5% of the book values declared in the Proposed Acquisition's financial statements dated February 28, 2018. In addition, the vendor and Zenith maintained different positions regarding the return of the deposit advanced by Andrea Cattaneo, Chief Executive Officer & President of the Company, in good faith and IN support of the Proposed Acquisition. The Company and Mr. Andrea Cattaneo consider the retention of the deposit by the vendor to be contrary to the mutually agreed terms and the parties' intentions.
- On 16 July 2018, the Company announced that the Board of Directors had decided not to proceed with completion of the Proposed Acquisition due to the vendor's refusal to renegotiate the total consideration required to complete the Proposed Acquisition in consideration of the due diligence accounting report

evidencing negative discrepancies largely exceeding 5 percent of the book values declared in the Proposed Acquisition's financial statements dated February 28, 2018.

## **FINANCIAL PERFORMANCE**

The following table summarizes key financial indicators for the six months ended September 30:

|  | Three months ended<br>September 30 |         | Six months ended<br>September 30 |         |
|--|------------------------------------|---------|----------------------------------|---------|
|  | 2018                               | 2017    | 2018                             | 2017    |
| Oil and gas revenue, net of royalties (\$'000)       | <b>2,089</b>                       | 958     | <b>3,803</b>                     | 2,471   |
| Oil and gas revenue, net of royalties – per boe (\$) | <b>91.80</b>                       | 47.05   | <b>81.27</b>                     | 55.18   |
| Total daily oil and gas sales volumes per boe        | <b>211</b>                         | 221     | <b>219</b>                       | 245     |
| Electricity revenue(\$'000)                          | <b>154</b>                         | 157     | <b>321</b>                       | 284     |
| Electricity gas sales volumes per mcf (\$)           | <b>5.00</b>                        | 8.36    | <b>4.53</b>                      | 7.61    |
| Net income (loss) (\$'000)                           | <b>(655)</b>                       | 106     | <b>(3,277)</b>                   | 421     |
| Net income (loss) per share – basic (\$)             | <b>(0.02)</b>                      | 0.01    | <b>(0.01)</b>                    | 0.01    |
| Net income (loss) per share – diluted (\$)           | <b>(0.01)</b>                      | 0.01    | <b>(0.01)</b>                    | 0.01    |
| Capital expenditures (\$'000)                        | <b>263</b>                         | 931     | <b>361</b>                       | 931     |
| Weighted average number of shares – basic ('000)     | <b>194,232</b>                     | 123,655 | <b>194,232</b>                   | 123,655 |
| Weighted average number of shares – diluted ('000)   | <b>232,331</b>                     | 170,849 | <b>232,331</b>                   | 170,849 |

## **PRODUCTION**

|   | Three months ended<br>September 30 |        | Six months ended<br>September 30 |        |
|---|------------------------------------|--------|----------------------------------|--------|
|   | 2018                               | 2017   | 2018                             | 2017   |
| <b><u>Total volumes</u></b>             |                                    |        |                                  |        |
| Oil (bbls) <sup>(1)</sup>               | <b>22,133</b>                      | 23,095 | <b>45,523</b>                    | 47,954 |
| Condensate (bbls) <sup>(2)</sup>        | <b>182</b>                         | 264    | <b>610</b>                       | 487    |
| Gas (mcf) <sup>(2)</sup>                | <b>2,641</b>                       | 4,831  | <b>3,978</b>                     | 9,621  |
| Total oil and gas sales volumes (boe)   | <b>22,755</b>                      | 24,164 | <b>46,796</b>                    | 50,045 |
| Electricity (gas) sales volumes (mcf)   | <b>30,811</b>                      | 18,768 | <b>70,849</b>                    | 37,315 |
| Total sales volumes (boe)               | <b>27,890</b>                      | 27,292 | <b>58,604</b>                    | 56,264 |
| <b><u>Daily volumes</u></b>             |                                    |        |                                  |        |
| Oil (bbls/day) <sup>(1)</sup>           | <b>241</b>                         | 251    | <b>249</b>                       | 262    |
| Condensate (bbls/day)                   | <b>2</b>                           | 3      | <b>3</b>                         | 3      |
| Gas (mcf/day)                           | <b>29</b>                          | 53     | <b>22</b>                        | 53     |
| Total daily oil and gas sales volumes   | <b>247</b>                         | 263    | <b>226</b>                       | 274    |
| Daily gas sales volumes for electricity | <b>335</b>                         | 206    | <b>387</b>                       | 204    |
| Total daily sales volumes (boe/day)     | <b>303</b>                         | 300    | <b>320</b>                       | 307    |

- During the three and six months ended September 30, 2018 the Company produced 22,133 and 45,523 bbls of oil from its assets in Azerbaijan, as compared to 23,095 and 47,954 bbls of oil produced in the 2017 similar period.

- During the three and six months ended September 30, 2018 the Company sold 18,813 and 38,695 bbls of oil from its assets in Azerbaijan, as compared to 19,292 and 42,682 bbls of oil sold in the 2017 similar period. At the end of September 2018, there were 140 bbls of unsold oil production in Azerbaijan held in inventory which were sold in subsequent months.
- During three and six months ended September 30, 2018, the Company sold 2,641 and 3,978 mcf of natural gas from its Italian assets as compared to 4,831 and 9,621 mcf of natural gas in the 2017 similar period.
- During the three and six months ended September 30, 2018, the Company sold 182 and 610 bbls of condensate from its Italian assets as compared to 264 and 488 bbls of condensate in the 2017 similar period, with an increase of 25% in the six months ended 30 September 2018.
- During the three and six months ended September 30, 2018, the Company sold 1,883 and 4,566 MWh of electricity from its Italian electricity production assets as compared to 2,741 and 5,263 MWh for the corresponding period of 2017.

### **Azerbaijan Crude Oil Production**

On March 16, 2016, the Company's wholly-owned subsidiary, Zenith Aran, entered into a REDPSA with SOCAR and a SOA. The REDPSA covers 642.4 sq. kilometres including the active Muradkhanli, Jafarli and Zardab oilfields located in the Lower Kura Region, about 240 kilometres inland from the city of Baku (the "**Azerbaijan Operations**").

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, was officially completed on August 11, 2016, when Zenith began production activities. The transfer of operational control did not result in any interruption of oil production operations.

Following the successful handover on August 11, 2016 Zenith began oil production activities in Azerbaijan. During the period from August 11, 2016 to September 30, 2016 the Company produced approximately 300 bopd. Natural gas is also produced in low quantities and is used onsite. 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% on total sales is payable to SOCARMO.

During the financial year ended March 31, 2018, the Group produced 97,471 bbls of oil and sold 81,745 bbls of oil from its assets in Azerbaijan. There is no exact comparative data for the year ended March 31, 2017 because the effective handover data, and the consequent beginning of operations was August 11, 2016.

Production from a number of the Group's wells in Azerbaijan was suspended during Q3 as a result of field rehabilitation operations, specifically the installation of electrical submersible pumps and well interventions. Daily production from the field was also affected as a result of the Group receiving faulty chemical to treat its oil production from an international chemical supplier. The Group is now seeking to have the faulty chemical replaced and has ordered new chemical supplies to avoid similar problems being incurred in future.

### **Italy Natural Gas Production**

During three and six months ended September 30, 2018, the Company sold 2,641 and 3,978 mcf of natural gas from its Italian assets as compared to 4,831 and 9,621 mcf of natural gas in the 2017 similar period.

Daily average gas sale volumes for electricity produced from the Torrente Cigno concession for the six months ended September 30, 2018 was 335 MCF/d.

### **Italy Condensate Production**

During the three and six months ended September 30, 2018, the Company sold 182 and 610 bbls of condensate from its Italian assets as compared to 264 and 488 bbls of condensate in the 2017 similar periods, with an increase of 25% in the six months ended September 30, 2018.

### **Italy Electricity production**

During the three and six months ended September 30, 2018, the Company sold 1,883 and 4,566 MWh of electricity from its Italian electricity production assets as compared to 2,741 and 5,263 MWh for the corresponding period of 2017.

Electricity production remained consistent for all the quarters since the cogeneration plant was acquired, as detailed in the following table.

| Italy Electricity Production | Production MWh |
|------------------------------|----------------|
| Q1 2018                      | 2,552          |
| Q2 2018                      | 2,741          |
| Q3 2018                      | 1,922          |
| Q4 2018                      | 790            |
| Q1 2019                      | 2,683          |
| Q2 2019                      | 1,883          |

### **Revenues**

|                                    | Three months ended<br>September 30 |       | Six months ended<br>September 30 |        |
|------------------------------------|------------------------------------|-------|----------------------------------|--------|
|                                    | 2018                               | 2017  | 2018                             | 2017   |
| <b><u>Commodity Prices</u></b>     |                                    |       |                                  |        |
| Oil and gas prices                 |                                    |       |                                  |        |
| Oil (Azerbaijan \$/bbl)            | <b>109.23</b>                      | 46.61 | <b>96.60</b>                     | 54.99  |
| Condensate (\$/bbl)                | <b>93.41</b>                       | 87.12 | <b>65.58</b>                     | 104.51 |
| Gas (\$/mcf)                       | <b>6.44</b>                        | 7.45  | <b>6.29</b>                      | 7.58   |
| Total oil and gas (\$/boe)         | <b>107.49</b>                      | 47.05 | <b>92.82</b>                     | 55.79  |
| Electricity (\$/mcf)               | <b>5.00</b>                        | 8.36  | <b>4.53</b>                      | 7.59   |
| <b><u>Revenues (CAD\$'000)</u></b> |                                    |       |                                  |        |
| Oil and gas revenue                |                                    |       |                                  |        |
| Oil (Azerbaijan)                   | <b>2,055</b>                       | 899   | <b>3,738</b>                     | 2,347  |
| Condensate (Italy)                 | <b>17</b>                          | 23    | <b>40</b>                        | 51     |
| Gas (Italy)                        | <b>17</b>                          | 36    | <b>25</b>                        | 73     |
| Other (Italy)                      | -                                  | -     | -                                | 27     |
| Total oil and gas (CAD\$)          | <b>2,089</b>                       | 958   | <b>3,803</b>                     | 2,498  |
| Electricity (CAD\$)                | <b>154</b>                         | 157   | <b>321</b>                       | 284    |
| Total (CAD\$)                      | <b>2,243</b>                       | 1,115 | <b>4,124</b>                     | 2,782  |

### **Condensate Revenue**

The price per bbl received for condensate during the three and six months ended September 30, 2018 was CAD\$93.41 and CAD\$65.58 per bbl as compared to CAD\$87.12 and CAD\$104.51 per bbl earned on condensate sales during the three and six months ended September 30, 2017, respectively.

### **Gas Revenue**

The sale price price per MCF of natural gas was CAD\$7.48 during the six months ended September 30, 2018, as compared to CAD\$7.86 per MCF during the six months ended September 30, 2017.

The price per mcf received for condensate during the three and six months ended September 30, 2018 was CAD\$6.44 and CAD\$6.29 per mcf of gas, as compared to CAD\$7.45 and CAD\$7.58 per mcf earned on gas sales during the three and six months ended September 30, 2017, respectively.

In general, gas prices are also impacted by fluctuations in the base price of European gas rates which is used in the formulas to establish the price of natural gas.

### Electricity Revenue

The difference in the gross revenues achieved is only for the electricity selling price that is determined by the market.

| Italy Electricity Production | Production MWh | Gross Revenues<br>CAD\$'000 | Average Price<br>CAD\$/MWH |
|------------------------------|----------------|-----------------------------|----------------------------|
| Q1 2018                      | 2,552          | \$ 127k                     | \$ 49.65                   |
| Q2 2018                      | 2,741          | \$ 157k                     | \$ 57.25                   |
| Q3 2018                      | 1,922          | \$ 145k                     | \$ 75.44                   |
| Q4 2018                      | 790            | \$ 170k                     | \$ 215                     |
| Q1 2019                      | 2,683          | \$ 188k                     | \$ 70.07                   |
| Q2 2019                      | 1,883          | \$ 154k                     | \$ 81.78                   |

### Operating Expenses

|  | Three months ended<br>September 30 |       | Six months ended<br>September 30 |       |
|--|------------------------------------|-------|----------------------------------|-------|
|  | 2018                               | 2017  | 2018                             | 2017  |
| <b>Operating and transportation (\$'000)</b> |                                    |       |                                  |       |
| Azerbaijan                                   | 897                                | 498   | 1,784                            | 1,243 |
| Italy  | 80                                 | 89    | (21)                             | 247   |
| Total  | 977                                | 587   | 1,763                            | 1,490 |
| Azerbaijan \$/bbl                            | 40.52                              | 21.56 | 39.19                            | 25.92 |
| Italy \$/boe                                 | 13.89                              | 21.25 | 0                                | 29.70 |
| Total \$/boe                                 | 35.03                              | 21.51 | 30.08                            | 26.48 |

### Netbacks

|                               | Three months ended<br>September 30 |         | Six months ended<br>September 30 |         |
|-------------------------------|------------------------------------|---------|----------------------------------|---------|
|                               | 2018                               | 2017    | 2018                             | 2017    |
| <b>Azerbaijan (\$/bbl)</b>    |                                    |         |                                  |         |
| Revenue                       | 109.23                             | 46.61   | 96.60                            | 54.99   |
| Operating expenses            | (40.52)                            | (21.56) | (39.19)                          | (25.92) |
| Field netback                 | 68.71                              | 25.05   | 57.41                            | 29.07   |
| <b>Italy (\$/boe)</b>         |                                    |         |                                  |         |
| Revenue                       | 32.66                              | 51.46   | 29.48                            | 49.10   |
| Operating expenses            | (13.89)                            | (21.25) | (0.00)                           | (29.70) |
| Field netback                 | 18.77                              | 30.21   | 29.48                            | 19.40   |
| <b>Total Company (\$/boe)</b> |                                    |         |                                  |         |
| Revenue                       | 80.42                              | 40.85   | 70.36                            | 53.23   |
| Operating expenses            | (35.03)                            | (21.51) | (30.08)                          | (26.48) |
| Field netback                 | 45.39                              | 19.34   | 40.28                            | 26.75   |

### General and Administrative Expenses ("G&A")

General and administrative expenses for the six months ended September 30 are composed of the following:

|   | Three months ended<br>September 30 |            | Six months ended<br>September 30 |            |
|---|------------------------------------|------------|----------------------------------|------------|
|   | 2018                               | 2017       | 2018                             | 2017       |
| Professional fees                         | 421                                | 187        | 1,169                            | 722        |
| Office                                    | 26                                 | 126        | 206                              | 274        |
| Administrative                            | 89                                 | 87         | 711                              | 313        |
| Salaries and benefits                     | 434                                | 438        | 874                              | 786        |
| Travel                                    | 294                                | 233        | 488                              | 343        |
| Share based payments                      | 48                                 | -          | 1,019                            | -          |
| Capitalised Expenses                      | -                                  | (500)      | -                                | (2,281)    |
| <b>Total G&amp;A expenses (CAD\$'000)</b> | <b>1,312</b>                       | <b>571</b> | <b>4,467</b>                     | <b>157</b> |

During the six months ended September 30, 2018, the Company incurred CAD\$4,467k of General and Administrative Expenses. In these costs are included CAD\$1,019k for Share based payments (non-cash items), relating to the granting of share options, CAD\$109k for the yearly audit fees, CAD\$360k for non-recurrent costs relating to listing costs and CAD\$64k for non-recurrent costs incurred in negotiations for proposed acquisitions

|  | Six months ended<br>September 30, 2018<br>CAD\$'000 |
|--|---|
| Professional fees                                | 483   |
| Audit fees (yearly cost)                         | 109   |
| Listing costs (non-recurrent)                    | 360   |
| Accounting and bookkeeping                       | 41  |
| Negotiations for acquisitions (non-recurrent)    | 64  |
| Legal  | 112   |
| Office   | 206   |
| Bank commissions                                 | 34  |
| Insurances                                       | 69  |
| Foreign exchange                                 | 23  |
| Other administrative expenses                    | 585   |
| Salaries   | 874   |
| Travel   | 488   |
| Share based payments (non-cash item)             | 1,019   |
| <b>Total General and Administrative Expenses</b> | <b>4,467</b>  |

### Depletion and depreciation

|                          | Three months ended<br>September 30 |             | Six months ended<br>September 30 |             |
|--------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                          | 2018                               | 2017        | 2018                             | 2017        |
| Other                    | 0                                  | 121         | 1                                | 211         |
| Azerbaijan               | 386                                | 126         | 785                              | 329         |
| Italy                    | 0                                  | 37          | 0                                | 69          |
| <b>Total (CAD\$'000)</b> | <b>386</b>                         | <b>284</b>  | <b>786</b>                       | <b>609</b>  |
| Azerbaijan \$/bbl        | 17.44                              | 5.45        | 17.24                            | 6.86        |
| Italy \$/boe             | 0                                  | 8.81        | 0                                | 8.30        |
| <b>Total \$/boe</b>      | <b>13.85</b>                       | <b>5.97</b> | <b>13.41</b>                     | <b>7.07</b> |



## **SUMMARY OF QUARTERLY INFORMATION**

The following is a summary of selected financial information for the Company for the past eight quarters.

|   | <b>Net revenue</b><br>CAD\$'000 | <b>Net<br/>income (loss)</b><br>CAD\$'000 | <b>Per share *</b><br>\$ |
|---|---------------------------------|---|--------------------------|
| <b>2019</b>                             |                                 |   |                          |
| Second quarter ended September 30, 2018 | 2,241                           | (654)                                     | (0.02)                   |
| First quarter ended June 30, 2018       | 1,881                           | (2,623)                                   | (0.01)                   |
| <b>2018</b>                             |                                 |   |                          |
| Second quarter ended September 30, 2017 | 1,115                           | 106                                       | 0.01                     |
| First quarter ended June 30, 2017       | 1,667                           | 315                                       | 0.01                     |
| <b>2017</b>                             |                                 |   |                          |
| Fourth quarter ended March 31, 2017     | 1,512                           | (47,335)                                  | (0.41)                   |
| Third quarter ended December 31, 2016   | 1,924                           | (1,556)                                   | (0.03)                   |
| Second quarter ended September 30, 2016 | 818                             | (1,150)                                   | (0.02)                   |
| First quarter ended June 30, 2016       | 242                             | 617,419                                   | 0.11                     |
| <b>2016</b>                             |                                 |   |                          |
| Fourth quarter ended March 31, 2016     | 251                             | (5,568)                                   | (0.14)                   |
| Third quarter ended December 31, 2015   | 284                             | (889)                                     | (0.03)                   |

The sum of quarterly amounts per share may not add to the year-to-date figure due to rounding.

- The revenues increased in the first and second quarter of 2019 due to an increase of production and the increase of the oil selling price on the international markets;
- The net revenues decreased in the fourth quarter of the 2018 FY year because of the reclassification, by the auditors, of the selling/transportation costs and share profit for the partner in Azerbaijan. The oil revenues are now net of these amounts.
- The net revenues increased in the third quarter of the 2018 FY because of the significant increases in the market price of oil;
- The net revenues decreased in the second quarter of the 2018 FY because the relevant stock of oil at the end of the period (2,588 bbls) was sold during the first days of the subsequent period;
- The net revenues increased in the first quarter of the 2018 FY; the capitalisation of general and administrative expenses, fully paid in past quarters and relating the Azerbaijan acquisition and the listing to the LSE, has allowed the Company to partially recover the past losses;
- The loss of the last quarter of the year ended March 31, 2017 was caused by Italian impairment, loss on Argentinian disposal and a revision to the valuation of the Azeri assets as per the August 2016 CPR. In the Q1 statements, the assets were valued using the March 2016 CPR. All these amounts are non-cash items, and loss is not related to the profitability of the Company.
- During Q3 of the 2017 FY the Company recorded the first full quarter of oil production from its operations in Azerbaijan. The Company's revenues during Q3 of 2017 FY exceeded those of the previous 5 quarters combined.
- During Q2 of the 2017 FY, following the successful handover which took place on August 11, 2016, Zenith began oil production operations in Azerbaijan. Production was consistent at a rate of approximately 275 barrels of oil per day resulting in total production of 14,010 bbls for the period and a gross revenue of CAD\$659k.

## LIQUIDITY RISK AND CAPITAL RESOURCES

|                                    | Six months ended 30 September |                       |                       |
|------------------------------------|-------------------------------|-----------------------|-----------------------|
|                                    | 2018                          | 2017                  |                       |
| Financial assets                   | CAD\$'000                     | CAD\$'000             |                       |
| Trade and other receivables        | 3,230                         | 1,382                 |                       |
| Cash and cash equivalents          | 4,197                         | 2,393                 |                       |
| <b>Total financial assets</b>      | <b>7,427</b>                  | <b>3,775</b>          |                       |
|                                    | <b>Other</b>                  | <b>Financial</b>      | <b>Financial</b>      |
|                                    | <b>financial</b>              | <b>liabilities at</b> | <b>liabilities at</b> |
|                                    | <b>liabilities</b>            | <b>FVTPL</b>          | <b>amortised cost</b> |
| <b>2018</b>                        | <b>CAD\$'000</b>              | <b>CAD\$'000</b>      | <b>CAD\$'000</b>      |
| <b>Financial liabilities</b>       |                               |                       |                       |
| Trade and other payables           | 10,588                        | -                     | -                     |
| Loans                              | 3,800                         | -                     | 1,158                 |
| Non-convertible bond               | -                             | 385                   | -                     |
| Deferred consideration             | 483,807                       | -                     | -                     |
| <b>Total financial liabilities</b> | <b>498,195</b>                | <b>385</b>            | <b>1,158</b>          |
|                                    | <b>Other</b>                  | <b>Financial</b>      | <b>Financial</b>      |
|                                    | <b>financial</b>              | <b>liabilities at</b> | <b>liabilities at</b> |
|                                    | <b>liabilities</b>            | <b>FVTPL</b>          | <b>amortised cost</b> |
| <b>2017</b>                        | <b>CAD\$'000</b>              | <b>CAD\$'000</b>      | <b>CAD\$'000</b>      |
| <b>Financial liabilities</b>       |                               |                       |                       |
| Trade and other payables           | 2,720                         | -                     | -                     |
| Loans                              | 2,471                         | -                     | 2,749                 |
| Non-convertible bond               | -                             | 385                   | -                     |
| Deferred consideration             | 484,474                       | -                     | -                     |
| <b>Total financial liabilities</b> | <b>489,665</b>                | <b>385</b>            | <b>2,749</b>          |

Details on the Group's financial liabilities are included below under liquidity risk.

Zenith finances its operations through a mixture of equity, debt and cash from operations. Finance requirements are reviewed by the Board when funds are required for the acquisition, exploration and development of projects.

Zenith's policy is to maintain an appropriate financial position to sustain future development of the business. There were no changes to the Group's capital management approach during the period ended September 30, 2018.

Zenith's treasury functions, which are managed by the board, are responsible for managing fund requirements and investments which include banking, cash flow management, interest and foreign exchange exposure to ensure adequate liquidity to meet cash requirements.

Zenith's principal financial instruments are cash and deposits and these instruments are only for the purpose of meeting its requirement for operations.

Zenith's main financial risks are foreign currency risk, liquidity risk, interest rate risk, commodity price risk and credit risks. Set out below are policies that are used to manage such risks:

### **a) Credit risk**

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its commercial obligations. The Group's maximum credit risk exposure is limited to the carrying amount cash of CAD\$4,197k (2017 – CAD\$2,393k) and trade and other receivables of CAD\$3,230k (2017 – CAD\$1,382k).

Deposits are, as a general rule, placed with banks and financial institutions that have credit rating of not less than AA or equivalent which are verified before placing the deposits.

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

|                                      | September 30, 2018<br>CAD\$'000 | September 30, 2017<br>CAD\$'000 |
|--------------------------------------|---------------------------------|---------------------------------|
| Oil and natural gas sales            | 2,686                           | 1,003                           |
| Stamp tax and other tax withholdings | -                               | 63                              |
| Goods and services                   | 365                             | 129                             |
| Other                                | 179                             | 187                             |
|                                      | 3,230                           | 1,382                           |

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 Azerbaijan and Italy. Oil and natural gas sales receivables are typically collected in the month following the sales month. Other receivables are related to the share subscription completed on June 21, 2018.

The Group considers its receivables to be aged as follows:

|           | September 30, 2018<br>CAD\$'000 | September 30, 2017<br>CAD\$'000 |
|-----------|---------------------------------|---------------------------------|
| Current   | 2,865                           | 1,382                           |
| 90 + days | 365                             | -                               |
|           | 3,230                           | 1,382                           |

#### **b) Liquidity risk**

Liquidity risk is the risk that the Group will incur difficulties meeting its financial obligations as they are due. The Group'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 Group's reputation.

The Directors have considered the recoverability of the outstanding debts of the Group and do not consider there to be any impairment necessary.

As of 30 September 2018, the contractual cash flows, including estimated future interest, of current and non-current financial liabilities mature as follows:

|                          | Carrying<br>Amount<br>CAD\$'000 | Contractual<br>cash flow<br>CAD\$'000 | Due on or<br>before<br>September<br>30 2019<br>CAD\$'000 | Due on or<br>before<br>September<br>30 2020<br>CAD\$'000 | Due after<br>September<br>30 2020<br>CAD\$'000 |
|--------------------------|---------------------------------|---------------------------------------|--|--|--|
| Trade and other payables | 10,588                          | 10,588                                | 10,588   | -  | -  |
| Loans                    | 4,958                           | 6,061                                 | 4,511  | 690  | 860  |
| Non-convertible bond     | 385                             | 410                                   | 410  | -  | -  |
| Deferred consideration   | 483,807                         | 1,190,981                             | 1,450  | 10,076   | 1,179,455                                      |
|                          | 499,738                         | 1,208,040                             | 16,959   | 10,766   | 1,180,315                                      |

#### **c) Foreign 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 as at September 30, 2018 and 2017 and for the six months period ended September 30, 2018 and 2017 are as follows:

|               | Closing rate |        | Average rate |        |
|---------------|--------------|--------|--------------|--------|
|               | 2018         | 2017   | 2018         | 2017   |
| US dollars    | 1.2895       | 1.2454 | 1.2986       | 1.2541 |
| Euro          | 1.4961       | 1.4697 | 1.5285       | 1.4733 |
| Swiss Franc   | 1.3132       | 1.2840 | 1.3186       | 1.3036 |
| British Pound | 1.6796       | 1.6686 | 1.7286       | 1.6412 |

The following represents the estimated impact on net (loss)/income of a 10% change in the closing rates as at September 30, 2018 and 2017 on foreign denominated financial instruments held by the Group, with other variables such as interest rates and commodity prices held constant:

|               | September 30, 2018<br>CAD\$'000 | September 30, 2017<br>CAD\$'000 |
|---------------|---------------------------------|---------------------------------|
| US dollars    | 54                              | 247                             |
| Euro          | 22                              | 52                              |
| Swiss Franc   | 225                             | 224                             |
| British Pound | -                               | 64                              |
|               | <b>301</b>                      | <b>588</b>                      |

**d) 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 September 30, 2018, a 5% change in the price of natural gas produced in Italy would represent a change in results for the period ended September 30, 2018 of approximately CAD\$3k (2017 – CAD\$3k) and a 5% change in the price of electricity produced in Italy would represent a change in results, for the period ended September 30, 2018 of approximately CAD\$32k (2017 – CAD\$10k).

As at September 30, 2018, a 5% change in the price of crude oil produced in Azerbaijan would represent a change in the results for the period ended September 30, 2018 of CAD\$187k (2017 – CAD\$72k).

**e) 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 Group has fixed interest on notes payable, loans payable and convertible notes and therefore is not currently exposed to interest rate risk.

**SUBSEQUENT EVENTS**

- a) On October 2, 2018, the Company's Chief Executive Officer & President, Mr. Andrea Cattaneo advised the Company that he had swapped his salary for the first two quarters of the 2019 financial year in exchange for common shares in the capital of Zenith ("**Salary Sacrifice Shares**"). As a result, on October 1, 2018, the Company issued Mr. Cattaneo 2,225,941 Salary Sacrifice Shares at an average price of CAD\$0.108 for the period from April 1, 2018 to June 30, 2018, and at an average price of CAD\$0.069 for the period from July 1, 2018 to September 30, 2018. The amount of Salary Sacrifice Shares was calculated on the basis of Mr. Cattaneo's salary as at October 1, 2018.
- b) On October 10, 2018 ARC Ratings, SA. ("**ARC Ratings**") assigned the Company a medium to long-term issuer credit rating of "B+" with Positive Outlook.
- c) On October 22, 2018, the Company announced that additional geological and reservoir investigations had enabled the Company to identify a new structure in the Middle Eocene and Upper Cretaceous formations of the Jafarli field.
- d) On November 7, 2018 the Company announced that it had received approval for admission to trading of its entire common share capital on the Merkur Market of the Oslo Børs (the "**Merkur Market**"). The Merkur Market is a multilateral trading facility owned and operated by the Oslo Børs. In addition, in order to satisfy the Merkur Market admission requirements the Company completed a private placement with Norwegian investors (the "**Private Placement**"). The Private Placement successfully raised gross proceeds of NOK 7,273,850 (approximately £668,300 or CAD\$1,141,600) through the placement of 20,782,429 common shares of no-par value (the "**Placement Shares**") at a subscription price of NOK 0.35 per share (approximately £0.032 or CAD\$0.055 per Placement Share). No Insider/Person Discharging Managerial Responsibility subscribed for Placement Shares. Following issuance of the Placement Shares, the Company will have a total of 237,102, 587 Common Shares in issue. 237,102,587 Common Shares will be admitted to trading on the Merkur Market and listed on the TSX Venture Exchange in Canada. The Company announced that an application for the Placement Shares to be listed on the standard segment of the UK Official List and to be admitted to trading to the Main

Market of the London Stock Exchange will be made within 12 months of the issue of the Placement Shares; the number of Common Shares listed on the standard segment of the UK Official List and to be admitted to trading to the Main Market of the London Stock Exchange remains at 216,320,158.

- e) On November 12, 2018, the Company announced that it had successfully completed a private placement on the Merkur Market of the Oslo Børs with Norwegian investors raising gross proceeds of NOK 1,000,000 (approximately £91,700 or CAD\$157,000) through the placement of 2,857,143 common shares of no par value (the “**Placement Shares**”) at a subscription price of NOK 0.35 per Placement Share (approximately £0.032 or CAD\$0.055).

#### **GOING CONCERN**

These financial statements have been prepared on a going concern basis which presumes that the Group will continue its operations in the normal course of business for the foreseeable future.

The Directors, having made due and careful enquiry, are of the opinion that the Group has adequate working capital to execute its operations over the next 12 months. In forming this opinion the Directors have considered the cash flow forecasts prepared by management and fund raises completed post year end. The cashflow forecasts include the capital expenses in respect of well workovers and drilling which the Group believe will be covered by a combination of funding generated by operations and the funds raised post year end. In order to operate at the levels of production stated in the competent persons report (“**CPR**”) the Group will need to raise additional funding to meet the capital expenditure required.

The Directors therefore have made an informed judgment, at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. As a result, the Directors have adopted the going concern basis of accounting in the preparation of the financial statements

#### **SHARES AND CONVERTIBLE, EXERCISABLE AND EXCHANGEABLE SECURITIES**

Zenith is authorised to issue an unlimited number of Common Shares, of which 55,296,059 were issued at no par value during the six months ended September 30, 2018 resulting in Total Common Shares in issue: 214,094,757 (September 30, 2017 – Total Common Shares in issue: 129,174,277). All Common Shares have the right to vote and the right to receive dividends. Zenith is authorised to issue an unlimited number of preferred shares, issuable in series, of which none have been issued as of the date of this Document. The Directors of the Company may by resolution fix the rights, privileges, restrictions and conditions of the preferred shares of each series.

The Group’s ordinary shares are all fully paid and have not been allocated a par value.

| <b>Issued</b>                             | <b>Number of<br/>common shares</b> | <b>Amount<br/>CAD\$’000</b> |
|---|------------------------------------|-----------------------------|
| <b>Balance – 31 March 2017</b>            | <b>115,577,230</b>                 | <b>17,229</b>               |
| Exercise of stock option (i)              | 1,000,000                          | -                           |
| Exercise of warrants (ii)                 | 1,019,250                          | 153                         |
| <b>Balance – 30 June 2017</b>             | <b>117,596,480</b>                 | <b>17,382</b>               |
| Non-brokered unit private placement (iii) | 3,533,333                          | 438                         |
| Finder’s fee                              | -                                  | (22)                        |
| Non-brokered unit private placement (iv)  | 2,666,667                          | 328                         |
| Finder’s fee                              | -                                  | (16)                        |
| Non-brokered unit private placement (v)   | 666,666                            | 82                          |
| Finder’s fee                              | -                                  | (4)                         |
| Non-brokered unit private placement (vi)  | 3,600,000                          | 404                         |
| Finder’s fee                              | -                                  | (20)                        |
| Exercise of stock option (vii)            | 1,000,000                          | 100                         |
| Settlement of debt (viii)                 | 111,131                            | 17                          |
| <b>Balance – 30 September 2017</b>        | <b>129,174,277</b>                 | <b>18,689</b>               |
| Exercise of warrants (ix)                 | 2,049,775                          | 307                         |
| Exercise of warrants (x)                  | 1,257,875                          | 189                         |
| Exercise of warrants (xi)                 | 1,306,050                          | 261                         |
| Exercise of warrants (xii)                | 500,000                            | 75                          |
| Exercise of warrants (xiii)               | 1,612,142                          | 322                         |

|   |                    |               |
|---|--------------------|---------------|
| Exercise of warrants (xiv)                  | 3,150,000          | 473           |
| Exercise of stock option (xv)               | 2,000,000          | 200           |
| Exercise of warrants (xvi)                  | 400,000            | 80            |
| Exercise of stock option (xvii)             | 1,000,000          | 150           |
| Exercise of stock option (xviii)            | 1,650,000          | 202           |
| Exercise of warrants (xviii)                | 100,000            | 20            |
| <b>Balance – 31 December 2017</b>           | <b>144,200,119</b> | <b>20,968</b> |
| Non-brokered unit private placement (xix)   | 4,000,000          | 500           |
| Non-brokered unit private placement (xx)    | 9,000,000          | 1,158         |
| Finder's fee                                | -                  | (58)          |
| Settlement of debt (xxi)                    | 1,598,579          | 224           |
| <b>Balance – 31 March 2018</b>              | <b>158,798,698</b> | <b>22,792</b> |
| Settlement of debt (xxii)                   | 1,123,608          | 185           |
| Non-brokered unit private placement (xxiii) | 54,172,451         | 3,694         |
| Finder's fee                                | -                  | (187)         |
| <b>Balance – 30 June 2018</b>               | <b>214,094,757</b> | <b>26,484</b> |
| Finder's fee                                | -                  | (5)           |
| <b>Balance – 30 September 2018</b>          | <b>214,094,757</b> | <b>26,479</b> |

- i) On May 25, 2017 the Group announced that, following its announcement on February 22, 2017 that a Director of the Group had exercised an option to acquire 1,000,000 new Common Shares in the capital of the Group, the Option Shares have been issued on May 23, 2017 following confirmation by Mr. Regis Milano of the custodian to whom they should be issued.
- ii) On June 29, 2017 an investor in the Group exercised warrants to acquire 1,019,250 new common shares of no par value in the capital of the Group. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received CAD\$153k (approximately £91k).
- iii) On July 14, 2017, the Group closed a non-brokered private placement of 3,533,333 Common Shares at a price of CAD \$0.123956 per unit for aggregate gross proceeds of CAD \$438k (approximately £265k). The Group also paid aggregate finders' fees of CAD\$22k (approximately £13k).
- iv) On August 2, 2017, the Group completed a non-brokered private placement of 2,666,667 Common Shares at a price of CAD \$0.1230606 per unit for aggregate gross proceeds of CAD \$328k (approximately £200k). The Group also paid aggregate finders' fees of CAD\$16k (approximately £10k).  
The proceeds of this Private Placement were used to fund Zenith's purchase of oil production equipment and provide general working capital.
- v) On August 2, 2017, the Group completed a non-brokered private placement of 666,666 Common Shares at a price of CAD\$0.1230606 per unit for aggregate gross proceeds of CAD \$82k (approximately £50k). The Group also paid aggregate finders' fees of CAD\$4k (approximately £2.5k). The proceeds of this Private Placement were used to fund the Group's purchase of oil production equipment and provide general working capital.
- vi) On September 11, 2017, the Group closed a non-brokered private placement of 3,600,000 Common Shares at a price of CAD\$0.11 per unit for aggregate gross proceeds of CAD\$404k (approximately £252k). The Group also paid aggregate finders' fees of CAD\$20k (approximately £13k).  
The proceeds of this Private Placement were used to accelerate the development of Zenith's oil production operations in Azerbaijan.
- vii) On September 27, 2017 the Group announced that a Director of Zenith had exercised part of 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 (approximately £60k).
- viii) On September 28, 2017 the Group announced that a Director of the Company, in accordance with TSX Venture Exchange rules, had swapped part of his salary for the first two quarters of the 2018 financial year for the equivalent of CAD\$2.5K per months, for a total of CAD\$15k (approximately £9k). As a result, the Director will receive 111,131 common shares in the capital of the Company at an average price of approximately CAD\$0.14 for the period April 1, 2017 until December 31, 2017.
- ix) On October 12, 2017 an investor in the Company exercised warrants to acquire 2,049,775 new common

- shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received was CAD\$307k (approximately £186k).
- x) On October 19, 2017 an investor in the Company exercised warrants to acquire 1,257,875 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received was CAD\$189k (approximately £114k).
  - xi) On October 23, 2017 an investor in the Company exercised warrants to acquire 1,306,050 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.20 per share, and the total consideration received was CAD\$261k (approximately £160k).
  - xii) On November 2, 2017 an investor in the Company exercised warrants to acquire 500,000 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received was CAD\$75k (approximately £44k).
  - xiii) On November 8, 2017 an investor in the Company exercised warrants to acquire 1,612,142 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.20 per share, and the total consideration received CAD\$322k (approximately £195k).
  - xiv) On November 22, 2017 an investor in the Company exercised warrants to acquire 3,150,000 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received CAD\$473k (approximately £284k).
  - xv) On November 23, 2017 a Director of the Company exercised stock options to acquire 2,000,000 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.10 per share, and the total consideration received CAD\$200k (approximately £118k).
  - xvi) On December 11, 2017 an investor in the Company exercised warrants to acquire 400,000 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.20 per share, and the total consideration received CAD\$80k (approximately £47k).
  - xvii) On December 15, 2017 a Director of the Company exercised stock options to acquire 1,000,000 new common shares of no par value in the capital of the Company. The exercise price of the warrant was CAD\$0.15 per share, and the total consideration received CAD\$150k (approximately £87k).
  - xviii) On December 18, 2017 the Company announced that a Director of the Company had exercised stock options to acquire 500,000 new common shares of no par value in the capital of the Company at an exercise price of CAD\$0.10 per stock option (approximately £0.06) at a total cost of CAD\$50,000 (£30k).  
The Company also announced that the Chief Financial Officer of the Company had exercised stock options to acquire a total of 1,150,000 new common shares of no par value in the capital of the Company. 400,000 of the new common shares had an exercise price of CAD\$0.10 per new share (approximately £0.0583). The remaining 750,000 new common shares had an exercise price of CAD£0.15 (approximately £0.0874). The total consideration for the Chief Financial Officer's exercise of stock options was CAD\$152,000 (approximately £91k).  
The Company also announced on December 18, 2017 that an investor in the Company had exercised warrants to acquire 100,000 new common shares of no par value in the capital of the Company. The exercise price per warrant was CAD\$0.20 per share, and the total consideration received was CAD\$20k (£12k).
  - xix) On January 10, 2018 the Company closed a private placement to raise gross proceeds of CAD\$500k (approximately £297k) through the issue of 4,000,000 new common shares of no par value in the capital of the Company at a price of CAD\$0.125 (approximately £0.0742) per new common share with Canadian investors. The proceeds of the private placement have been allocated for the purchase of oil production equipment to develop the Company's oil production operations in Azerbaijan. The Company also paid finder's fees of £3k (approximately CAD\$5k).
  - xx) On January 24, 2018 the Company completed a placing in the UK (the "**Placing**") to raise gross proceeds of £678k (approximately CAD\$1,158k) by issuing 9,000,000 common shares of no par value in the capital of the Company (the "**New Common Shares**") at a price of £0.0742 (approximately CAD\$0.1287) per New Common Share. The Company also paid finder's fees for £34k (approximately CAD\$58k) and under the terms of the Placing, the broker was issued 180,000 warrants in the Company, priced at £0.0925, with an expiry date of two years from Admission.

The New Common Shares were offered by the Company's broker to certain investors, principally UK institutions, at the same sterling equivalent price as the Canadian Placing. The Placing garnered considerable interest, with the Company receiving offers for subscription three times in excess of the

maximum 9,000,000 New Common Shares that the Company was able to offer to UK investors, in compliance with Standard list regulations.

The Company intends to use the proceeds of the Placing to finance its continued investment in its Azerbaijan field operations and for general working capital.

- xxi) On January 24, 2018 the Company agreed to issue 1,598,579 common shares at a deemed price of CAD\$0.14 to settle a debt of US\$180,000 owing by the Company.
- xxii) On May 4, 2018 Mr. Cattaneo swapped part of his salary for the 2018 financial year in exchange for common shares in Zenith. As a result, the Company issued Mr. Andrea Cattaneo 1,123,068 common shares in the capital of the Company at an average price of CAD\$0.165 (approximately £0.094) for the period from April 1, 2017 until March 31, 2018, for an amount of CAD\$185k. The amount of the Salary Sacrifice Shares was calculated based on Mr. Cattaneo's salary as at April 1, 2017.
- xxiii) On June 21, 2018, the Company raised gross proceeds totalling, in aggregate, £2,167k (CAD\$3,694k). As a result of the Placing, Subscription the Company issued a total of 54,172,451 new common shares, (the "**New Common Shares**").

The Company also paid finder's fees for CAD\$192k, of which CAD\$5k were recognized in the Q2 of the FY 2019, and issued 1,280,000 warrants, that could be exercised at a price of CAD\$0.07 for a duration of three years.

| <b>Warrants and options</b>         | <b>Number of options</b> | <b>Number of warrants</b> | <b>Weighted average exercise price</b> | <b>Amount CAD \$'000</b> |
|-------------------------------------|--------------------------|---------------------------|--|--------------------------|
| <b>Balance – March 31, 2017</b>     | <b>5,000,000</b>         | <b>56,995,908</b>         | <b>0.21</b>                            | <b>1,877</b>             |
| Options issued                      | 2,750,000                | -                         | 0.15                                   | 200                      |
| Warrants exercised                  | -                        | (1,019,250)               | 0.15                                   | (153)                    |
| Expired                             | -                        | (7,533,833)               | 0.25                                   | (220)                    |
| <b>Balance – June 30, 2017</b>      | <b>7,750,000</b>         | <b>48,442,825</b>         | <b>0.20</b>                            | <b>1,704</b>             |
| Options issued                      | 2,000,000                | -                         | 0.17                                   | 305                      |
| Warrant issued                      | -                        | 180,000                   | 0.07                                   | 12                       |
| Options exercised                   | (3,900,000)              | -                         | 0.10                                   | (226)                    |
| Options exercised                   | (1,750,000)              | -                         | 0.12                                   | (98)                     |
| Warrants exercised                  | -                        | (10,375,842)              | 0.25                                   | (53)                     |
| Warrants expired                    | -                        | (2,349,320)               | 0.15                                   | (76)                     |
| Warrants expired                    | -                        | (8,870,019)               | 0.25                                   | (693)                    |
| <b>Balance – March 31, 2018</b>     | <b>4,100,000</b>         | <b>27,027,644</b>         | <b>0.19</b>                            | <b>875</b>               |
| Options issued                      | 10,500,000               | -                         | 0.12                                   | 927                      |
| Warrants issued                     | -                        | 1,280,000                 | 0.07                                   | 43                       |
| Warrants expired                    | -                        | (1,807,500)               | 0.25                                   | (192)                    |
| Warrants expired                    | -                        | (8,628,813)               | 0.15                                   | -                        |
| <b>Balance – June 30, 2018</b>      | <b>14,600,000</b>        | <b>17,871,331</b>         | <b>0.19</b>                            | <b>1,653</b>             |
| Warrants issued                     | -                        | 6,977,988                 | 0.05                                   | 48                       |
| Warrants expired                    | -                        | (1,350,000)               | 0.25                                   | (46)                     |
| <b>Balance – September 30, 2018</b> | <b>14,600,000</b>        | <b>23,499,319</b>         | <b>0.15</b>                            | <b>1,655</b>             |



| Type          | Grant Date          | Number of options        | Exercise price per unit CAD\$ | Expiry Date   |
|---------------|---------------------|--------------------------|-------------------------------|---------------|
| Stock options | November 2016       | <b>1,100,000</b>         | 0.10                          | November 2021 |
| Stock options | May 2017            | <b>1,000,000</b>         | 0.15                          | May 2022      |
| Stock options | November 2017       | <b>2,000,000</b>         | 0.18                          | November 2022 |
| Stock options | April 2018          | <b><u>10,500,000</u></b> | 0.12                          | April 2023    |
|               | <b><u>TOTAL</u></b> | <b><u>14,600,000</u></b> |                               |               |

## Options

The Company has a stock options plan (the "**Plan**") for its 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 recognised in the consolidated statements of income (loss) and comprehensive income (loss). Share options expire five years from the date of granting.

As at September 30, 2018, the Group had 14,600,000 stock options outstanding (relating to 14,600,000 shares) and exercisable at a weighted average exercise price shown on the table above per share with a weighted average life remaining of 4.2 years.

The fair value of the options was calculated using the Black-Scholes pricing model calculations based on the following significant assumptions:

|                         |               |
|-------------------------|---------------|
| Risk-free interest rate | 0.50% - 0.70% |
| Expected volatility     | 100%          |
| Expected life           | 5 years       |
| Dividends               | Nil           |

## Granting of options

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 Options 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 Stock Options Plan was approved by shareholders of the Company at the last AGM held on March 29, 2018.

On February 22, 2017, the Company announced that a Director of the Company had exercised stock options to acquire a total of 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\$100k.

On May 17, 2017, Zenith granted options to certain of its Directors and employees to acquire a total of 2,750,000 common shares in accordance with Zenith's Stock Options Plan. Each stock option entitles the relevant holder to acquire one common share for an exercise price of CAD\$0.15 per common share. The expiry date of the options is the date falling five years from the date of grant, being May 17, 2022.

On November 29, 2017, the Company granted options to certain of its Directors and employees to acquire a total of 2,000,000 common shares in accordance with Zenith's Stock Options Plan. Each stock option entitles the relevant holder to acquire one common share for an exercise price of CAD\$0.175 per common share. The expiry date of the options is the date falling five years from the date of grant, being November 29, 2022.

On April 3, 2018 the Board of Directors resolved to grant its directors, certain employees and consultants a total of 10,500,000 stock options (the "Options"), in accordance with the Company's Stock Option Plan. The exercise price of

the Options was equivalent to the Company's TSXV closing price of March 26, 2018, being CAD\$0.12 (approximately £0.067). The Options are fully vested and have the duration of five years from the date of granting.

### Exercise of options

On May 25, 2017, the Company announced that 1,000,000 new common shares (the "Option Shares") had been issued by the Company on May 23, 2018, following the exercise of options made by an Executive Director of the Company, Mr. Luigi Regis Milano, on February 22, 2018, following confirmation by Mr. Regis Milano regarding the custodian to whom the Option Shares should be issued.

- On September 27, 2017, the Company announced that a Director of the Company had exercised 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 (£60k);
- On November 23, 2017, the Company announced that a Director of the Company had exercised stock options to purchase 2,000,000 common shares in the capital of the Company at a price of CAD\$0.10 per Common Share and a total cost of CAD\$200,000 (£118k);
- On December 15, 2017, the Company announced that a Director of the Company had exercised stock options to purchase 1,000,000 common shares in the capital of the Company at a price of CAD\$0.15 per Common Share and a total cost of CAD\$150,000 (£87k).
- On December 18, 2017, the Company announced that a Director of the Company had exercised stock options to acquire 500,000 new common shares of no par value in the capital of the Company at an exercise price of CAD\$0.10 per stock option (approximately £0.06) at a total cost of CAD\$50,000 (£30k).
- On December 18, 2017, the Company announced that the Chief Financial Officer of the Company had exercised stock options to acquire a total of 1,150,000 new common shares of no par value in the capital of the Company. 400,000 of the new common shares had an exercise price of CAD\$0.10 per new share (approximately £0.0583). The remaining 750,000 new common shares had an exercise price of CAD\$0.15 (approximately £0.0874). The total consideration for the Chief Financial Officer's exercise of stock options was CAD\$152,000 (approximately £91k).

| Type                         | Grant Date  | Number of Warrants       | Price per unit CAD\$ | Expiry Date |
|------------------------------|-------------|--------------------------|----------------------|-------------|
| Warrants                     | November-15 | 4,214,125                | 0.25                 | November-18 |
| Warrants                     | November-16 | 732,920                  | 0.20                 | November-18 |
| Warrants                     | January-17  | 1,114,286                | 0.11                 | January-19  |
| Warrants                     | January-17  | 9,000,000                | 0.24                 | January-19  |
| Warrants                     | January-18  | 180,000                  | 0.16                 | January-20  |
| Warrants                     | June-18     | 1,280,000                | 0.07                 | June-21     |
| Warrants                     | Sept-18     | 6,977,988                | 0.05                 | February-20 |
| <b><u>TOTAL WARRANTS</u></b> |             | <b><u>23,499,319</u></b> |                      |             |

As at September 30, 2018, the Group had 23,499,319 warrants outstanding (relating to 23,499,319 shares) and exercisable at a weighted average exercise price of CAD\$0.17 per share with a weighted average life remaining of 0.9 year.

The fair value of the warrants was calculated using the Black-Scholes pricing model calculations based on the following significant assumptions:

|                         |               |
|-------------------------|---------------|
| Risk-free interest rate | 0.50% - 0.70% |
| Expected volatility     | 75-100%       |
| Expected life           | 2 years       |
| Dividends               | Nil           |

## **RELATED PARTY TRANSACTIONS**

Related party transactions are considered to be in the normal course of operations and are initially recognised at fair value. Related party transactions during the periods ended 30 September 2018 and 2017 not disclosed elsewhere in these consolidated financial statements are as follows:

- a) Included in trade and other payables is CAD\$180k (2017 – CAD\$nil) owing to a Director of the Group in respect of salaries. Mr. Cattaneo fully swapped his salary for the 2018 and 2019 Financial Years in exchange for common shares in Zenith. The Salary Sacrifice Shares were calculated based on the basis of Mr. Cattaneo's salary as at April 1, 2018 and were issued on October 2, 2018.
- b) During the six months ended September 30, 2018, an Executive Director of Zenith, Mr. Andrea Cattaneo, purchased a total amount of 9,328,808 common shares of no-par value in the capital of the Company at an average price of CAD\$0.06118 per common share (approximately £0.03641), and a total amount of CAD\$571k (approximately £340k).
- c) On July 6, 2018, Mr. Andrea Cattaneo agreed to act as a third-party guarantor in support of the Company. On July 5, 2018, Mr. Cattaneo pledged a total of 4,542,187 common shares in the capital of the Company, in which he has a direct beneficial interest, as collateral for the two-year non-convertible loan facility signed by Zenith Energy Ltd on May 24, 2018, for a total amount of up to US\$2,000,000.
- d) As of September 30, 2018, Mr. Andrea Cattaneo had a direct beneficial interest in a total of 15,146,992 common shares in the capital of the Company.

## **OFF-BALANCE SHEET ARRANGEMENTS**

The Company has not entered into any off-balance sheet financing arrangements.

## **OUTLOOK**

Zenith's business activities, together with facts likely to affect its future operations and financial and liquidity positions are set out in the note 2 of the financial statements. In addition, note 23 of the financial statements discloses the Company's financial risk management policy, and note 3 details further considerations made by the Board of Directors in respect of going concern.

The Directors, having made due and careful enquiry, are of the opinion that Zenith has adequate working capital to execute its operations over the next 12 months. The Directors therefore have made an informed judgment, at the time of approving the financial statements, that there is a reasonable expectation that the Zenith has adequate resources to continue in operational existence for the foreseeable future. As a result, the Directors have adopted the going concern basis of accounting in the preparation of the financial statements.

The Company's primary operational goal is to successfully increase oil production from its Azerbaijan assets, as well as consolidating its Italian energy production and exploration portfolio. In addition, the Company is also seeking to complete value accretive acquisitions of oil and gas production and exploration assets with significant undeveloped commercial value where the Company's operational qualities may be best applied.

### ***THE COMPANY'S PLANS FOR THE 2018 FINANCIAL YEAR INCLUDE:***

- (a) **Italy:** After the acquisition of 9 producing licenses and 4 exploration applications from Mediterranean Oil & Gas Plc., Zenith has evaluated drilling opportunities in these permits and will formalise plans to either participate directly in such potential operations, or farm-out its interest to third parties. The Company's technical team has conducted in depth geological, geophysical and engineering evaluations on all these assets. Natural gas from two assets which is not suitable for transportation in the national pipeline grid will now be produced to generate electricity with the use of gas turbines. New seismic data has defined a very interesting structure in the Macchia Nuova area (part of the San Teodoro Concession) and plans are being formulated to drill this prospect in the future. Plans for side-track drilling operations at the Masseria Petrilli

and the drilling of a new well in the San Teodoro concession are also being evaluated. These activities are expected to increase Zenith's natural gas production in Italy.

Submission of extensive environmental reports relating to the commencement of production of the Torrente Vulgano and Canaldente gas concessions has been completed and preliminary approval has been received. The Company is now looking forward to beginning production operations once final approval is received. Production of natural gas from the Torrente Vulgano and Canaldente concessions is expected to commence in mid-2019.

Improvements of facilities at San Teodoro will be completed with the tie-in of new dehydration equipment. While the field has been capable of production, a lack of regional infrastructure has limited additional expansion in the past. In December 2014, Zenith reached an agreement with Basengas S.r.l., a successful retail marketer of natural gas within Italy, to handle forthcoming production from this 100% owned asset, which is anticipated to resume production in June 2018. Production from the existing wellbore is expected to commence at 3,000 cubic meters/day (106 MCF/d or 18 boepd), increasing Zenith's current daily production in Italy by 25%, to over 100 boepd. The costs of the refurbishment necessary for the resumption of production have been calculated as €300k and will be paid through an equipment leasing facility.

Zenith is also evaluating the possibility of drilling a deviated well into the crestal formation of the Torrente Salsola structure, where the Company holds a 100% working interest, in order to unlock residual reserves. The Company has an ambitious programme to enhance its Italian daily gas production rate in the Puglia Region by 100% by performing a number of well workovers as part of a rehabilitation programme.

Zenith intends to implement an innovative plan for the exploitation of the Traetta 1 well in the Masseria Grottavecchia concession (20% working interest) through the sweetening of the produced gas enabling it to be sold into the national pipeline grid. The development plan will be submitted to the relevant authorities for their analysis and necessary prior approval. Approval is expected to be received by March 2019.

- (b) Azerbaijan:** On June 20, 2016, the Rehabilitation, Exploration, Development and Production Sharing Agreement ("**REDPSA**") for the Area in the Republic of Azerbaijan was ratified by the Parliament of the Republic of Azerbaijan and enacted into national law once signed by the President of the Republic of Azerbaijan. The Area covers an area of 642.4 sq. kilometres and, at the time of the formal finalisation of the transaction, the Area was producing approximately 300 bopd, having produced significantly larger quantities historically. Minor quantities of natural gas are also produced and used onsite. In subsequent months the Company reported increases in its production.

The term of the REDPSA is 25 years from the date of SOCAR's approval of the contractor's development programme. The term of each Area may be extended by an additional five years at the option of SOCAR.

Zenith's corporate office in Baku, the capital of Azerbaijan, is approximately 2 hours by car from Zenith's field office where field operations are managed, located in the southern region of Azerbaijan. Azeri field management personnel have been supplemented with the hiring of international managers and petroleum engineers who provide international expertise and specialist knowledge in order to achieve Zenith's strategy of significantly increasing oil production from the Area.

Zenith Aran, the Company's wholly-owned subsidiary, acts as the operating entity for the management of the Azerbaijan oil assets.

On August 11, 2016, the handover of the Azerbaijan assets was formally completed with the necessary signatures on related documents and the Company commenced oil production operations at a rate of approximately 275 barrels per day.

The Company sells its oil through SOCAR's Marketing and Operations Department ("**SOCARMO**"). A related commission of 1% on total oil sales is payable by the Company to SOCARMO.

#### *Field rehabilitation Activities*

The Company has undertaken numerous workovers and other operational activities between the effective date of the REDPSA in August 2016 and March 2017 as summarized in the following table.

|                |  |
|----------------|--|
| January 2017   | Signed a service contract with a well-established local oilfield service company to perform the workovers of wells M-195 and M-45 located in the Muradkhanli field   |
| February 2017  | <p>Division of the field rehabilitation activities between two teams: 'Team A' and 'Team B'.</p> <ul style="list-style-type: none"> <li>• Team B was staffed by personnel from the oilfield service company contracted to perform the workovers of wells M-195 and M-45, operating the Service Company's workover rig.</li> <li>• Team A was staffed by Zenith's field personnel, operating the Company's A-80 workover rig inherited by SOCAR.</li> </ul>   |
| March 2017     | <ol style="list-style-type: none"> <li>1. Successfully resolved obstructions in Well M-195, enabling to reach the top of the production liner section at 3,014 metres.</li> <li>2. Modernisation work of its A-80 rig was fully completed.</li> <li>3. Installation of a new ESP in wells M-70 and M-48 in the Muradkhanli field and well C-34 in the Jafarli field</li> </ol>   |
| April 2017     | <ol style="list-style-type: none"> <li>1. Pump replacements in wells C-31 and C-34 in Jafarli field and wells M-67 and M-70 in the Muradkhanli field.</li> <li>2. Well C-39 in the Jafarli field had pump repair work performed to address minor technical problems.</li> <li>3. The field rehabilitation activities resulted in a net increase of 14 barrels of oil per day in total across the five wells.</li> <li>4. Team A began workover operations at well M-45 in the Muradkhanli field.</li> <li>5. The Company also commenced sidetrack operations at well M-195 with the arrival of the required larger workover rig.</li> </ol>  |
| May 2017       | Announced the appointment of a Chief Operating Officer, Mike Palmer, to lead its operations in Azerbaijan  |
| June 2017      | Announced the success of its side-track operations at well M-195.  |
| July 2017      | <ol style="list-style-type: none"> <li>1. The workover of M-45 was successfully completed; a production rate of 46 bopd was achieved, but potentially higher flowrates were inhibited by partial blockages of old well material.</li> <li>2. Restored production at well M-66 in the Muradkhanli field, achieving a flow rate of 50 bopd.</li> </ol>   |
| August 2017    | <ol style="list-style-type: none"> <li>1. Signed a contract for the procurement of oil production materials with Kerui petroleum, a leading Chinese manufacturer of oilfield equipment, for a value of the procurement contract of US\$1,705,608 (approximately £1,325,000; CAD\$2,146,000), by which: <ul style="list-style-type: none"> <li>• Zenith paid the 15% of the contract value in advance as deposit.</li> <li>• The materials procured include: a blowout preventer (BOP); a full set of well control equipment; drill pipes to be used as a work string; tubing to be used in the installation of new electric submersible pumps and in old wells that have been returned to production; new oilfield infrastructure; lighting equipment; and a generator system to enable a workover rig to operate without the need for nearby infrastructure across Zenith's 642.4 km<sup>2</sup> field area.</li> </ul> </li> <li>2. Successful installation of the custom-built Schlumberger ESP in well M-45 in the Muradkhanli field. Following the installation, the well achieved a production rate of 49 bopd.</li> </ol> |
| September 2017 | <ol style="list-style-type: none"> <li>1. Began the installation of ESPs in a further 11 wells, employing its own A-80 workover rig, upgraded earlier in the year, and a similar sized workover rig operated by an experienced local oilfield service company.</li> </ol>  |

|               |   |
|---------------|---|
|               | 2. Successful perforation of well C-26 in the Jafarli field; the well achieved a production rate of 70 bopd; it was previously not producing.   |
| October 2017  | <ol style="list-style-type: none"> <li>1. Successful perforation of a new, unexploited production zone in well C-21 in the Jafarli field, achieving a flow rate of 15 bopd. Prior to the perforation well C-21 was non-producing.</li> <li>2. Experienced difficulties in its workover of the Z-21 well, which initially flowed at a rate below 5 bopd.</li> </ol>  |
| December 2017 | <ol style="list-style-type: none"> <li>1. Cleaned out well Z-28. However, during the post-workover inspection of the wellhead, Zenith's petroleum engineers observed a leak during a pressure test from the wellhead in the 9 5/8 inches casing seal assembly, delaying further activity. To resolve this problem, the Company contracted a UK-based company specialised in oilfield leak-sealing technology with an established presence in Azerbaijan</li> <li>2. Completed the civil works on the roads to well Z-21 and at the well location.</li> </ol>  |
| January 2018  | Signed a purchase agreement for the order of a new workover rig with a manufacturer based in Azerbaijan. The total value of the purchase agreement contract was approximately CAD\$440k (approximately £251k).  |
| February 2018 | <ol style="list-style-type: none"> <li>1. Successfully cleaned out the entirety of the tubing string in well Z-21, circulating and drilling out mud and debris that had accumulated since the well was last produced in 1988. Due to the small coiled tubing bit (1.875 inches) and the restricted diameter of the tubing, the casing could not be cleaned out further. To rectify this the Company prepared its A-80 workover rig to pull the tubing string from the well. Once completed, it will run in hole with a drill bit and clean out the casing to total depth, 3,982 metres. The well will subsequently be put on production.</li> <li>2. Successfully sealed the wellhead leaks in well Z-28 and subsequent coiled tubing intervention cleaned out the well to a depth of 3,583 meters, however, it was determined that it would have to mill out 63 metres of tubing inside the liner and then clean out an additional 298 metres of the liner to a total depth of 3,944 metres to complete the workover.</li> <li>3. The Company's A-80 workover rig received further upgrades to increase its capabilities and enable it to be utilised more extensively in the Company's workover operations. This will be supplemented by an A-100 truck-mounted workover rig ordered in January 2018.</li> <li>4. Successfully installed seven electrical submersible pumps. While this resulted in an uplift in production, it has also reduced production downtime that had been observed as a recurrent problem with the previous generation of electrical submersible pumps.</li> </ol> |

Stable production rates have increased by approximately 25 STB/d since the Effective Date of the REDPSA. One workover rig is active at present. A further new workover rig has been purchased and is scheduled to be operational during the beginning of 2019. Additional equipment may be purchased or contracted as required to optimize field redevelopment.

Between 2018 and 2020, the Company plans to workover a total of 38 existing wells which are currently inactive or produce at low rates to increase production up to as much as 40STB/d per well, using improved technology, non-damaging fluids and optimized treatments. It is expected that 12 wells will undergo workovers in 2019, fifteen wells in 2020, and twenty in 2021.

The historical performance of each well including peak rates, cumulative oil and water production, and recent performance has been studied to identify wells that are likely to have successful workover. The results of previous workovers were noted. Although most wells flow to surface, the installation of electrical submersible pumps was usually very beneficial and is expected to form part of most future workovers.

In addition to the 33 recently shut in or marginal producing wells, five non-producing wells completed in the Maykop zone in the Zardab field are expected to be worked over and to be returned to production after wellbore

and sand production problems have been resolved. Depending on the results of the programme, the Zardab field may be more fully developed.

### **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

In the ordinary course of business, the Company and its subsidiaries may enter into contracts which contain indemnification provisions, such as service agreements, leasing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, and land use agreements. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

The Company subleases premises in London, UK, under an operating lease on a month to month basis which requires payments of approximately CAD\$50k per annum.

### **BUSINESS RISKS AND UNCERTAINTIES**

The Company has production operations in Azerbaijan and Italy, and primarily centres its focus on the successful development of its operations in these countries. Some of the Company's operations and related assets are located in countries which carry a higher degree of political and economic risk.

Oil and natural gas are commodities whose prices have fluctuated widely in recent years and are determined based on world demand, supply and other factors, all of which are beyond the control of the Company.

The Company operates in the petroleum, natural gas and electricity industry which is subject to numerous risks that can affect the amount of cash flow from operating activities and the ability to grow. These risks include but are not limited to:

- Global economic uncertainty;
- Risks associated with operating in foreign jurisdictions;
- Competition with more established companies and the availability of services;  
Volatility in commodity pricing, exchange and interest rates;
- Government and regulatory risk with respect to royalty and income tax regimes;
- Operational risks that may affect the quality and recoverability of reserves;
- Geological risks associated with accessing and recovering new quantities of reserves;
- Ability to capitalize on farm-in and farm-out opportunities as they arise;
- Production risks associated with the ability to extract commercial quantities of petroleum and natural gas;
- Transportation risk with respect to the ability to transport petroleum and natural gas to market;
- Third party credit risk and the resulting ability to collect amounts owed;
- Capital markets risk and the ability to finance future growth;
- Uncertainty as to the nature of evolving environmental legislation that is likely to result in stricter standards and enforcement; and
- Environmental risk with respect to the ability to remedy spills, releases or emissions of various substances produced in association with petroleum and natural gas operations.

The Company will seek to minimise these business risks by:

- Employing management, technical staff and consultants with extensive industry experience;
- Maintaining a low-cost structure;
- Enforcing prudent financial practices;
- Ensuring effective oversight on the timing and magnitude of operations and their related capital costs;
- Working with established industry partners; and
- Being insured, in accordance with industry standards, against the risk of liabilities such as pollution, blow-

outs, property damage, personal injury and other hazards.

**OTHER**

Additional information about the Company can be found on SEDAR at: [www.sedar.com](http://www.sedar.com).