

**Primeline Energy Holdings Inc.**  
**Interim Consolidated Financial Statements**  
**December 31, 2016**  
**(Unaudited)**

**Primeline Energy Holdings Inc.**

Interim Consolidated Statement of Financial Position (Unaudited)

As at December 31, 2016 and March 31, 2016

(In RMB)

	Notes	December 31, 2016 RMB'000	March 31, 2016 RMB'000	December 31, 2016 CAD\$'000 (Note 4.5)
<b>Non-current assets</b>				
Exploration and evaluation assets	7	477,237	459,222	91,882
Property, plant and equipment	8	1,680,682	1,822,201	323,581
Restricted cash	9	45,533	28,425	8,767
Restricted bank deposits	4.18	150,000	150,000	28,879
		<u>2,353,452</u>	<u>2,459,848</u>	<u>453,109</u>
<b>Current assets</b>				
Cash and cash equivalents		9,886	150,570	1,903
Trade receivables	18	18,306	11,717	3,524
Prepaid expenses and other receivables		16,323	10,517	3,143
Inventories		11,427	13,342	2,200
		<u>55,942</u>	<u>186,146</u>	<u>10,770</u>
<b>Total assets</b>		<u>2,409,394</u>	<u>2,645,994</u>	<u>463,879</u>
<b>Equity attributable to shareholders</b>				
Share capital	10	1,320	1,270	254
Share premium and reserves		848,914	846,516	163,440
Accumulated deficit		(671,379)	(408,075)	(129,260)
<b>Total equity</b>		<u>178,855</u>	<u>439,711</u>	<u>34,434</u>
<b>Non-current liabilities</b>				
Accounts payable	19	10,447	17,647	2,011
Convertible bonds	13	115,141	102,487	22,168
Decommissioning liabilities	9	156,681	152,801	30,166
		<u>282,269</u>	<u>272,935</u>	<u>54,345</u>
<b>Current liabilities</b>				
Bank loans	11	1,753,882	1,743,940	337,675
Accounts payable and accrued liabilities		194,388	189,408	37,425
		<u>1,948,270</u>	<u>1,933,348</u>	<u>375,100</u>
<b>Total liabilities</b>		<u>2,230,539</u>	<u>2,206,283</u>	<u>429,445</u>
<b>Total shareholders' equity and liabilities</b>		<u>2,409,394</u>	<u>2,645,994</u>	<u>463,879</u>

Nature of Operations and Going Concern (Note 1)

Commitments (Note 15)

Subsequent Events (Note 20)

Approved by the Board of Directors

"Brian Chan"

Director

"Ming Wang"

Director

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

**Primeline Energy Holdings Inc.**

Interim Consolidated Statement of Loss and Comprehensive Loss (Unaudited)

For the three months and nine months ended December 31, 2016 and December 31, 2015

(In RMB)

	Notes	Three Months Ended			Nine Months Ended		
		December 31			December 31		
		2016	2015	2016	2016	2015	2016
		RMB'000	RMB'000	CAD\$'000	RMB'000	RMB'000	CAD\$'000
				(Note 4.5)			(Note 4.5)
<b>Revenue</b>							
Oil and gas	17	93,774	85,936	18,054	181,347	117,684	34,915
<b>Interest and other income</b>							
	12	1,881	2,292	362	5,949	7,701	1,145
<b>Exchange gain (loss), net</b>	6	(75,239)	(55,304)	(14,486)	(124,834)	(92,182)	(24,034)
<b>Expenses</b>							
Production Costs		27,043	35,889	5,207	64,640	77,137	12,445
General and administrative		5,499	1,807	1,059	12,996	8,220	2,502
Depletion and depreciation		87,509	76,643	16,848	172,887	101,153	33,286
Bank interest expenses		22,282	22,958	4,290	69,223	66,996	13,327
Accretion	9	1,304	1,261	251	3,880	3,752	747
Amortization of convertible bonds issuance costs		708	-	136	2,140	-	412
		144,345	138,558	27,791	325,766	257,258	62,719
Profit/(Loss) and comprehensive loss		(123,929)	(105,634)	(23,861)	(263,304)	(224,055)	(50,693)
		RMB	RMB	CAD	RMB	RMB	CAD
Basic and diluted profit(loss) per share		(0.662)	(0.590)	(0.127)	(1.418)	(1.289)	(0.273)
Weighted average number of shares outstanding	10	187,216,132	178,920,168	187,216,132	185,653,841	173,821,819	185,653,841

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

**Primeline Energy Holdings Inc.**

Interim Consolidated Statement of Changes in Equity (Unaudited)

(In RMB)

	Attributable to equity owners of the company						Total
	Share Capital	Share Premium	Contributed Surplus	Share Option Reserve	Shares Purchase Warrants Reserve	Deficit	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
Balance – April 1, 2015 (Restated – Note 3)	1,030	484,967	217,897	69,679	950	(149,018)	625,505
Shareholder loan conversion to shares	193	40,145	18,719	-	-	-	59,057
Share based payments	-	-	-	1,268	-	-	1,268
Convertible bonds conversion options (Note 13)	-	-	-	8,806	-	-	8,806
Issue shares in payment of Bond interest accrued	18	(18)	-	-	-	-	-
Bond interest accrued	-	1,447	-	-	-	-	1,447
Issue shares in payment of share finder fee	29	2,439	-	-	-	-	2,468
Shareholder loan conversion costs	-	(146)	-	-	-	-	(146)
Shareholder contribution	-	-	363	-	-	-	363
Loss and comprehensive loss for the year	-	-	-	-	-	(259,057)	(259,057)
Balance – March 31, 2016	1,270	528,834	236,979	79,753	950	(408,075)	439,711
Share based payments	-	-	-	103	-	-	103
Issue shares in payment of Bond interest accrued	50	(50)	-	-	-	-	-
Bond interest accrued	-	2,345	-	-	-	-	2,345
Loss and comprehensive loss for the period	-	-	-	-	-	(263,304)	(263,304)
Balance – December 31, 2016	1,320	531,129	236,979	79,856	950	(671,379)	178,855
Balance – December 31, 2016, in CAD\$'000 (Note 4.5(c))	254	102,257	45,626	15,374	183	(129,260)	34,434

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**Primeline Energy Holdings Inc.**

Interim Consolidated Statement of Cash Flows (Unaudited)

For the nine months ended December 31, 2016 and December 31, 2015

(in RMB)

	Notes	December 31, 2016 RMB'000	December 31, 2015 RMB'000	December 31, 2016 CAD\$'000 (Note 4.5)
<b>Cash flows (used in) from operating activities</b>				
Loss for the period		(263,304)	(224,055)	(50,693)
Items not involving cash				
Gain on disposal of property, plant and equipment		-	(150)	-
Interest income		(5,949)	(7,033)	(1,145)
By product inventory		2,112	(2,053)	407
Depletion and depreciation	8	172,887	101,153	33,286
Finance income from fair value adjustment of warrant liability	4.11	-	(657)	-
Finance costs		73,103	70,749	14,074
Amortization of transaction costs for issuance of convertible bonds		2,140	-	412
Stock-based compensation		31	736	6
Unrealized foreign exchange loss (gain)		125,510	93,942	24,164
		<u>106,530</u>	<u>32,632</u>	<u>20,511</u>
Changes in non-cash working capital items:				
Trade receivables and prepaid expenses		(6,994)	(1,314)	(1,347)
Accounts payable and accrued liabilities		19,969	14,914	3,844
Inventory		(196)	-	(38)
		<u>12,779</u>	<u>13,600</u>	<u>2,459</u>
		<u>119,309</u>	<u>46,232</u>	<u>22,970</u>
<b>Cash flows (used in) from investing activities</b>				
Oil and gas development assets	8	(29,569)	(8,832)	(5,693)
Expenditures on exploration and evaluation assets	7	(10,192)	(30,357)	(1,962)
Disposal of property, plant and equipment	7	-	150	-
Interest received		549	1,633	106
		<u>(39,212)</u>	<u>(37,406)</u>	<u>(7,549)</u>
<b>Cash flows (used in) from financing activities</b>				
Share issue costs		-	(146)	-
Loan drawdown		38,000	135,400	7,316
Loan repayment		(145,374)	(135,450)	(27,989)
Restricted cash		(17,108)	(17,062)	(3,294)
Interest paid		(98,857)	(87,959)	(19,033)
Issue of convertible bonds		-	114,740	-
Legal fees for issuance of convertible bonds		(97)	-	(19)
		<u>(223,436)</u>	<u>9,523</u>	<u>(43,019)</u>
<b>(Decrease) Increase in cash and cash equivalents</b>				
		<u>(143,339)</u>	<u>18,349</u>	<u>(27,598)</u>
<b>Effect of foreign exchange rate on cash and cash equivalents</b>				
		<u>2,655</u>	<u>1,883</u>	<u>512</u>
<b>Cash and cash equivalents - Beginning of period</b>				
		<u>150,570</u>	<u>68,951</u>	<u>28,989</u>
<b>Cash and cash equivalents - End of period</b>				
		<u>9,886</u>	<u>89,183</u>	<u>1,903</u>

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

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

**1. Nature of Operations and Going Concern**

Primeline Energy Holdings Inc. (the Company or Primeline) was incorporated under the Companies Law of the Cayman Islands on March 31, 1995. The Company is in the business of exploration, development and production of offshore oil and gas properties in the People's Republic of China (PRC).

The Company owns exploration, development and production rights in the East China Sea in relation to Petroleum Contract 25/34 and Petroleum Contract 33/07. The Petroleum Contracts were entered between China National Offshore Oil Corporation (CNOOC) and the Company's wholly owned subsidiaries Primeline Energy China Ltd. (PECL) and Primeline Petroleum Corporation (PPC).

Block 25/34 is the development and production area for the LS36-1 gas field (LS36-1) and CNOOC China Ltd. (CCL) is the Operator with a 51% interest, and PECL and PPC hold 36.75% and 12.25% interests respectively. The development of LS36-1 commenced in 2010 and was completed in July 2014 with trial gas production commenced on July 16, 2014. On October 29, 2014, CNOOC China Ltd. (CCL), on behalf of itself and as sales agent for Primeline, and Zhejiang Natural Gas Development Company Limited (Zhejiang Gas) signed the Gas Sales Contract which superseded the Gas Sale Agreement-in principle and subsequent Framework and Amendment Agreements signed between 2008, 2010 and 2011 and confirmed the general commercial terms already negotiated including, inter alia, gas quality, take-or-pay principles, base price and annual quantity. The formal delivery period of the Gas Sales Contract commenced on January 1, 2015.

Block 33/07 covers an offshore area enclosing Block 25/34. PECL and PPC are collectively the Contractors with interests of 75% and 25% respectively. The Contractors are responsible for 100% of the exploration costs and CCL has the right to participate in up to 51% of any commercial development. Primeline Energy Operations International Ltd (PEOIL), a wholly owned subsidiary of the Company, is the Operator for Block 33/07.

The Company commenced arbitration against Zhejiang Gas (the Zhejiang Gas Arbitration) for its failure to comply with both the base price and minimum quantities required under the Gas Sales Contract. (Note 17), and its failure to take the agreed upon minimum take or pay quantity of natural gas deliveries for the 2015 and 2016 contract years. The Company has also commenced arbitration against CNOOC and CCL, a subsidiary of CNOOC, in respect of claims in respect of CCL's mismanagement in relation to the failure of enforcing the Gas Sale Contract, breach of fiduciary duties as Primeline's agent under the Gas Sales Contract, and for failures to comply with its responsibilities as Operator of Petroleum Contract 25/34 (the CNOOC Arbitration).

The Company's interim consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2017 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, to continue as a going concern, the Company may need to successfully conclude the ongoing arbitrations (as described above), generate sufficient operating cash flows, secure additional capital, obtain continued financial support or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, then the Company is unlikely to have sufficient capital resources or cash flows from operations to satisfy its ongoing obligations and future contractual commitments, including the principal and interest payments due on the Syndicate Facility. Thus, it may not be able to continue as a going concern. Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. As at December 31, 2016, the Company had a working capital deficiency of RMB 1,892 million (CAD\$364 million). Therefore, the Company is actively seeking to successfully resolve the disputes related to the Zhejiang Gas Arbitration and the CNOOC Arbitration and has reached agreement to restructure the Syndicate Facility (Note 11), while remaining focused on minimizing uncommitted capital and exploration expenditures and preserving the Company's growth options. While in the past the Company has been successful in closing financing agreements, there can be no assurance it will be able to do so again. Factors that could affect the availability of financing include the state of debt and equity markets, investor perceptions and expectations, and the natural gas markets. Further, there can be no assurance that the Company will prevail in its commercial arbitration actions, as to the timing of the completion of those actions, or that amounts owing will be collected when required for future cash outflows.

## **2. Basis of Presentation**

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), effective as of December 31, 2016. The Board of Directors authorized these interim consolidated financial statements for issue on February 28, 2017. Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements; they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying unaudited condensed interim financial statements of the Company have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor. The interim consolidated financial statements should be read in conjunction with the Company's annual financial statements for the year ended March 31, 2016.

These interim consolidated financial statements have been prepared in accordance with IFRS as issued by the IASB using the accrual basis except for the revaluation of the derivative warrant liability, which is re-measured and re-translated each reporting period in accordance with IAS 32. The comparative information has also been prepared on this basis.

The preparation of the financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Areas where estimates are significant to the interim consolidated financial statements are disclosed in Note 6.

The preparation of interim consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and expenses. Estimates and judgments are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods. Further information on management's judgments, estimates and assumptions and how they impact the various accounting policies are described below and in the relevant notes to the consolidated financial statements.

The Company may not be successful in the CNOOC Arbitration or the Zhejiang Gas Arbitration (Note 17). Zhejiang Gas may renegotiate a lower price for gas sold under the Gas Sales Contract. In any such event, the Company's future revenues will be lower than anticipated, and there may be a material adverse effect on the Company's debt repayment obligations under the Syndicate Facility.

## **3. Continuity of Interest Basis of Accounting**

The acquisition of PPC in 2015 is a common control transaction under applicable Canadian securities laws. As the acquisition has been determined to be a common control transaction, it has been accounted for on a continuity of interest basis. In accordance with the continuity basis of accounting, these interim consolidated financial statements reflect the assets, liabilities, operations and cash flows of the Company as if the Company and PPC had always been one entity.

There is currently no guidance in IFRS on the accounting treatment for combinations among entities under common control. IAS 8 – Accounting policies, changes in accounting estimates and errors (IAS 8) requires management, if there is no specifically applicable standard of interpretation, to develop a reliable policy that is relevant to the decision-making needs of users. The Company has determined to apply the concept of continuity of interest basis of accounting for transactions under common control as detailed under United States generally accepted accounting principles (US GAAP). US GAAP requires an acquirer in a combination between entities or business under common control to recognize the assets acquired and liabilities assumed in the transaction at their carrying amounts in the accounts of the transferring entities at the date of transfer.

#### **4. Summary of Significant Accounting Policies**

The principal accounting policies applied in the preparation of these interim consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

##### *4.1 Property, Plant and Equipment (PP&E)*

PP&E is recorded at cost less accumulated depletion and depreciation and accumulated impairment losses, net of recovered impairment losses.

PP&E may include the costs of oil and gas development and production wells and costs for the associated plant and for general corporate assets. All development costs incurred after the technical feasibility and commercial viability of producing oil and gas have been demonstrated are capitalized within PP&E. Development and production assets are capitalized on an area-by-area basis and include all costs associated with the development of oil and natural gas reserves. These costs may include expenditures on the construction, installation and completion of infrastructure facilities such as platforms, pipelines, and development wells drilling (including delineation wells), decommissioning costs, amounts transferred from exploration and evaluation assets and directly attributable internal costs.

The Block 25/34 Joint Management Committee (JMC) declared that the 15-year production period for LS36-1 would commence from December 1, 2014. Per the Supplemental Development Agreement between CNOOC, PECL and PPC relating to the development of LS36-1 (the SDA), the production period may be extended by agreement between the parties if additional gas resources are discovered which can be conveniently tied into, transported and processed using the production facility.

Development and production assets are capitalized on an area-by-area basis and include all costs associated with the development and production of oil and natural gas reserves. These costs may include proved property acquisitions, development drilling (including delineation wells), completion, gathering and infrastructure, decommissioning costs, amounts transferred from E&E assets and directly attributable internal costs.

Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred.

Any gains or losses from the divestiture of development and production assets are recognized in earnings.

Accumulated costs are depleted using the unit-of-production method based on estimated proved and probable reserves. Depletion is calculated based on individual components (i.e. fields or combinations thereof and other major components with different useful lives).

Subsequent expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred.

##### *4.2 Depletion, Depreciation, Amortization (DD&A)*

Property, plant and equipment related to the oil and gas production activities is depreciated on a unit of production basis over the proved and probable reserves of the field concerned, except in the case of assets whose useful life differs from the lifetime of the field, in which case the straight-line method is applied.

Computer and office equipment is depreciated at a straight-line basis at the rate of 30% per annum.

##### *4.3 Asset Retirement Obligations (ARO)*

The Company records the present value of legal obligations associated with the retirement of long-term tangible assets, such as producing well sites and processing plants, in the period in which they are incurred with a corresponding increase in the carrying amount of the related long-term asset. The obligation generally arises when the asset is installed or the ground/environment is disturbed at the field location. In subsequent periods, the asset is adjusted for any changes in the estimated amount or timing of the



settlement of the obligations. The carrying amounts of the associated assets are depleted using the unit of production method, in accordance with the depreciation policy for development and production assets. Actual costs to retire tangible assets are deducted from the liability as incurred.

#### *4.4 Exploration and evaluation (E&E) assets*

Once the legal right to explore has been acquired, costs directly associated with an exploration project are capitalized as either tangible or intangible exploration and evaluation assets per the nature of the asset acquired. Such E&E costs may include undeveloped land acquisition, geological, geophysical and seismic modelling, exploratory drilling and completion, testing, decommissioning and directly attributable internal costs. E&E costs are not depleted and are carried forward until technical feasibility and commercial viability of extracting an oil and gas resource is determined.

The technical feasibility and commercial viability of an oil and gas resource is considered to be established when all the following conditions are met - proved and/or probable reserves are determined to exist, the decision to proceed with development has been approved by the Board of Directors, regulatory approval to develop the project has been received and the Company has sufficient funds to complete or participate in the project.

All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the exploratory activity. When this is no longer the case, the impairment costs are charged to exploration and evaluation expense.

Upon determination that the technical feasibility and commercial viability of an oil and gas resource is established, E&E assets attributed to those reserves are first tested for impairment and then reclassified to oil and gas development and production assets within property, plant and equipment, net of any impairment. Expired land costs are also expensed to exploration and evaluation expense as they occur.

E&E assets are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount and upon transfer to PP&E where they are allocated to cash-generating units based on geographical proximity and other factors.

#### *4.5 Foreign currency translation*

##### *(a) Functional and presentation currency*

Items included in the interim consolidated financial statements of the Company and its subsidiaries are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The interim consolidated financial statements are presented in RMB, which is also the functional currency of the Company and its subsidiaries.

##### *(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of loss.

##### *(c) Convenience Translation into CAD\$*

The CAD\$ amounts provided in the interim consolidated financial statements represent supplementary information solely for the convenience of the reader. The financial information presented in CAD\$ has been translated from RMB using a convenience translation at the rate of RMB 5.194 to CAD\$1, which is the exchange rate published in South China Morning Post as of December 31, 2016. Such presentation is not in accordance with IFRS and should not be construed as a representation that the RMB amounts shown could be readily converted, realized or settled in CAD\$ at this or at any other rate.

#### *4.6 Impairment of non-current assets*

The carrying amounts of the Company's PP&E are reviewed at each reporting date for indicators of impairment. If any such indication exists, the recoverable amount of the asset is estimated to determine the amount of the impairment, if any. The recoverable amount of an asset is evaluated at the CGU level, which is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of a CGU is the greater of its fair value less costs of disposal and its value in use. Fair value is determined as the amount that would be received upon sale of the asset in an orderly transaction between market participants, less the costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is recognized in earnings for the period to the extent that the carrying amount of the asset (or CGU) exceeds the recoverable amount.

Impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the carrying amount of the asset (or CGU) does not exceed the carrying amount that would have been determined, net of depletion and depreciation, had no impairment loss been recognized for the asset (or CGU). A reversal of an impairment loss is recognized immediately in earnings.

#### *4.7 Financial assets and liabilities*

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognised when the contractual rights to the cash flows from the financial asset expire or when the contractual rights to those assets are transferred.

Financial liabilities are de-recognised when the obligation specified in the contract is discharged, cancelled or expired. It is the Company's policy that when there is a change to the contractual terms of a financial liability, the Company will use quantitative criteria to establish if the change in the contractual terms resulted in an extinguishment of the financial liability. The Company will also consider qualitative criteria to assess if the change in the contractual terms were to be substantially different and accordingly will account for the change in the contractual terms as an extinguishment even if the quantitative criteria are not met.

The Company classifies its financial assets as loans and receivables. The Company classifies its financial liabilities as other financial liabilities. Loans and receivables and other financial liabilities are recognized initially at fair value and subsequently at amortized cost using the effective interest method. Financial assets and liabilities are classified as current if the assets are realized / liabilities are settled within 12 months. Otherwise, they are presented as non-current.

#### *4.8 Cash and cash equivalents*

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents have been classified as loans and receivables and are measured at amortized cost using the effective interest rate method.

#### *4.9 Trade payables*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as other financial liabilities and are measured at amortised cost using the effective interest method.

#### *4.10 Conversion of debt to equity*

When there is a conversion of debt to equity and the creditor is a shareholder acting in its capacity as such, then the equity issued is recorded at the carrying amount of the financial liability extinguished. No gain or loss arises from such conversions of debt to equity.

#### *4.11 Derivative financial instruments*

The Company's derivative instruments are the share purchase warrants issued. The Company has issued warrants as part of a Unit offering with an exercise price in CAD\$ rather than RMB, the functional currency of the Company. Such share purchase warrants are considered to be derivative instruments.

The Company measured the warrant liability at fair value at the date on which the warrants were issued. The Company's warrant liability is subsequently revalued by reference to the fair value of the warrants at each reporting date using the Black Scholes model and the exchange rate at the balance sheet date with changes in fair value recorded to the statement of loss. Valuation of the warrant liability also requires determining the most appropriate inputs to the valuation model and making assumptions about them. Significant assumptions include: expected life of the warrants, volatility, and dividend yield. A change in the valuation model or related inputs would change the reported amount of the components of the instrument.

#### *4.12 Share capital*

The Company's ordinary shares ("Shares") are classified as equity. Incremental costs directly attributable to the issue of new Shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Share purchase warrants that are issued for underwriting services are initially accounted for under IFRS 2 as equity instruments (their initial fair value would be recognized as a share issue cost). After their issuance, share purchase warrants issued for services that can be tracked (are non-transferable) are considered as equity for their entire life. The fair values of such share purchase warrants are not re-measured. Where these share purchase warrants are ultimately exercised, the applicable amounts of share purchase warrants are credited to share capital.

#### *4.13 Current and deferred income tax*

Tax is recognized in the statement of loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

The income tax charge is calculated based on the tax laws enacted or substantively enacted at the date of the statement of financial position in the countries where the Company and its subsidiaries operate. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate based on amounts expected to be paid to the tax authorities. As the Company and its subsidiaries are domiciled in an income tax-exempt jurisdiction and are in a taxable loss position in the PRC, there is no current income tax.

Deferred income tax is recognised, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for circumstances where the Company controls the timing of the reversal of the

temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

#### *4.14 Share-based payments*

The Company has a share-based compensation plan, details of which are disclosed in Note 10. The Company applies the fair value based method of accounting to recognize the expenses arising from stock options granted to employees and non-employees. The fair value is determined using the Black – Scholes option pricing model, which requires the use of certain assumptions including future stock price volatility and expected life of the instruments.

The total share-based compensation expense is recognised over the vesting period, which is the period over which all the specified vesting conditions are to be satisfied. At the end of each reporting period, the Company revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the statement of loss, with a corresponding adjustment to equity.

When the options are exercised, the Company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital when the options are exercised.

#### *4.15 Revenue recognition*

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods supplied, stated net of discounts, returns and value added taxes. The Company recognizes revenue when the amount of revenue can be reliably measured; when it is probable that future economic benefits will flow to the entity; and when specific criteria have been met for each of the Company's activities, as described below.

Revenues from the sale of natural gas, petroleum, CO<sub>2</sub> and other related products are recorded when title passes to the customer.

Under take or pay contracts, the Company makes a long-term supply commitment in return for a commitment from the buyer to pay for minimum quantities, whether the customer takes delivery. If a buyer has a right to get a “make-up” delivery later, revenue is deferred and recognized only when the product is delivered or the make-up product can no longer be taken. If no such option exists within the contractual terms, revenue is recognized when the take-or-pay penalty is triggered.

#### *4.16 Per share amounts*

Basic earnings (loss) per share are computed per IAS 33 by dividing the net earnings or loss for the period by the weighted average number of Shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if the Company's stock options and warrants outstanding are exercised into Shares. Diluted Shares are calculated using the treasury stock method, which assumes that any proceeds received from “in-the-money” stock options, would be used to buy back Shares at the average market price for the period. No adjustment is made to the weighted average number of Shares if the result of these calculations is anti-dilutive.

#### *4.17 Borrowing costs*

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until the assets are substantially ready for their intended use. All other borrowing costs are recognised as finance costs in the statement of loss in the period in which they are incurred.

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*4.18 Restricted Cash/Restricted Bank Deposit*

Restricted Cash is held as for security for decommissioning costs and is reported in the balance sheet and statement of cash flow separately. If the expected duration of the restriction is less than twelve months, then it is shown in current assets.

Restricted Bank Deposit is cash held on deposit of RMB150,000,000 (CAD\$28,879,476), which is held in a debt service reserve account on a 3-year term for servicing the Syndicate Facility and RMB Banking Facility (Note 11), and can be accessed with penalty loss of interest and/or permission of the Syndicate.

*4.19 Trade receivables*

Trade receivables are recognized and carried at the original invoiced amount less any provision for estimated unrecoverable amounts.

*4.20 Inventories*

Inventories of materials, product inventory supplies and natural gas by-products are stated at the lower of cost and net realizable value. Cost is determined on the first-in, first-out method.

*4.21 Consolidation**Subsidiaries*

Subsidiaries are all entities over which the Company has control. The Company controls an entity when the Company is exposed to, or has the rights to, variable returns from its involvement with the entity and can affect that return through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases. All subsidiaries, as listed below, have been consolidated into the Company's interim consolidated financial statements.

<b>Name of subsidiary</b>	<b>Place of Incorporation</b>	<b>Paid up issued share capital</b>	<b>Percentage of issued capital held by the Company</b>	<b>Functional currency</b>
Primeline Petroleum Corp	British Virgin Islands	US\$1	100%	RMB
Primeline Energy China Limited	Cayman Islands	US\$2	100%	RMB
Primeline Energy Operations International Limited	Cayman Islands	US\$2	100%	RMB

PPC, PECL and PEOIL are registered and have been granted business licenses by the Shanghai Administration of Industry and Commerce in China.

PPC became a subsidiary on August 14, 2015 – for the retroactive effect of such consolidation refer to Note 3.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated.

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*Interests in Joint Operations*

A joint arrangement is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties.

The Company's interests in joint operations are accounted for by recognizing its shares of the assets held jointly, liability held jointly, its revenue from the sale of its share of the output arising from the joint operation and expenses incurred jointly.

The Company and CNOOC's participation in the development and production activities of LS36-1 is through a joint operation without establishing a separate legal entity for this arrangement. The joint operation has engaged CNOOC China Lishui Operating Company (LOC), wholly owned by CCL, as the Operator for the project. LOC is accountable to the JMC, in which both CCL and the Company have equal voting rights and decision-making power. The JMC's executive decisions are to be made jointly by chief representatives from both partners.

The Company's share of the results, assets and liabilities from LS36-1 under the joint operation are incorporated in these interim consolidated financial statements. The Company recognizes, on a line-by-line basis in the interim consolidated financial statements, its share of the assets, liabilities, revenues and expenses of this joint operation incurred jointly with other parties.

*4.22 Segmental reporting*

The Company has one operating segment, which is the exploration of oil and gas properties located in the PRC.

Primeline's interim consolidated financial statements have been prepared in accordance with IFRS as issued by the IASB. Significant accounting policies are disclosed above for the period ended December 31, 2016. Certain of the Company's accounting policies require subjective judgement and estimation in uncertain circumstances.

#### *4.23 Accounting estimates*

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the interim consolidated financial statements. These underlying assumptions are based on historical experience and other factors that management believes to be reasonable under the circumstances, and are subject to change as new events occur, as more industry experience is acquired, as additional information is obtained and as the Company's operating environment changes. Specifically, amounts recorded for depletion, depreciation, amortization and impairment, asset retirement obligations (ARO), assets and liabilities measured at fair value, employee future benefits, income taxes and contingencies are based on estimates.

##### 4.23.1. Depletion, Depreciation, Amortization (DD&A) and Impairment

Eligible costs associated with oil and gas activities are capitalized on a unit of measure basis. Depletion expense is subject to estimates including petroleum and natural gas reserves, future petroleum and natural gas prices, estimated future remediation costs, future interest rates as well as other fair value assumptions. The aggregate of capitalized costs, net of accumulated DD&A, less estimated salvage values, is charged to DD&A over the life of the proved developed reserves using the unit of production method, except in the case of assets whose useful life is shorter or longer than the lifetime of the proved developed reserves of that field, in which case the straight-line method or a unit-of-production method based on total proved plus probable reserves is applied.

##### 4.23.2. Impairment of Non-Financial Assets

The carrying amounts of the Company's non-financial assets are reviewed at the end of each reporting period to determine whether there is any indication of impairment. Determining whether there are any indications of impairment requires significant judgment of external factors, such as an extended decrease in prices or margins for oil and gas commodities or products, a significant decline in an asset's market value, a significant downward revision of estimated volumes, an upward revision of future development costs, a decline in the entity's market capitalization or significant changes in the technological, market, economic or legal environment that would have an adverse impact on the entity. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to net earnings.

The determination of the recoverable amount for impairment purposes involves the use of numerous assumptions and estimates. Estimates of future cash flows used in the evaluation of impairment of assets are made using management's forecasts of commodity prices, operating costs and future capital expenditures, marketing supply and demand, forecasted crack spreads, growth rate, discount rate and, in the case of oil and gas properties, expected production volumes. Expected production volumes take into account assessments of field reservoir performance and include expectations about proved and probable volumes and where applicable economically recoverable resources associated with interests which are risk-weighted utilizing geological, production, recovery, market price and economic projections. Either the cash flow estimates or the discount rate is risk-adjusted to reflect local conditions as appropriate. Future revisions to these assumptions will impact the recoverable amount. As a result of the ongoing arbitrations over the price of gas in the Gas Sales Contract, we have had to make certain judgments around future prices based on our estimate of success in having our rights under the contract upheld or otherwise agreeing to accept a market related approach (Note 8). We have used the Henry Hub and an oil based forward price curve to estimate such potential future market prices.

##### 4.23.3. ARO

Estimating ARO requires that Primeline estimate costs many years in the future. Restoration technologies and costs are constantly changing, as are regulatory, political, environment, safety and public relations considerations. Inherent in the calculation of ARO are numerous assumptions and estimates, including the ultimate settlement amounts, future third-party pricing, inflation factors, credit-adjusted discount rates, timing of settlement and changes in the legal, regulatory, environmental and political environments. Future revisions to these assumptions may result in changes to the ARO.

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**4.23.4. Fair Value of Financial Instruments**

The fair values of derivatives are determined using valuation models, which require assumptions concerning the amount and timing of future cash flows and discount rates. These estimates are also subject to change with fluctuations in commodity prices, interest rates, foreign currency exchange rates and estimates of non-performance. The actual settlement of a derivative instrument could differ materially from the fair value recorded and could impact future results.

The payments overdue in respect of gas for which Zhejiang Gas has only made partial payment have not been recognized in the accounts, given revenue recognition has not yet been established. Full recovery of these amounts will be dependent on successful resolution of the Zhejiang Gas Arbitration and CNOOC Arbitration or an alternative settlement.

**4.23.5 Income Taxes**

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations. Estimates that require significant judgments are also made with respect to the timing of temporary difference reversals, how realizable tax assets are, and in circumstances where the transaction and calculations for which the ultimate tax determination are uncertain. All tax filings are subject to audit and potential reassessment, often after the passage of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

**4.23.6 Legal, Environmental Remediation and Other Contingent Matters**

Primeline is required to determine both whether a loss is probable based on judgment and interpretation of laws and regulations and whether the loss can be reasonably estimated. When a loss is determined, it is charged to net earnings. Primeline must continually monitor known and potential contingent matters and make appropriate provisions by charges to net earnings when warranted by circumstances.

*4.24 Key Judgements*

Management makes judgments regarding the application of IFRS for each accounting policy. Critical judgments that have the most significant effect on the amounts recognized in the consolidated financial statements include successful efforts and impairment assessments, the determination of cash generating units (CGUs), the determination of a joint arrangement and the designation of the Company's functional currency.

**4.24.1. Impairment of Financial Assets**

The Company's derivative instruments are share purchase warrants issued with an exercise price in CAD\$ rather than RMB. Such share purchase warrants are derivative instruments. The Company measured the warrant liability at fair value at the date on which the warrants were issued. The Company's warrant liability is subsequently revalued by reference to the fair value of the warrants at each reporting date using the Black Scholes model and the exchange rate at the balance sheet date with changes in fair value recorded to the income (loss) statement. Valuation of the warrant liability also requires determining the most appropriate inputs to the valuation model and making assumptions about them. Significant assumptions include: expected life of the warrants, volatility, and dividend yield. A change in the valuation model or related inputs would change the reported amount of the components of the instrument.

A financial asset is assessed at the end of each reporting period to determine whether it is impaired based on objective evidence indicating that one or more events have had a negative effect on the estimated future cash flows of that asset. Objective evidence used by the Company to assess impairment of financial assets includes quoted market prices for similar financial assets and historical collection rates for loans and receivables. The calculations for the net present value of estimated future cash flows related to derivative financial assets requires the use of estimates and assumptions, including forecasts of commodity prices, marketing supply and demand, product margins and expected production volumes, and it is possible that the assumptions may change, which may require a material adjustment to the carrying value of financial assets.



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## 4.24.2. CGUs

The Company's assets are grouped into CGUs, which is the smallest identifiable group of assets, liabilities and associated goodwill that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The determination of the Company's CGUs is subject to management's judgment.

## 4.24.3. Joint Arrangements

Joint arrangements represent activities where the Company has joint control established by a contractual agreement. Joint control requires unanimous consent for financial and operational decisions. A joint arrangement is either a joint operation whereby the parties have rights to the assets and obligations for the liabilities or a joint venture whereby the parties have rights to the net assets.

Determining the type of joint arrangement as either joint operation or joint venture is based on management's assumptions of whether it has joint control over another entity. The considerations include, but are not limited to, determining if the arrangement is structured through a separate vehicle and whether the legal form and contractual arrangements give the entity direct rights to the assets and obligations for the liabilities within the normal course of business. Management also assesses the entity's rights to the economic benefits, other facts and circumstances and its involvement and responsibility for settling liabilities associated with the arrangement.

## 4.24.4. RMB as Functional Currency

Functional currency is the currency of the primary economic environment in which the Company and its subsidiaries operate and is normally the currency in which the entity primarily generates and expends cash. The designation of RMB as the Company's functional currency is a management judgment based on the composition of revenues and costs in the locations in which it operates.

## 4.24.5. Exploration and evaluation (E&amp;E) costs

Costs directly associated with an exploration project are initially capitalized as exploration and evaluation assets. Such E&E costs may include undeveloped land acquisition, geological, geophysical and seismic modelling, exploratory drilling and completion, testing, decommissioning and directly attributable internal costs.

Expenditures related to wells that do not contain reserves or where no future activity is planned are expensed as exploration and evaluation expenses. Exploration and evaluation costs are excluded from costs subject to depletion until technical feasibility and commercial viability is assessed or production commences. At that time, costs are either transferred to property, plant and equipment or their value is impaired. Impairment is charged directly to net earnings. Drilling results, required operating costs and capital expenditure and estimated reserves are important judgments when making this determination and may change as new information becomes available.

E&E costs are not depleted and are carried forward until technical feasibility and commercial viability of extracting an oil and gas resource is determined. The technical feasibility and commercial viability of an oil and gas resource is established when all the following conditions are met - proved and/or probable reserves are determined to exist, the decision to proceed with development has been approved by the Board of Directors, regulatory approval to develop the project is received, and the Company has sufficient funds to complete or participate in the project. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the exploratory activity. When this is no longer the case, the impairment costs are charged to exploration and evaluation expense.

Upon determination that the technical feasibility and commercial viability of an oil and gas resource is established, E&E assets attributed to those reserves are first tested for impairment and then reclassified to oil and gas development and production assets within property, plant and equipment, net of any impairment. Expired land costs are also expensed to exploration and evaluation expense as they occur.

E&E assets are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount, and upon transfer to property, plant and equipment whereby they are allocated to CGUs based on geographical proximity and other factors.

#### 4.24.6. Accounting for take or pay contracts

Under take or pay contracts, the Company make a long-term supply commitment in return for a commitment from the buyer to pay for minimum quantities, whether or not the customer takes delivery. If a buyer has a right to get a “make-up” delivery at a later date, revenue is deferred and recognized only when the product is delivered or the make-up product can no longer be taken. If no such option exists within the contractual terms, revenue is recognized when the take-or-pay penalty is triggered.

Important judgements are required in assessing the ability of the buyer to physically take future extra gas shipments in order to “make-up” shortfalls in a contract year including assessing any annual off-take plan filed by the buyer setting the offtake arrangements for the coming year, the minimums and maximums established under the take or pay contract and actual offtake to March 31 each year.

Under IFRS, only that portion of the make-up that has been determined to be no longer capable of being taken may be recognized as revenue.

## 5 Changes in accounting standards

### New, Amended and Future IFRS Pronouncements

The following new standards, amendments to standards and interpretations are not yet effective or have otherwise not yet been adopted by the Company. The Company is evaluating the impact, if any; adoption of the standards will have on the disclosures in the Company’s interim consolidated financial statements:

(i) IFRS 9 *Financial Instruments* (IFRS 9)

IFRS 9, ‘Financial Instruments’, addresses the classification, measurement and recognition of the financial assets and financial liabilities. IFRS 9 was issued in November 2009 and 2010 and is effective for the periods commencing on or after January 1, 2018, with earlier adoption permitted. It replaces parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity’s business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements.

The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity’s own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company is set to assess IFRS 9’s full impact. The Company will also consider the impact of the remaining phases of IFRS 9 ahead of the effective date of January 1, 2018.

(ii) IFRS 15 *Revenue from Contracts with Customers* (IFRS 15)

The IASB issued IFRS 15 in May 2014. This IFRS replaces IAS 18 Revenue, IAS 11 Construction Contracts and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework, which requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. The new standard is effective for the periods commencing on or after January 1, 2018, with earlier adoption permitted. The Company is currently evaluating the impact of adopting IFRS 15 on the interim consolidated financial statements.

(iii) IFRS 16 *Leases* (IFRS 16)

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The IASB issued IFRS 16 in January 2016. This IFRS will result in all leases being recognized on the statement of financial position of lessees, except those that meet the limited exception criteria. The standard is effective for the periods commencing on or after January 1, 2019, with earlier adoption permitted.

**6 Financial risk management***6.1 Financial risk factors*

The Company's financial instruments consist of the Syndicate Facility, RMB Banking Facility (Note 11), cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, cash calls payable and convertible bonds.

Fair values of assets and liabilities are amounts at which these items could be exchanged in transactions between knowledgeable parties. Fair value is based on available public market information or when such information is not available, estimated using present value techniques and assumptions concerning the amount and timing of future cash flows and discount rates, which factor in the appropriate credit risk. The calculation of estimated fair value is based on market conditions at the specific point in time and in the respective geographic locations and may not be reflective of future values.

The fair value of the financial assets and current liabilities approximates their carrying value given the short maturity of these instruments, and anticipates a successful conclusion to the CNOOC Arbitration and Zhejiang Gas Arbitration for the Company.

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk and interest rate risk.

*(a) Currency risk*

The Company held financial instruments in different currencies during the years ended as follows:

	December 31, 2016	March 31, 2016
Cash and cash equivalents of:		
- CAD\$ '000	101	101
- US\$ '000	166	11,221
- GBP '000	14	18
- HK\$ '000	223	151
Bank loans and interest of US\$ '000	(231,300)	(256,900)
Convertible bonds and interest of US\$ '000	(18,036)	(18,000)

Based on the above net exposures, and if all other variables remain constant, a 10% depreciation or appreciation of the RMB against the CAD\$, US\$, British Pound and Hong Kong Dollar, would result in an increase/decrease of the Company's net (loss) income of approximately:

	December 31, 2016 RMB'000	March 31, 2016 RMB'000	December 31, 2016 CAD\$'000
- CAD\$	53	51	10
- US\$	173,821	185,406	33,466
- GBP	12	17	2
- HK\$	20	13	4

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*(b) Credit and trade receivables risk*

Credit and trades receivables risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company's cash and cash equivalents outside China are principally held at large international financial institutions in interest bearing accounts. The majority of current cash balances are held at a Chinese financial institution in RMB, primarily for the purpose of debt servicing requirements relating to the Syndicate Facility.

The Company currently sells its natural gas a single customer, Zhejiang Gas through CCL and receives sales proceeds on a weekly basis. Significant amounts not recognized under the Company's revenue recognition policy are also due from Zhejiang Gas and are subject to arbitration proceedings and continued negotiations with the customer (Note 18).

*(c) Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. Financing may be required in relation to any future development work and exploration commitments. (Notes 1 and 15)

*(d) Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is subject to interest rate risk relating to the Syndicate Facility.

*6.2 Capital management*

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern to pursue the exploration and development of its petroleum property interests, acquire additional petroleum property interests and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. In the management of capital, the Company includes its cash and cash equivalent balances, convertible bonds, bank loan and components of shareholders' equity.

The Company manages the capital structure and adjusts it considering changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents and investments.

To facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The Board of Directors approves the annual and quarterly budgets.

At this stage of the Company's development, to maximize ongoing development efforts, the Company does not pay out dividends.

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**7 Exploration and evaluation assets**

	<b>Exploration and evaluation assets</b>
	RMB'000
<b>Balance at April 1, 2015 (Restated – Note 3)</b>	306,267
Additions	152,955
<b>Balance at March 31, 2016</b>	459,222
Additions	18,015
<b>Balance at December 31, 2016</b>	477,237
	CAD\$'000
<b>Balance at December 31, 2016 in CAD\$ (Note 4.5)</b>	91,882

E&E relates to Petroleum Contract 33/07 where PECL and PPC are collectively the Contractors. The Contractors are responsible for 100% of the exploration costs and CNOOC has the right to participate in up to 51% of any commercial development.

By entering phase two of the Exploration stage, the Company has agreed to relinquish 25% of the contract area under the Petroleum Contract. The contract area for Petroleum Contract 33/07 now is 4,397 sq. km and the commitment is to drill one well within 2 years.

**8 Property, plant and equipment**

In accordance with Petroleum Contract 25/34, the production period for LS36-1 will be for a minimum of 15 years from the commencement of commercial production and may be extended by agreement between the parties in the event that additional gas resources are discovered which can be conveniently tied into, transported and processed using the production facility.

	<b>Oil &amp; Gas Properties</b>	<b>Computer &amp; Office Equipment</b>	<b>Total</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	CAD\$'000
<b>COST</b>				<b>(Note 4)</b>
At April 1, 2015 (Restated – Note 3)	2,079,858	20	2,079,878	400,439
Additions	12,242	-	12,242	2,357
Disposal	(458)	-	(458)	(88)

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<b>At March 31, 2016</b>	2,091,642	20	2,091,662	402,708
Additions	31,346	22	31,368	6,039
<b>At December 31, 2016</b>	<b>2,122,988</b>	<b>42</b>	<b>2,123,030</b>	<b>408,747</b>

**DEPLETION AND,  
DEPRECIATION**

At April 1, 2015 (Restated- Note 3)	98,636	18	98,654	18,994
Charge for the year	171,265	-	171,265	32,974
Disposal	(458)	-	(458)	(88)
<b>At March 31, 2016</b>	<b>269,443</b>	<b>18</b>	<b>269,461</b>	<b>51,880</b>
Charge for the year	172,883	4	172,887	33,286
<b>At December 31, 2016</b>	<b>442,326</b>	<b>22</b>	<b>442,348</b>	<b>85,166</b>

<b>CARRYING VALUES</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>CAD\$000</b>
At April 1, 2015 (Restated- Note 3)	1,981,222	2	1,981,224	381,445
At March 31, 2016	1,822,199	2	1,822,201	350,828
<b>At December 31, 2016</b>	<b>1,680,662</b>	<b>20</b>	<b>1,680,682</b>	<b>323,581</b>

As at December 31, 2016, the Company reviewed the carrying amounts of its gas assets for indicators of impairment such as the dispute with its sole customer, which resulted in lower than contracted offtake and payments below the contracted price, changes in future prices, future costs and reserves. Based on this review, the Company's LS36-1 CGU was tested for impairment in accordance with the Company's accounting policy. The recoverable amount of the CGU was estimated based on the FVLCD using a scenario weighted discounted cash flow model. Key assumptions by management included significant judgement around the potential outcomes of the ongoing arbitrations and negotiations with the parties to the Gas Sales Contract, estimates of reserves and resources comprising proved, probable and certain prospective resources, consistent with the independent engineer's reserve report and using the oil price forecast contained in the report. Other key inputs include estimate of the future cash price received by the Company from Zhejiang Gas, gas quality, liquids and by-products yields, take-or-pay principles, annual quantity from the Gas Sales Contract, and a discount rate of 12%.

A reasonably possible change in the aforementioned key assumptions on which management has based its determination of the recoverable amount would cause the carrying amount to exceed the recoverable amount of the CGU. The amount by which the Company's recoverable amount exceeds its carrying amount is in the range of RMB 9.1 to 51.1 million, depending on the forward curve used to inflate the future gas prices. A change in the discount rate of 0.5% is a sufficient change to reduce the headroom by approximately RMB 35.0 million and would create a recoverable amount less than the carrying amount of the CGU using the Henry Hub forward gas curve and a recoverable amount in excess of the carrying amount using an oil linked gas curve in the independent engineer's reserve report.

A 10% reduction in the probability applied to negotiating or fully winning the arbitrations, either of these resulting in having the terms of the existing Gas Sales Contract with Zhejiang Gas upheld and the resulting

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10% increase in the probability of agreeing or being ordered to accept a market based pricing arrangement, would reduce the Company's headroom in the impairment test by approximately RMB 6.3 million. A complete loss through negotiation or arbitration would yield an impairment of approximately RMB 22.0 million using the Henry Hub forward gas curve or significant headroom using the oil linked gas curve in the independent engineer's reserve report.

**9 Decommissioning Liabilities**

	<b>December 31, 2016</b>	<b>March 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	RMB'000	CAD\$'000 (Note 4)
Balance, beginning of year (Restated – Note 3)	152,801	147,777	29,419
Accretion	3,880	5,024	747
Balance, end of year	<u>156,681</u>	<u>152,801</u>	<u>30,166</u>

The total undiscounted future asset retirement obligations, including costs to reclaim and abandon wells and facilities in the years in which such costs are expected to be incurred is estimated by CNOOC and stated in the Overall Development Plan for LS36-1 to be RMB 417,820,000. The Company's share of the liability is RMB204,731,800.

At December 31, 2016, the Company's share of the liability in the principal amount of RMB204,731,800 (CAD\$39,416,981) which has a net present value of RMB156,681,304 (CAD\$30,165,827) (assuming the liability is settled in 10 years and using an estimated risk-free nominal interest rate of 3.4% which equates to the long term yield on PRC government bond). The Company's share of the decommissioning liability has been determined to be non-current. Financing costs relating to the accretion of the decommissioning liabilities are RMB3,880,101 (CAD\$747,035). Cash held as security for the decommissioning costs is reported in the balance sheet as restricted cash of RMB45,533,250 (CAD\$8,766,509).

**10 Share Capital and Share Options***a) Share Capital*

	<b>Number of shares</b>	<b>Share Capital RMB'000</b>	<b>Share Premium RMB'000</b>	<b>Total RMB'000</b>	<b>Total CAD\$'000</b>
Balance – as at April 1, 2015 (Restated – Note 3)	157,460,869	1,030	484,967	485,997	93,569
Shareholder loan converted to Shares (i)	21,218,535	193	40,145	40,338	7,766
Issue of shares in payment of Bond interest accrued	1,960,716	18	(18)	-	-
Bond interest accrued	-	-	1,447	1,447	279
Issue shares in payment of share finder fee	3,140,775	29	2,439	2,468	475
Shareholder loan conversion costs	-	-	(146)	(146)	(29)
Balance – as at March 31, 2016	183,780,895	1,270	528,834	530,104	102,060
Issue of shares in payment of Bond interest accrued	5,484,449	50	(50)	-	-
Bond interest accrued	-	-	2,345	2,345	451
Balance – as at December 31, 2016	<u>189,265,344</u>	<u>1,320</u>	<u>531,129</u>	<u>532,449</u>	<u>102,511</u>

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

(i) On June 5, 2015, the balance of the Company's shareholder loans of US\$10.1667 million from Mr. Victor Hwang, the Company's Chairman, President and majority shareholder, was converted into 21,218,535 Shares at a conversion price of CAD\$0.58 per share with TSX-V approval.

*b) Share Purchase Options*

The Company has a stock option plan ("the Plan"), pursuant to which the directors are authorized to grant options to purchase up to 10% of the issued and outstanding Shares from time to time. The options enable the directors, officers, consultants and employees of the Company to acquire Shares. The board of directors, subject to TSX-V policy, sets the exercise price of a share option. Options granted under the Plan may have a maximum term of ten years and, subject to any vesting restrictions imposed by the TSX-V, vest over such period as is determined by the board of directors at the grant date.

The following table summarizes the stock option activity under the Plan:

	<b>Options outstanding</b>	<b>Weighted Average exercise price CAD\$</b>	<b>Options exercisable</b>	<b>Weighted Average exercise price CAD\$</b>
As at April 1, 2015	5,935,000	0.51	2,550,000	0.38
Granted	-	-	3,085,000	0.60
Expired	(625,000)	(0.47)	(475,000)	(0.41)
As at March 31, 2016	5,310,000	0.51	5,160,000	0.51
Vested	-	-	150,000	0.68
Expired	(1,575,000)	(0.32)	(1,575,000)	(0.32)
As at December 31, 2016	3,735,000	0.60	3,735,000	0.60

As at December 31, 2016, there are 189,265,344 Shares and 3,735,000 stock options outstanding and exercisable as follows:

<b>Exercise price</b>	<b>Number of outstanding options</b>	<b>Weighted average remaining contractual life</b>	<b>Number of exercisable options</b>
As at March 31, 2016			
CAD\$0.32 (a)	1,575,000	0.32 years	1,575,000
CAD\$0.50 (b)	500,000	1.24 years	500,000
CAD\$0.60 (c)	2,785,000	1.49 years	2,785,000
CAD\$0.68 (d)	450,000	3.36 years	300,000
	<b>5,310,000</b>	<b>1.08 years</b>	<b>5,160,000</b>



**Primeline Energy Holdings Inc.**  
Notes to Interim Consolidated Financial Statements (Unaudited)  
For the nine months ended December 31, 2016  
(in RMB)

As at December 31, 2016

CAD\$0.50 (b)	500,000	0.48 years	500,000
CAD\$0.60 (c)	2,785,000	0.74 years	2,785,000
CAD\$0.68 (d)	450,000	2.61 years	450,000
	<b>3,735,000</b>	<b>0.73 years</b>	<b>3,735,000</b>

- a) On July 27, 2011, the Company granted 2,100,000 options at an exercise price of CAD\$0.32 per share to directors, officers, employees and consultants, the last of which expired on July 27, 2016.
- b) On July 9, 2012, the Company granted 500,000 options at an exercise price of CAD\$0.50 per share to D&D Securities Inc. in consideration of on-going investor relations services. The options expire on June 25, 2017.
- c) On September 26, 2012, the Company granted 3,105,000 options at an exercise price of CAD\$0.60 per share to directors, officers, employees and consultants of which 320,000 options expired and 2,785,000 expire on September 26, 2017. 3,085,000 options vested on June 5, 2015 upon the conversion of shareholder loan. .
- d) On August 11, 2014, the Company granted 450,000 options at an exercise price of CAD\$0.68 per share to an officer. Such options will expire on August 11, 2019. Share based payments of RMB 30,889 (CAD\$5,947) (2015 – RMB89,808) were recognized as salary and benefit in the consolidated statement of loss and comprehensive loss. Share based payment of RMB 72,075 (CAD\$13,877) (2015 – RMB209,553) was capitalized as exploration and evaluation assets. All 450,000 options have vested.

**11 Bank Loans**

	<b>December 31, 2016</b>	<b>March 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	RMB'000	CAD\$'000
Within one year	1,753,882	1,743,940	337,675
More than one year	-	-	-
Secured floating-rate bank loan	<b>1,753,882</b>	<b>1,743,940</b>	<b>337,675</b>

The original principal amount of the Syndicate Facility is US\$274 million which is repayable over 9 years at an all-in interest rate of 6 month LIBOR+4.7% with interest and principal repayments made bi-annually (except the first year which has no principal repayment). The initial two principal repayments of US\$21 million were paid on November 20, 2015 and on May 20, 2016.

As at March 31 and December 31, 2016, the Company was in default of certain covenants under the Syndicate Facility. The Syndicate is aware that certain project economic parameters, including, inter alia, the debt repayment reserve account and the debt recovery ratio, did not meet the Syndicate Facility threshold. Thus, all amounts due to the Syndicate are shown as current in accordance with IFRS.

On 20 November 2016, the Syndicate agreed to support the Company during the Zhejiang Gas Arbitration and CNOOC Arbitration and this includes reduced principal repayments on the Syndicate Facility in November 2016 and May 2017 to US\$2 million, representing a deferral of principal repayments of US\$36 million over the life of the loan, and to reduce the Company's interest rate margin from 470bps to 335bps over 6 month LIBOR to term. The Company made the reduced third principal repayment of US\$1 million on November 20, 2016.

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

Principal repayment amounts outstanding under the Syndicate Facility are as follows:

	<b>December 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	CAD\$ '000
Within 1 year	1,611,456	310,254
More than 1 year, but not more than 5 years	-	-
More than 5 years	-	-
Total	<u>1,611,456</u>	<u>310,254</u>

Estimated interest amounts outstanding under the Syndicate Facility are as follows:

	<b>December 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	CAD\$ '000
Within 1 year	82,025	15,792
More than 1 year, but not more than 5 years	178,406	34,348
More than 5 years	897	173
Total	<u>261,328</u>	<u>50,313</u>

On December 9 and 24, 2015, January 13, 2016 and May 10, 2016, PECL signed short term RMB banking facilities with Shanghai Pudong Development Bank (the RMB Banking Facility) reserved for LS36-1 operations. The principal amounts of the facilities are a total of RMB142.5 million at an interest rate of 4.0455% per annum. The Company made a partial principal repayment of RMB74,310 towards one of the facilities with a principal amount of RMB21.5 million on December 24, 2016. The principal repayment dates of facilities with principal amounts of RMB45 million and RMB21.5 million were extended on the December 8 and 26, 2016 respectively for another 12 months. The principal repayment amounts outstanding under the RMB Banking Facility based on the extended repayment schedules are as follows:

	<b>December 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	CAD\$ '000
Within 1 year	142,426	27,421
Total	<u>142,426</u>	<u>27,421</u>

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

The estimated interest amounts outstanding under the RMB Banking facility are as follows:

	<b>December 31, 2016</b>	<b>December 31, 2016</b>
	RMB'000	CAD\$ '000
Within 1 year	3,206	617
Total	<u>3,206</u>	<u>617</u>

**12 Interest and other income**

	<b><u>Nine Month Period Ended December 31,</u></b>		
	<b>2016</b>	<b>2015</b>	<b>2016</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>CAD\$'000</b>
Bank interest income	5,949	6,883	1,145
Gain on disposal of property, plant and equipment	-	150	-
Gain on fair value of re-measurement of warrant liability	-	668	-
	<u>5,949</u>	<u>7,701</u>	<u>1,145</u>

**13 Convertible Bonds**

The term of the convertible bonds is three years extendable for two one-year periods. Interest is payable quarterly at 7% per annum, of which 4.5% will be paid in cash and 2.5% in Shares at a deemed price per share equal to the volume-weighted average trading price of the shares on the TSX-V for the 10 consecutive trading days preceding the interest payment date.

The Tranche A Bonds had a total nominal value of RMB63,940,000 (CAD\$12,310,358) at August 14, 2015. Liability component of RMB59,026,215 (CAD\$11,364,308) and equity conversion component of RMB4,913,785 (CAD\$946,050) were recognized initially. Transaction cost of RMB5,738,241 (CAD\$1,104,783), were determined at the date of issuance of the Bonds.

The Tranche B Bonds had a total nominal value of RMB50,800,000 (CAD\$9,780,516) at November 10, 2015. Liability component of RMB46,907,627 (CAD\$9,031,118) and the equity conversion component of RMB3,892,213 (CAD\$749,367) were recognized initially. Transaction cost of RMB220,709 (CAD\$42,493), were determined at the date of issuance of the Bonds.

The fair value of the liability component included in the Bonds was calculated using a market interest rate for an equivalent non-convertible Bond. The liability component is subsequently stated at amortised cost until extinguished on conversion or maturity of the Bond. The residual amount, representing the value of the equity conversion component, is included in shareholder's equity in convertible bonds reserves.

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)  
For the nine months ended December 31, 2016  
(in RMB)

	December 31, 2016		
	RMB'000	RMB'000	RMB'000
	<u>Tranche A</u>	<u>Tranche B</u>	<u>Total</u>
Face value	63,940	50,800	114,740
Equity component	(4,914)	(3,892)	(8,806)
Liability component on initial recognition	59,026	46,908	105,934
Transaction costs for the issuance	(8,472)	(1)	(8,473)
Amortization of transaction costs and share finder fee	4,002	-	4,002
Fair value adjustment	8,439	5,239	13,678
Total Convertible bonds	<u>62,995</u>	<u>52,146</u>	<u>115,141</u>

**14 Transactions with related parties and directors**

During the period ended December 31, 2016, the Company paid or accrued the following:

- a) Fees and benefits paid or accrued to key management personnel of the Company being Dr. Ming Wang, Mr. Andrew Biggs, Mr. Stuart Joyner, Mr. Mark Norman and others were RMB4,334,986 (CAD\$834,614) (December 31, 2015 – RMB4,837,897) and share based payment of RMB102,964 (CAD\$19,824) (December 31, 2015 – RMB641,046) was recognized for the 450,000 (December 31, 2015 – 2,360,000) share options granted to these key management personnel.
- b) Fees and benefits paid or accrued to certain directors, being Mr. Victor Hwang, Mr. Brian Chan, Mr. Peter Kelty, Mr. Alan Johnson, Mr. Vincent Lien and Mr. Timothy Baldwin were RMB379,180 (CAD\$73,003) (December 31, 2015 – RMB379,171) and share based payment of Nil (December 31, 2015 – RMB331,150) was recognized for Nil (December 31, 2015 – 2,100,000) share options granted to the directors.

These transactions are measured on terms equivalent to those that prevail in arm's length transactions are made only if such terms are substantiated.

**15 Commitments**

- a) Under Petroleum Contract 33/07, the Company has a 7.5 years' exploration period divided into 3 exploration periods of 3.5, 2 and 2 years each. On May 5, 2016, Primeline agreed with CNOOC that it would enter the second phase of exploration commitment under Petroleum Contract 33/07, with a commitment to drill one well to 2,500 meters. There are no anticipated expenditures for such exploration activities currently; and
- b) The Company entered a lease agreement in June 2015 for new premises for its Shanghai office in the PRC which covers the three-year period from September 15, 2015 to 2018 for a monthly rental fee of RMB141,757.00 (CAD\$27,292).

**16 Fair value measurement**

Certain financial assets and liabilities are measured at fair value on a recurring basis and classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Certain non-financial assets and liabilities may also be measured at fair value on a non-recurring basis. There are three levels of the fair value hierarchy that prioritize inputs to valuation techniques used to measure fair value, with Level 1 inputs having the highest priority. The levels and valuation techniques used to value the Company's financial assets and liabilities are described below:

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

*1) Level 1- Quoted Prices in Active Markets for Identical Assets*

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

The Company does not have any financial assets or liabilities that are included in Level 1 of the fair value hierarchy.

*2) Level 2 – Significant Other Observable Inputs*

Quoted prices in market that are not active, quote prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

The Syndicate Facility (Note 11) which is a secured floating rate instrument, was recorded at fair value on inception and is carried at amortized cost.

A 1% change in the 6-month USD LIBOR rate would cause a 19.4% increase in interest expense.

A 1% change in the USD/RMB rate would cause (from RMB 6.976 to RMB 7.046) a 1% change in interest expense.

The Convertible Bond liability is included in Level 2 of the fair value hierarchy as the Bonds are valued using a pricing model, which require a variety of inputs, including but not limited to discount rates.

*3) Level 3 – Significant Unobservable Inputs*

Unobservable (supported by little or no market activity) prices.

The Company does not have any financial assets and liabilities that are included in Level 3 of the fair value hierarchy.

**17 Revenue**

	<b><u>For the nine months ended December 31,</u></b>		
	<b>2016</b>	<b>2015</b>	<b>2016</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>CADS'000</b>
Natural gas - Billed	155,481	102,634	29,935
CO2	-	-	-
Condensate	18,839	13,439	3,627
Light Oil	4,262	1,611	821
LPG	2,765	-	532
	<hr/>	<hr/>	<hr/>
	181,347	117,684	34,915
	<hr/>	<hr/>	<hr/>

Under the terms of the Company's Gas Sales Contract with Zhejiang Gas the base price and minimum annual quantities are both fixed (Note 18). During the year ended March 31, 2016 and the period ended December 31, 2016, Zhejiang Gas disputed the base price in the agreement and significantly short paid amounts invoiced to it by CCL. As a result of the significant period of dispute with Zhejiang Gas, which ultimately led to the filing of the Zhejiang Gas Arbitration for its failure to comply with both the base price and minimum quantities required under the Gas Sales Contract, the Company determined that in accordance with IFRS revenue recognition standards that its share of the disputed and unpaid portion of the offtake invoices issued by CCL should not be recognized as revenue from the point that Zhejiang Gas unilaterally began to apply a lower price to payment of these invoices. Accordingly, the Company has not recognized a total of approximately RMB235 million (CAD\$45 million) being the take or pay and its share of the unpaid amounts properly invoiced by CCL, of

**Primeline Energy Holdings Inc.**

Notes to Interim Consolidated Financial Statements (Unaudited)

For the nine months ended December 31, 2016

(in RMB)

which RMB24 million (CAD\$5 million) relates to the quarterly period ended December 31, 2016. Notwithstanding this accounting treatment, the Company remains firmly of the opinion that Zhejiang Gas will agree or be compelled to honour its commitments under the Gas Sales Contract and that this revenue will subsequently be recognised as income.

**18 Trade receivables**

	<b>December 31, 2016</b>	<b>March 31, 2016</b>	<b>December 31 , 2016</b>
	RMB'000	RMB'000	CAD\$ '000
Less than 30 days past due	18,306	11,717	3,524
More than 30 days past due	-	-	-
Total	<u>18,306</u>	<u>11,717</u>	<u>3,524</u>

Because of the continuing dispute with Zhejiang Gas, the Company has decided that, in accordance with IFRS revenue recognition accounting standards, it will not currently recognize its share of the amount invoiced by CCL for take or pay volume. Notwithstanding this accounting treatment, the Company remains firmly of the opinion that Zhejiang Gas will agree or be compelled to honour its commitments under the Gas Sales Contract and that such revenue will subsequently be recognised as income.

The trade receivable of RMB 18,305,628 as at 31 December 2016 relating to the natural gas and by products sales in the month of December 2016 and it was fully paid in January 2017.

**19 Long term accounts payable**

Under the repayment agreement with CNOOC in December 2014, which governs the terms and basis for the Company's repayment of its LS36-1 development cost obligations, the Company and CNOOC agreed a supplementary management fee would be added in consideration of the carry by CNOOC of those costs during that period. The fee is expected to be paid by cash call adjustments by CNOOC and the non-current portion has been accrued as an account payable with the full amount capitalised as a development cost into PP&E.

**20 Subsequent event**

On March 1, 2017 Following extensive negotiations, CCL and Primeline entered settlement agreements with Zhejiang Gas. The settlement is based on a pricing arrangement that results in Primeline receiving for its share of gas:

- at the original price agreed under the GSC up to December 31, 2016 and then
- at price which is at 7% reduction from the GSC price, fixed from January 1, 2017 for the rest of the GSC delivery period.

Pursuant to the settlement,

- Primeline will receive approximately RMB 256 million (CAD\$49 million) net of VAT for its share of all outstanding unpaid or partly paid amounts due for natural gas already delivered to the end of 2016 and for the 2015 and 2016 take-or-pay payments.
- Primeline will withdraw the CIETAC arbitration against Zhejiang Gas.
- Once the settlement payment is received, Primeline will fully settle its own overdue payment owed to China Oilfield Services Limited ("COSL") in the order of RMB116 million (CAD\$22 million) in relation to the 2015 drilling contract and COSL will withdraw its arbitration proceedings against Primeline.

# Primeline Energy Holdings Inc. Management Discussion and Analysis For the Three Months Ended December 31, 2016

Primeline Energy Holdings Inc. (TSX Venture-PEH) (“the Company”)

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## 1. Reader Advisories

### 1.1. Forward Looking Statements

Some of the following disclosures contain forward-looking statements, which involve inherent risk and uncertainty affecting the business of Primeline Energy Holdings Inc. (the “**Company**”). These statements relate to matters such as: the financing of, and the results of, the Company’s exploration programme; assumptions that production from LS36-1 will proceed in accordance with the Gas Sales Contract and other relevant agreements; the Company’s expectations with respect to the outcome of its arbitration action with China National Offshore Oil Corporation (“**CNOOC**”), a Chinese State oil company and its subsidiary CNOOC (China) Ltd. (“**CCL**”), and the amounts of cash Primeline expects to receive from Zhejiang Natural Gas Development Company (“**Zhejiang Gas**”) under the Settlement with Zhejiang Gas, and the price it expects to receive for gas delivered under the Gas Sales Contract for the balance of the delivery period under the Settlement with Zhejiang Gas (see Section 3.2). While these statements are based on assumptions that management considers reasonable, actual results may vary from those anticipated. Sufficient cash flow and/or external finance may not be available to the Company for debt service and exploration and it may then be in breach of its funding obligations. Zhejiang Gas may not honour its obligations under the Settlement with Zhejiang Gas. Any such event may materially and adversely affect Primeline’s financial position, and if Zhejiang Gas does not honour its obligations under the Settlement with Zhejiang Gas, that will result in a material, adverse effect on Primeline’s cash flow and financial results, and its ability to meet its financial obligations to its lenders. Exploration for oil and gas is subject to the inherent risk that it may not result in a commercial discovery. The forward-looking information and statements contained in this Management’s Discussion and Analysis (“**MD&A**”) are made as of the date of this document and the Company does not undertake any obligation to update or to revise any forward-looking information or statements, except as required by applicable law.

### 1.2. Intention of MD&A

In this MD&A, ‘**Primeline**’ refers generally to the Company and its wholly owned subsidiaries, Primeline Energy China Ltd. (“**PECL**”), Primeline Energy Operations International Ltd. (“**PEOIL**”) and Primeline Petroleum Corporation (“**PPC**”). References to CNOOC include its subsidiary CCL.

This MD&A is intended to provide an explanation of the Company’s financial condition and operational performance compared with prior periods, and the Company’s prospects and plans. It provides additional information that is not contained in the Company’s unaudited interim consolidated financial statements for the quarter ended December 31, 2016, which are prepared in accordance with International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board (“**IASB**”).

### 1.3. Date

The effective date of this MD&A is February 28, 2017 Events after that date could materially alter the veracity and usefulness of the information contained in this document.

### 1.4. Standard Comparisons in this Document

Unless otherwise indicated comparisons of results are for the quarters ended December 31, 2016 and 2015 and the Company’s financial condition at December 31, 2016 and March 31, 2016.



All monetary amounts in this MD&A are expressed in Chinese Yuan Renminbi (“**RMB**”) unless otherwise noted. Canadian dollar (“**CAD\$**”) equivalents are provided for information only. Such presentation in CAD\$ is not in accordance with IFRS and should not be construed as a representation that the RMB amounts shown could be readily converted, realized or settled in CAD\$ at the date of these financial statements or any other date. The exchange rate of CAD\$ to RMB published in the South China Morning Post on December 31, 2016 was RMB 5.194 to CAD\$1.00.

### 1.5.Reclassifications and Materiality for Disclosures

Certain prior year amounts have been reclassified to conform to current year presentation. The acquisition of PPC in 2015 by the Company (the “**Acquisition**”) is a common control transaction under applicable Canadian securities laws. As the Acquisition has been determined to be a common control transaction, it has been accounted for on a continuity of interest basis. In accordance with the continuity basis of accounting, these annual consolidated financial statements reflect the assets, liabilities, operations and cash flows of the Company as if the Company and PPC had always been one entity. There is currently no guidance in IFRS on the accounting treatment for combinations among entities under common control. IAS 8 – Accounting policies, changes in accounting estimates and errors (IAS 8) requires management, if there is no specifically applicable standard of interpretation, to develop a reliable policy that is relevant to the decision-making needs of users. US GAAP requires an acquirer in a combination between entities or business under common control to recognize the assets acquired and liabilities assumed in the transaction at their carrying amounts in the accounts of the transferring entities at the date of transfer, and Primeline has adopted this accounting treatment for the Acquisition. Materiality for disclosures is determined based on whether the information omitted or misstated would cause a reasonable investor to change their decision to buy, hold or sell the Company’s securities.

### 1.6.Operating Segments

The Company has one operating segment, which is the exploration of oil and gas properties located in the People’s Republic of China (“**PRC**”). CCL is the operator under Petroleum Contract 25/34, in which the producing LS36-1 gas field (“**LS36-1**”), which is the Company’s sole source of revenue, is located.

## 2. Introduction

The Company is listed on the TSX Venture Exchange (“**TSX-V**”) and is focused exclusively on upstream oil and gas opportunities in the PRC. The Company owns exploration, development and production rights in the East China Sea pursuant to two Petroleum Contracts, one in relation to Block 25/34 (“**Petroleum Contract 25/34**”) and one in relation to Block 33/07 (“**Petroleum Contract 33/07**”) both between CNOOC and PECL and PPC. Petroleum Contract 25/34, dated March 24, 2005, and Petroleum Contract 33/07, dated June 15, 2012, are together referred to as “**the Petroleum Contracts**”. PECL and PPC act jointly as the “**Contractor**” under the Petroleum Contracts.

Block 25/34 covers 84.7 sq. km, being the development and production area for the LS36-1 for which CCL is the Operator holding a 51% interest and the Company holds a 49% interest (PECL 36.75% and PPC 12.25%).

PEOIL is the operator for Block 33/07 which covers an offshore area of 4,397 sq. km (1.08 million acres) enclosing Block 25/34, and the Company owns the Contractor’s interest 100% (PECL 75% and PPC 25%). The Contractor is responsible for 100% of the exploration costs and CNOOC has the right to participate in up to 51% of any commercial development. The first exploration phase under Petroleum Contract 33/07 expired in April 2016 when Primeline entered the second exploration phase, which is for a period of two years, to enable it to continue with its exploration operations in the Lishui Basin.

Primeline and CNOOC are implementing a rolling development and exploration strategy in the Lishui Basin with CCL operating LS36-1 under Petroleum Contract 25/34 and Primeline leading the effort on exploration under Petroleum Contract 33/07. LS36-1's production infrastructure is the first natural gas facility in the southern part of the East China Sea and could become a hub for successful exploration and development work in the remainder of the petroliferous Lishui Basin.

During 2010-2014, CCL, as Operator, carried out and completed LS36-1's development works including the production platform, subsea pipeline, development wells and onshore processing terminal. Trial production from LS36-1 commenced on July 16, 2014 and commercial production commenced on December 1, 2014.

In October 2014, CCL and Zhejiang Gas signed the Gas Sales Contract, which superseded the first gas sale agreement in principle signed in 2008, and a framework agreement for gas sale signed in 2010, which together provided the commercial support for the development of LS36-1.

Primeline's share of development cost was financed by a US\$274 million loan ("**Syndicate Facility**") from China Development Bank, China Export and Import Bank and Shanghai Pudong Development Bank (together the "**Syndicate**") in 2014.

The development has established access to the Zhejiang provincial gas grid in Eastern China, and together with the production infrastructure, enhances the value of LS36-1's incremental reserves and prospective resources and any additional resources which may be discovered in Block 33/07. The Company is continuing its exploration operations in the East China Sea and is also exploring opportunities to acquire additional assets either by itself or in joint venture with others.

The Company was an exploration company for over 20 years and first discovered gas in the East China Sea in 1997. LS36-1 has now been in production and selling gas to Zhejiang Gas under the Gas Sales Contract for over two years, since 2014.

Due to a dispute with Zhejiang Gas regarding the price for gas payable and take or pay obligations under the Gas Sales Contract (see Section 3.2), Primeline has been in arbitration proceedings against Zhejiang Gas before the China International Economic and Trade Arbitration Commission ("**Zhejiang Gas Arbitration**") since April 2016. Agreements to settle the Zhejiang Gas Arbitration have recently been signed ("**Zhejiang Gas Settlement**") and accordingly this two year long dispute has now been settled. Further details are set out below.

The Company is also engaged in arbitration proceedings against CNOOC and CCL, commenced in May 2016 under the dispute resolution provisions of Petroleum Contract 25/34 ("**CNOOC Arbitration**"), relating to Primeline's claim that CCL has failed to properly manage and implement the Gas Sales Contracts, and Primeline's continuing disputes with CNOOC and CCL regarding the development, production and sales of gas from LS36-1. Further details are set out in Section 3.3. The Zhejiang Gas Settlement does not affect the proceedings under CNOOC Arbitration.

### **3. Operations**

#### **3.1 Operational Overview**

During the quarter under review, the Company, together with its partner CNOOC, has delivered approximately 64.51 million cubic metres (mmcm) natural gas from LS36-1 to Zhejiang Gas under the Gas Sales Contract. Volumes were about 89% higher than the 34.06 mmcm in the previous quarter, and represented a significant improvement over the 56 mmcm in the quarter ending December 31, 2015. The production facility of LS36-1 operated safely and smoothly without technical issues and CCL continued to finalise the remainder of the development, including the development of a dock for transporting future sales of by-products.

Primeline's total oil and gas revenue for the quarter was RMB 94 million (CAD\$18 million), as compared to RMB 86 million (CAD \$ million) for the same quarter in the previous year. EBITDA (a financial measure which does not have any standardized meaning under the Company's GAAP and therefore may not be comparable to similar measures presented by other issuers) provides useful information to investors as a measure of underlying cash profitability was RMB63 million (CAD\$12 million) presented before exchange difference, which has been volatile. As a result of the substantial depreciation charge of RMB88 million (CAD\$17 million), and particularly the foreign exchange loss as a result of the sharp depreciation of RMB against US\$ of RMB75 million (CAD\$14 million), the Company's quarterly net loss was RMB124 million (CAD\$24 million) (see Section 4).

Primeline has continued its post well evaluation of the two exploration wells drilled at the end of 2015 to fully assess the remaining prospectivity in Block 33/07. The Company's strategy is to use the LS36-1 production and its infrastructure as a springboard to expand in the neighbouring area in the East China Sea. In addition to the production and cash flow from the first phase, the main benefit of LS36-1 is that the infrastructure provides anchor and support for future development. Based on the current production from LS36-1, the production infrastructure has spare capacity. Such spare capacity is anticipated to allow the Company to capitalise on its access to the Chinese gas market through exploration in the remainder of the Lishui Basin.

### 3.2 Zhejiang Gas Settlement

Following extensive negotiations, CCL and Primeline entered the Zhejiang Gas Settlement on March 1, 2017. This represents the culmination of considerable effort on all sides and fully resolves the current dispute.

The Company had been in dispute with Zhejiang Gas from April 2015 regarding the price payable and the take or pay obligations under the Gas Sales Contract. Zhejiang Gas did not pay in full for gas delivered, did not offtake in accordance with the Gas Sales Contract and failed to make payment under the take-or-pay arrangements, all of which significantly impacted Primeline's cash flow. CCL is a joint seller and acts as agent for Primeline under the Gas Sales Contract.

The Zhejiang Gas Settlement is based on an innovative dual pricing arrangement that meets Primeline's requirement for a fixed price while CCL takes a fully floating price that reflects CCL's greater ability to absorb short term price reductions and benefit from its long-term view of the market. Primeline will be paid in full for its share of gas to the end of 2016 at the original fixed price stipulated in the Gas Sales Contract and from January 1, 2017 the end of the delivery period under the Gas Sales Contract, at a fixed price with a reduction of 7% from the original Gas Sales Contract price.

As at December 31, 2016 the Company estimates that it had approximately RMB 235 million net of estimated unpaid or partly paid amounts. This comprises Primeline's share of the following gross amounts:

- RMB 263 million (CAD\$51 million) due for natural gas already delivered through to December 31, 2016 for which Zhejiang Gas did not pay in full; and
- RMB 250 million (CAD\$48 million) for the 2015 take-or-pay payments.

As part of the settlement arrangements Primeline will withdraw the CIETAC arbitration against Zhejiang Gas.

### 3.3 Update on Disputes with COSL and CNOOC Arbitration

Once the settlement payment is received, Primeline will settle its own overdue payment owed to China Offshore Services Limited ("COSL") in relation to the 2015 drilling contract and the arbitration proceedings instituted by COSL against Primeline will then also be withdrawn.

The settlements with Zhejiang Gas and COSL do not affect or halt the CNOOC Arbitration that includes claims in respect of CCL's mismanagement in relation to the development and production of LS36-1 and breach of fiduciary duties as agent for Primeline under the Gas Sales Contract. CNOOC has a significant conflict of interest in relation to its dealings with Zhejiang Gas and, thus, Primeline believes that CNOOC and CCL have failed to act in good faith in relation to the performance of the Gas Sale Contract and the relationship with with Zhejiang Gas.

Accordingly, Primeline commenced the CNOOC Arbitration on May 24, 2016 under the dispute resolution provisions of Petroleum Contract 25/34. Primeline appointed an arbitrator and on June 6, 2016 filed the formal Notice of Arbitration in accordance with the UNCITRAL Arbitration Rules 1976 and the arbitration clause under Petroleum Contract 25/34. CNOOC has subsequently confirmed the identity of their appointed arbitrator.

## 4. Financial Summary

### 4.1. Financial Position

As at December 31, 2016, the Company held cash resources of RMB 9,885,613 (CAD\$1,903,276) and a bank deposit of RMB 150,000,000 (CAD\$28,879,476) in a debt service reserve account serving the Syndicate Facility.

As at December 31, 2016 the amounts outstanding under the Syndicate Facility are RMB 1,611,456,002 (CAD\$310,253,370) and under the convertible bonds issued to GEMS (the "**Bonds**") are RMB 115,140,944 (CAD\$22,168,068). The Syndicate agreed in November 2016 to reduce the Company's capital repayments on its outstanding US\$232 million Syndicate Facility to US\$1 million respectively for two payments (November 2016 and May 2017), representing a deferral of capital repayments of US\$36 million to a later stage over the life of the loan. The Company thus met the repayment obligation in November 2016. Further, the Syndicate agreed to reduce the Company's interest rate margin from 470bps to 335bps over 6 month LIBOR. All payments of principal and interest required under the Bonds have been timely made.

Accounts receivable as at December 31, 2016 were RMB18 million (CAD\$4 million). The Company has been in dispute with Zhejiang Gas from April 2015 regarding the price payable and the take or pay obligations under the Gas Sales Contract. Zhejiang Gas did not pay in full for gas delivered, did not offtake in accordance with the Gas Sales Contract and failed to make payment under the take-or-pay arrangements, all of which significantly impacted Primeline's cash flow. CCL is a joint seller and acts as agent for Primeline under the Gas Sales Contract. Accounts receivable do not include the approximate RMB 256 million (CAD\$49 million) (post VAT) due to the Company and which the Company expects to recover (see sections 3, 2, 5.2.5 and 7.1.4)

### 4.2. Financial Performance

The Company's results for the quarter ended December 31, 2016 were a loss of RMB123,929,407 (CAD\$23,860,109), compared to the loss of RMB105,633,910 for the same quarter last year.

Revenues were RMB93,774,062, an increase of 9% on the same period last year and 113% from the last quarter. These revenues comprised RMB80 million (CAD\$15 million) from Primeline's share of gas revenues and RMB14 million (CAD\$3 million) by-product revenues (RMB 7.7m in the prior quarter). Revenue was booked at the price Zhejiang Gas actually paid which is at significant discount to the contract price (see section 4.1).

The Company's operating expenses for the quarter were RMB27 million (CAD\$5 million), a decrease of 25% from RMB36 million in the same quarter last year. G&A was RMB5 million (CAD\$1 million). During the quarter the Company's share of the contribution to the abandonment fund for LS36-1 was RMB6 million (CAD\$1 million).

EBITDA (a non-GAAP financial measure as described in section 3) before exchange differences for the quarter is RMB63 million (CAD\$12 million).

However, the amortization charge of RMB88 million (CAD\$17 million) relating to oil and gas properties and a foreign exchange loss of RMB75 million (CAD\$14 million) mainly due to the translation effects on the Company's US dollar denominated bank loan as a result of the weaker Chinese currency contributed to the net loss reported of RMB124 million (CAD\$24 million).

Exploration expenditures of RMB6,157,222 (CAD\$1,185,449) were incurred during the quarter, which were comprised mainly of technical evaluations & management of RMB587,827 (CAD\$113,174), interest on funding of deferred exploration expenditures of RMB2,972,761 (CAD\$572,345), project administration of RMB1,120,099 (CAD\$215,652) and salaries and benefits of RMB1,279,821 (CAD\$246,404). These amounts were capitalized as exploration and evaluation assets.

The Company estimates that the realization of income tax benefits related to its deferred income tax assets is uncertain and is not more likely than not. Accordingly, no deferred income tax asset has been recorded.

The Company's financial statements are reported under IFRS issued by the IASB. Because of the prudent approach the Company has adopted about revenue recognition the Company has amended the disclosures for the quarters ended December 31, 2015 and September 30, 2015 but does not consider the changes to be material such that the Company would re-file. The following tables provide highlights from the Company's financial statements for the past eight quarters

Quarter Ended	Dec 31, 2016	Dec 31, 2016	Sep 30, 2016	Jun 30, 2016	Mar 31, 2016
	CAD\$	RMB	RMB	RMB	RMB
Revenue	18,054,305	93,774,062	44,004,308	43,568,666	60,869,960
Operating and production	(5,206,568)	(27,042,914)	(17,624,654)	(19,972,247)	(15,440,331)
General & Administration	(1,058,711)	(5,498,942)	(3,211,430)	(4,285,749)	(5,699,597)
Exchange Gain/(Loss)	(14,485,834)	(75,239,422)	(5,284,264)	(44,310,676)	20,037,818
Depreciation	(16,848,070)	(87,508,875)	(42,702,942)	(42,674,932)	(70,112,006)
Finance costs	(4,677,389)	(24,294,355)	(25,192,513)	(25,756,443)	(26,860,068)
Net Profit (loss)	(23,860,109)	(123,929,407)	(48,149,986)	(91,224,536)	(35,001,257)
Per basic share	(0.127)	(0.662)	(0.259)	(0.496)	(0.199)
Per diluted share	(0.127)	(0.662)	(0.259)	(0.496)	(0.199)
Total assets	463,880,108	2,409,393,283	2,489,742,462	2,514,917,385	2,645,993,506

<b>Quarter Ended</b>	<b>Dec 31, 2015</b>	<b>Sep 30, 2015</b>	<b>Jun 30, 2015</b>	<b>Mar 31, 2015</b>	<b>Dec 31, 2014</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
			<b>(Restated)</b>	<b>(Restated)</b>	<b>(Restated)</b>
Revenue	85,935,717	24,687,210	7,060,841	91,450,721	67,576,663
Operating and production	(35,888,944)	(24,693,583)	(16,554,529)	(19,410,335)	(11,228,413)
General & Administration	(1,806,756)	(3,194,803)	(3,218,484)	(3,406,073)	(2,205,992)
Exchange Difference	(55,303,872)	(36,877,518)	1,068,329	(2,462,966)	(20,436,486)
Depreciation	(76,643,060)	(19,463,485)	(5,046,487)	(56,911,807)	(41,729,330)
Finance costs	(24,219,287)	(23,927,339)	(22,602,059)	(21,579,974)	(8,098,865)
Net income (loss)	(105,633,910)	(82,071,761)	(37,006,590)	(376,788)	(15,464,038)
Per basic share	(0.590)	(0.690)	(0.310)	(0.003)	(0.140)
Per diluted share	(0.590)	(0.690)	(0.310)	(0.003)	(0.140)
Total assets	2,821,779,989	2,621,986,456	2,569,346,843	2,562,736,595	2,519,801,543

## 5. Risk Management

### 5.1. Risk Management

The Company's risk management supports decision-making via comprehensive and systematic identification and assessment of risks that could materially impact the results of the Company. Through this framework, the Company builds risk management and mitigation into strategic planning and operational processes through the adoption of standards and best practices.

The Company attempts to mitigate its financial, operational and legal risks to an acceptable level through a variety of policies, systems and processes. The following provides a list of the most significant risks relating to the Company and its operations.

### 5.2 Significant Risk Factors

#### 5.2.1 Operational, Environmental and Safety Incidents

The Company's operations are subject to inherent operational risks with respect to safety and the environment that require continuous vigilance. The Company seeks to minimise these operational risks by carefully designing and building its facilities and conducting its operations in a safe and reliable manner. Failure to manage the risks effectively could result in potential fatalities, serious injury, interruptions to activities or use of assets, damage to assets, environmental impact, or loss of license to operate. Enterprise risk management, emergency preparedness, business continuity and security policies and programmes are in place for all operating areas and are adhered to on an ongoing basis. The Company, in accordance with industry practice, maintains insurance coverage against losses from certain of these risks. Nonetheless, insurance proceeds may not be sufficient to cover all losses, and insurance coverage may not be available for all types of operational risks.

#### 5.2.2 Commodity Price Volatility

Primeline's results of operations and financial condition are dependent on the prices received for its natural gas, LPG and condensate production. Lower prices will adversely affect the value and quantity of Primeline's oil and gas reserves. All Primeline's natural gas production is currently sold to Zhejiang Gas through CCL as sales agent. Therefore, most of Primeline's revenue is currently dependent on the one contract, being the Gas Sales Contract. The Gas Sales Contract is between CCL (as agent for Primeline and the operator of LS36-1) and Zhejiang Gas and as such Primeline must rely on CCL for performance of the Gas Sales Contract. If Zhejiang Gas was to attempt to terminate the Gas Sales Contract, or the cost of production from LS36-1 were to rise above the price provided for in the Gas Sales Contract that would have a material, adverse effect on Primeline's business. If Zhejiang Gas does not honour its obligations under the Zhejiang Gas Settlement, or CNOOC Arbitration is concluded adversely to the Company's expectations, that could have a material adverse effect on the Company's business, financial condition and cash flow. (See Sections 3 and 4.1).

#### 5.2.3 History of Losses

Primeline has incurred net losses in each of the years since the date of its incorporation. If Primeline is unable to achieve profitable operations in the future, there may be a material adverse effect on its ability to continue operations. A lack of cash flow could impede the ability of Primeline to raise capital through debt or equity financing to the extent required for continued operations or planned expansion. Accordingly, future losses may have a material adverse effect on the business, financial condition, results of operations and cash flows of Primeline.

#### 5.2.4 Requirement for New Capital

Primeline may require additional financing to fund its operations. If additional financing is required, there can be no assurance that it will be available on acceptable terms, or at all. If Primeline raises additional funds by issuing

equity securities, dilution to the holders of its ordinary shares (“**Shares**”) may result. If adequate funds are not available, Primeline may be required to delay, scale back or eliminate portions of its operations.

#### 5.2.5 Risks Relating to Arbitrations

Primeline is engaged in the CNOOC Arbitration (See Section 3.3). While Primeline believes its legal position is good and that it will be successful, the outcome of such proceedings is inherently uncertain and no assurance can be given of Primeline’s success. If Primeline is successful in the CNOOC Arbitration, it may nonetheless be unable to enforce the award of the arbitrator. If either event were to occur, that would likely have a material, adverse effect on Primeline’s business and financial position. See Section 5.2.18.

#### 5.2.6 Volatility of the Market Price of the Shares

The market price of the Shares may exhibit significant fluctuations in response to the following or other factors, many of which are beyond the control of Primeline. The factors include the outcome of the CNOOC Arbitration, variations in the operating results of Primeline, results of its oil and gas exploration activities, material announcements by Primeline or its competitors of exploration developments, strategic partnerships, joint ventures or capital commitments, general economic and political conditions in China and in the oil and gas industry, and regulatory developments. The price at which an investor purchases or acquires Shares may not be indicative of the price of the Shares that will prevail in the trading market.

#### 5.2.7 Dependence on Key Management Personnel

Primeline’s success is highly dependent upon the continued services of key managerial employees, including the Chairman and President of the Corporation, Mr. Victor Hwang, and the Chief Executive Officer of Primeline, Dr. Ming Wang. Primeline does not currently maintain key-man life insurance policies on any member of management. Accordingly, the loss of these key executives or one or more other key members of management could have a material adverse effect on Primeline.

#### 5.2.8 Exploration Risk

Oil and natural gas exploration involves a high degree of risk. These risks are more acute in the early stages of exploration. Primeline’s exploration expenditures with respect to Block 33/07 may not result in new discoveries of oil or natural gas in commercially viable quantities. If exploration costs exceed estimates, or if exploration efforts do not produce results which meet expectations, exploration efforts may not be commercially successful, which could adversely impact Primeline’s ability to generate revenues from operations. Primeline faces additional risk due to the offshore nature of its exploration and development operations. Drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions or other geological and mechanical conditions.

#### 5.2.9 Reservoir Performance Risk

Lower than projected reservoir performance at LS36-1 could have a material impact on the Company's financial position, medium to long-term business strategy and cash flow. Inaccurate appraisal of large project reservoirs could result in missed production, revenue and earnings targets and negatively affect the Company's reputation, investor confidence and the Company's ability to deliver on its growth strategy. To maintain the Company's future production of crude oil, natural gas and NGL and maintain the value of the reserves portfolio, additional reserves must be added through discoveries, extensions, improved recovery, performance related revisions and acquisitions. The production rate of oil and gas properties tends to decline as reserves are depleted while the associated unit operating costs increase. To mitigate the effects of this, the Company must undertake successful exploration and development programmes, increase the recovery factor from existing properties through applied technology and identify and execute strategic acquisitions of proved developed and undeveloped properties and unproved prospects. Maintaining an inventory of developable projects depends on, among other things, obtaining and



renewing rights to explore, develop and produce oil and natural gas, drilling success, completing long-lead time capital intensive projects on budget and on schedule and the application of successful exploitation techniques on mature properties.

#### 5.2.10 Reserves Data and Future Net Revenue Estimates

The reserves data contained or referenced in this MD&A are estimates only. The accurate assessment of oil and gas reserves is critical to the continuous and effective management of the Company's upstream assets. Reserves estimates support various investment decisions about the development and management of oil and gas properties. In general, estimates of economically recoverable crude oil and natural gas reserves and the future net cash flow therefrom are based upon several variable factors and assumptions, such as product prices, future operating and capital costs, historical production from the properties and the assumed effects of regulation by government agencies, including with respect to royalty payments, all of which may vary considerably from actual results. All such estimates are to some degree uncertain, and classifications of reserves are only attempts to define the degree of uncertainty involved. For those reasons, estimates of the economically recoverable oil and gas reserves attributable to any group of properties, classification of such reserves and resources based on risk of recovery and estimates of future net revenues expected therefrom may differ substantially from actual results. The data may be prepared by different engineers or by the same engineers at different times. These factors may cause the estimates to vary substantially over time. All reserves estimates involve a degree of ambiguity and, at times, rely on indirect measurement techniques to estimate the size and recoverability of the resource. While new technologies have increased the accuracy of these techniques, there remains the potential for human or systemic error in recording and reporting the magnitude of the Company's oil and gas reserves. Inaccurate appraisal of large project reservoirs could result in missed production, revenue and earnings targets and could negatively affect the Company's reputation, investor confidence and the Company's ability to deliver on its growth strategy.

#### 5.2.11 Unplanned Shutdowns and Pipeline Interruptions

Unplanned shutdowns and closures of facilities or platform may limit may potentially have a material impact on the Company's financial condition, short-term to long-term business strategy, cash flow, and earnings. The Company's corporate reputation is particularly vulnerable to these events. Prolonged problems may threaten the commercial viability of operations.

#### 5.2.12 Security and Terrorist Threats

Security threats and terrorist or activist activities may impact the Company's personnel, which could result in injury, death, extortion, hostage situations and/or kidnapping, including unlawful confinement. A security threat, terrorist attack or activist incident targeted at a facility, office or offshore vessel/installation owned or operated by the Company could result in the interruption or cessation of key elements of the Company's operations. Outcomes of such incidents could have a material impact on the Company's financial condition, business strategy and cash flow. A cyber incident may impact the operational state and/or cause physical damage to the Company's assets, along with potential health and safety risks or loss of intellectual property.

#### 5.2.13 Lack of Diversification

Primeline's business focuses exclusively on the oil and gas industry in China, and therein exclusively on exploration and development of two properties, Block 25/34 and Block 33/07. Completion of the Acquisition has increased Primeline's exposure to the exploration and development risks of these properties. Larger companies can manage their risk by diversification. However, Primeline currently lacks diversification, in terms of both the nature and geographic scope of business. Thus, factors affecting the oil and gas industry or China in general or Blocks 25/34 and 33/07 are likely to impact Primeline more acutely than if its business were more diversified.

#### 5.2.14 Insurance

Involvement in the exploration for and development of oil and natural gas properties may result in Primeline becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Primeline will obtain insurance in accordance with industry standards to address such risks, such

insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances, be insurable or, in certain circumstances, Primeline may choose not to obtain insurance to protect against specific risks due to the high premiums associated with such insurance or for other reasons. The payment of such uninsured liabilities would reduce funds available. If Primeline suffers a significant event or occurrence that is not fully insured, or if the insurer of such event is not solvent, then Primeline would be required to fund any shortfall.

#### 5.2.15 Competition

The oil and gas industry is highly competitive. Other companies engaged in the same line of business may compete with Primeline from time to time in obtaining capital from investors. Competitors include much larger companies, which may have access to greater resources than Primeline, may be more successful in the recruitment and retention of qualified employees and may conduct their own marketing operations, which may give them a competitive advantage. In addition, actual or potential competitors may be strengthened through the acquisition of additional assets and interests.

#### 5.2.16 Risks Related to Primeline's Controlling Shareholder

Primeline is controlled by Mr. Victor Hwang, its Chairman and President, who directly and indirectly through PIHI owns Shares representing approximately 66.16% of the votes attaching to all the Shares and management share options in respect of a further 200,000 Shares. Mr. Hwang can control election to the board of directors and may be able to cause Primeline to effect corporate transactions without the consent of its other shareholders, subject to applicable law and the fiduciary duty of Primeline's directors and officers. Transactions effected between Primeline and Mr. Hwang may not be on the same terms as could be obtained from independent parties. Mr. Hwang is also able to cause or prevent a change of control of Primeline. This may have an adverse effect on the market price or value of the Shares.

#### 5.2.17 PRC Political and Economic Considerations

The location of its operations wholly in the PRC may expose the Company to uncertain political, economic and other risks. The Company's operations may be adversely affected by events that may include, but are not limited to, onerous fiscal policy, renegotiation, nullification or failure to perform agreements, imposition of onerous regulation, changes in laws governing existing operations, financial constraints, including currency and exchange rate fluctuations, unreasonable taxation and corrupt behaviour of public officials, joint venture partners or third-party representatives that could result in lost business opportunities for Primeline. This could adversely affect the Company's interest in its PRC operations and future profitability. Changes in PRC government policy, legislation or regulation could impact the Company's existing and planned projects as well as impose costs of compliance and increase capital expenditures and operating expenses. Examples of the Company's regulatory risks include, but are not limited to, uncertain or negative interactions with government, uncertain energy policies, uncertain climate policies, uncertain environmental and safety policies, penalties, taxes, royalties, government fees, reserves access, limitations or increases in costs relating to the exportation of commodities, restrictions on the acquisition of exploration and production rights and land tenure, expropriation or cancellation of contract rights, limitations on control over the development and abandonment of fields and loss of licences to operate.

#### 5.2.18 Partner Misalignment

CNOOC, as joint venture partner operates all Primeline's producing assets. Primeline is at times dependent upon CNOOC for the successful execution of various projects. If a dispute with partners were to occur over the development and operation of a project or if partners were unable to fund their contractual share of the capital expenditures, a project may be delayed and the Company may be partially or totally liable for its partner's share of the project. The CNOOC Arbitration may have an adverse impact on Primeline's relationship with CNOOC. See Section 3.3.

### 5.2.19 Environmental Considerations

As Primeline is involved in oil and gas exploration, it is subject to extensive environmental and safety legislation (for example, in relation to plugging and abandonment of wells, discharge of materials into the environment and otherwise relating to environmental protection) and this legislation may change in a manner that may require additional or stricter standards than those now in effect, a heightened degree of responsibility for companies and their directors and employees and more stringent enforcement of existing laws and regulations. There may be unforeseen environmental liabilities resulting from oil and gas activities that may be costly to remedy. The acceptable level of pollution and the potential clean-up costs and obligations and liability for toxic or hazardous substances for which Primeline may become liable because of its activities may be impossible to assess against the current legal framework and current enforcement practices of PRC. The extent of potential liability, if any, for the costs of abatement of environmental hazards cannot be accurately determined and consequently no assurances can be given that the costs of implementing environmental measures or meeting any liabilities in the future will not be material to Primeline or affect its business or operations. Primeline will be committed to meeting its responsibilities to protect the environment and anticipates making increased expenditures of both a capital and an expense nature because of the increasingly stringent laws relating to the protection of the environment in China, and will be taking such steps as required to ensure compliance with such legislation.

Under the Environmental Protection Law of PRC, the division of the State Council responsible for environmental protection has the power to set national environmental quality standards and supplement the national standards in areas where the national standards are silent. Due to the very short history of the Environmental Protection Law of PRC, national and local environmental protection standards are still in the process of being formulated and implemented. Primeline believes there are no outstanding notices, orders or directives from central or local environmental protection agencies or local government authorities alleging any breach of national or local environmental quality standards by Primeline and that Primeline has complied with all existing environmental protection laws, regulations, administrative orders and standards. Given the nature of Primeline's business, there is a possibility that Primeline must meet higher environmental quality standards as the economy of the PRC expands and its level of environmental consciousness increases in the future.

### 5.2.20 Reliability of Information

While the information contained herein regarding the PRC and its economy has been obtained from a variety of government and private publications, independent verification of this information is not available and there can be no assurance that the sources from which it is taken or on which it is based are wholly reliable.

## 5.3 Financial Risks

### 5.3.1. Currency risk

Primeline is exposed to currency risk to the extent that it holds cash deposits primarily denominated in US\$ and CAD\$, whereas accounts payable by reference to various currencies are denominated primarily in US\$, CAD\$, £Sterling and RMB. For instance, the Syndicate Facility is denominated in US\$, and serviced from cash from operations in RMB. Therefore, fluctuation between exchange rates for CAD\$ and US\$, in which Primeline holds most of its cash deposits as against RMB and £Sterling could adversely affect Primeline and, accordingly, the market price of the Shares. Primeline believes the foreign exchange risk is currently significant and is in discussions with the Syndicate to mitigate.

The Company's cash and cash equivalents outside China are principally held at large international financial institutions in interest bearing accounts. Most current cash balances are held at a Chinese financial institution in RMB and US\$, primarily for debt servicing requirements relating to the Syndicate Facility.

The Company held financial instruments in different currencies during the periods ended as follows:

	December 31, 2016	March 31, 2016
Cash and cash equivalents of:		
- CAD\$ '000	101	101
- US\$ '000	166	11,221
- GBP '000	14	18
- HK\$ '000	223	151
Bank loans and interest of US\$ '000	(231,300)	(256,900)
Convertible bonds and interest of US\$'000	(18,036)	(18,000)

Based on the above net exposures, and if all other variables remain constant, a 10% depreciation or appreciation of the RMB against the CAD\$, US\$, British Pound and Hong Kong Dollar, would result in an increase/decrease of the Company's net (loss) income of approximately:

	December 31, 2016	March 31, 2016	December 31, 2016
	RMB'000	RMB'000	CAD\$'000
- CAD\$	53	51	10
- US\$	173,821	185,406	33,466
- GBP	12	17	2
- HK\$	20	13	4

### 5.3.2. Credit risk and trade receivable risk

Credit and trade receivables risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company currently sells its natural gas a single customer, Zhejiang Gas through CCL and is contractually entitled to receive sales proceeds on a weekly basis.

### 5.3.3. Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due and arises through the excess of financial obligations due over financial assets at any point in time. Remittances from the PRC to overseas may be subject to delay or withholding taxes. Financing may be required in relation to any future exploration work and to fund any current working capital deficiency. (See Section 6.1).

### 5.3.4 Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company has inherent interest rate risk in the Syndicate Facility, which currently carries a floating interest rate of US\$ 6 month LIBOR plus 3.35% (see Section 4.1). The Company does not hedge against this risk.

## 6. Liquidity and Capital Resources

### 6.1 Liquidity

The Company's unaudited interim consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2017 and will be able to realise its assets and discharge its liabilities in the normal course of operations as they come due.

The Company had a working capital deficiency of RMB 1,892 million (CAD\$364 million) as at December 31, 2016 compared to RMB 1,747 million (CAD\$336 million) as at March 31, 2016 due to the Syndicate Facility being classified as current under IFRS despite on the agreement with the Syndicate in November 2016 to defer capital repayments and reduce the interest rate. Under Petroleum Contract 33/07, the Company has a 7.5-year exploration period divided into 3 exploration periods of 3.5, 2 and 2 years each. On May 5, 2016, Primeline agreed with CNOOC that it would enter the second exploration phase of two years under the Petroleum Contract for Block 33/07 with a commitment to drill one well to a depth of 2500 metres, but substantial expenditures for such exploration activities may not occur before 2018. The Company may finance these expenditures when due by securing a farm in from a partner, from further financing, or a combination of these. No assurance can be given any such sources of financing will be available or, if available, will be sufficient.

To continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital, obtain continued financial support from its majority shareholder or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, then the Company may not have sufficient capital resources or cash flows from operations to satisfy its ongoing obligations and future contractual commitments, including the principal and interest payments due on the Syndicate Facility. Thus, it may not be able to continue as a going concern.

If for any reason, the Company is unable secure additional sources of financing and continue as a going concern, that could result in adjustments to the amounts and classifications of assets and liabilities in the Company's interim consolidated financial statements and such adjustments could be material.

As at December 31, 2016, the Company had total assets of RMB 2,409 million (CAD\$464 million) (March 31, 2016 – RMB2,646 million), which were financed by net shareholders' equity of RMB 179 million (CAD\$34 million) March 31, 2016 – RMB440 million), the Syndicate Facility and a short-term bank loan of RMB 1,754 million (CAD\$338 million) (March 31, 2016 – RMB 1,744 million).

As at December 31, 2016, the Company had an accumulated deficit of RMB 671 million (CAD\$129 million) (March 31, 2016 – RMB408 million).

During the quarter, exploration and evaluation assets of RMB6 million (CAD\$1 million) were incurred. As at December 31, 2016, the total amount of exploration and evaluation assets incurred and capitalized amounted to RMB 477 million (CAD\$92 million). The total development cost incurred by the Company for LS36-1 up to December 31, 2016 was RMB1,922 million (CAD\$370 million), including the management charge for CNOOC's carry of the development costs from 2010 to 2014. Development costs of RMB6 million (CAD\$1 million) were incurred during the quarter.

### 6.2 Capital Structure

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, to pursue the exploration and development of the Petroleum Contracts, acquire additional petroleum property interests and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable

risk. In the management of capital, the Company includes its cash and cash equivalent balances and components of shareholders' equity.

The Company manages the capital structure and adjusts it considering changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents and investments.

To facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The Board of Directors approves the annual and updated budgets. At this stage of the Company's development, to maximize ongoing development efforts, the Company does not pay out dividends. Additional information regarding capital management is disclosed in Note 6 of the interim consolidated financial statements as at December 31, 2016.

There are no significant budgeted exploration and development, or research and development expenditures required to maintain properties or agreements in good standing above and beyond the operating expenditures for the LS36-1 Gas Field, which are expected to be funded from cash flow from operations from that asset. See Section 6.1.

### 6.3 Transactions with Related Parties and Directors

During the period ended December 31, 2016, the Company paid or accrued the following:

- i. Fees and benefits paid or accrued to key management personnel of the Company being Dr. Ming Wang, Mr. Andrew Biggs, Mr. Stuart Joyner, Mr. Mark Norman and others were RMB4,334,986 (CAD\$834,614) (December 31, 2015 – RMB4,837,897) and share based payment of RMB102,964 (CAD\$19,824) (December 31, 2015 – RMB641,046) was recognized for the 450,000 (December 31, 2015 – 2,360,000) share options granted to such personnel.
- ii. Fees and benefits paid or accrued to certain directors, being Mr. Victor Hwang, Mr. Brian Chan, Mr. Peter Kelty, Mr. Alan Johnson, Mr. Vincent Lien and Mr. Timothy Baldwin were RMB379,180 (CAD\$73,003) (December 31, 2015 – RMB379,171) and share based payment of Nil (December 31, 2015 – RMB331,150) was recognized for Nil (December 31, 2015 – 2,100,000) share options granted to the directors.

These transactions are measured on terms equivalent to those that prevail in arm's length transactions are made only if such terms are substantiated.

### 6.4 Outstanding Share Data

As at February 28, 2017, there are 189,265,344 Shares and 3,735,000 stock options outstanding.

## 7. Critical Accounting Estimates and Key Judgements

Primeline's consolidated financial statements have been prepared in accordance with IFRS as issued by the IASB. Significant accounting policies are disclosed in Note 4 to the interim Consolidated Financial Statements for the three months ended December 31, 2016. Certain of the Company's accounting policies require subjective judgement and estimation in uncertain circumstances.

### 7.1 Accounting estimates

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. By their nature, estimates are subject to measurement uncertainty and a change in such estimates in future years could require a material change in the consolidated financial statements. These underlying assumptions are based on historical experience and other factors that management believes to be reasonable under the circumstances, and are subject to change as new events occur, as more industry experience is acquired, as additional information is obtained and as the Company's operating environment changes. Specifically, amounts recorded for depletion, depreciation, amortization and impairment, asset retirement obligations ("ARO"), assets and liabilities measured at fair value, employee future benefits, income taxes and contingencies are based on estimates.

#### 7.1.1. Depletion, Depreciation, Amortization ("DD&A") and Impairment

Eligible costs associated with oil and gas activities are capitalized on a unit of measure basis. Depletion expense is subject to estimates including petroleum and natural gas reserves, future petroleum and natural gas prices, estimated future remediation costs, future interest rates as well as other fair value assumptions. The aggregate of capitalized costs, net of accumulated DD&A, less estimated salvage values, is charged to DD&A over the life of the proved developed reserves using the unit of production method, except in the case of assets whose useful life is shorter or longer than the lifetime of the proved developed reserves of that field, in which case the straight-line method or a unit-of-production method based on total proved plus probable reserves is applied.

#### 7.1.2. Impairment of Non-Financial Assets

The carrying amounts of the Company's non-financial assets are reviewed at the end of each reporting period to determine whether there is any indication of impairment. Determining whether there are any indications of impairment requires significant judgment of external factors, such as an extended decrease in prices or margins for oil and gas commodities or products, a significant decline in an asset's market value, a significant downward revision of estimated volumes, an upward revision of future development costs, a decline in the entity's market capitalization or significant changes in the technological, market, economic or legal environment that would have an adverse impact on the entity. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to net earnings.

The determination of the recoverable amount for impairment purposes involves the use of numerous assumptions and estimates. Estimates of future cash flows used in the evaluation of impairment of assets are made using management's forecasts of commodity prices, operating costs and future capital expenditures, marketing supply and demand, forecasted crack spreads, growth rate, discount rate and, in the case of oil and gas properties, expected production volumes. Expected production volumes consider assessments of field reservoir performance and include expectations about proved and probable volumes and where applicable economically recoverable resources associated with interests which are risk-weighted utilizing geological, production, recovery, market price and economic projections. Either the cash flow estimates or the discount rate is risk-adjusted to reflect local conditions as appropriate. Future revisions to these assumptions impact the recoverable amount.

#### 7.1.3. ARO

Estimating ARO requires that Primeline estimate costs many years in the future. Restoration technologies and costs are constantly changing, as are regulatory, political, environment, safety and public relations considerations.

Inherent in the calculation of ARO are numerous assumptions and estimates, including the ultimate settlement amounts, future third-party pricing, inflation factors, credit-adjusted discount rates, timing of settlement and changes in the legal, regulatory, environmental and political environments. Future revisions to these assumptions may result in changes to the ARO.

#### 7.1.4. Fair Value of Financial Instruments

The fair values of derivatives are determined using valuation models, which require assumptions concerning the amount and timing of future cash flows and discount rates. These estimates are also subject to change with fluctuations in commodity prices, interest rates, foreign currency exchange rates and estimates of non-performance. The actual settlement of a derivative instrument could differ materially from the fair value recorded and could impact future results.

Because of the continuing dispute with Zhejiang Gas, the Company has decided, in accordance with IFRS revenue recognition accounting standards, it will not currently recognise its share of the amount invoiced by CCL. Full recovery of these amounts will be dependent on successful resolution of the Zhejiang Gas Arbitration and CNOOC Arbitration or an alternative settlement.

#### 7.1.5 Income Taxes

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations. Estimates that require significant judgments are also made with respect to the timing of temporary difference reversals, how realizable tax assets are, and in circumstances where the transaction and calculations for which the ultimate tax determination are uncertain. All tax filings are subject to audit and potential reassessment, often after the passage of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

#### 7.1.6 Legal, Environmental Remediation and Other Contingent Matters

Primeline is required to determine both whether a loss is probable based on judgment and interpretation of laws and regulations and whether the loss can be reasonably estimated. When a loss is determined, it is charged to net earnings. Primeline must continually monitor known and potential contingent matters and make appropriate provisions by charges to net earnings when warranted by circumstances.

## 7.2 Key Judgements

Management makes judgments regarding the application of IFRS for each accounting policy. Critical judgments that have the most significant effect on the amounts recognized in the consolidated financial statements include successful efforts and impairment assessments, the determination of cash generating units (“CGUs”), the determination of a joint arrangement and the designation of the Company's functional currency.

#### 7.2.1. Impairment of Financial Assets

The Company's derivative instruments are share purchase warrants issued with an exercise price in CAD\$ rather than RMB. Such share purchase warrants are derivative instruments. The Company measured the warrant liability at fair value at the date, which the warrants were issued. The Company's warrant liability is subsequently revalued by reference to the fair value of the warrants at each reporting date using the Black Scholes model and the exchange rate at the balance sheet date with changes in fair value recorded to the income (loss) statement. Valuation of the warrant liability also requires determining the most appropriate inputs to the valuation model and making assumptions about them. Significant assumptions include: expected life of the warrants, volatility, and dividend yield. A change in the valuation model or related inputs would change the reported amount of the components of the instrument.

A financial asset is assessed at the end of each reporting period to determine whether it is impaired based on objective evidence indicating that one or more events have had a negative effect on the estimated future cash



flows of that asset. Objective evidence used by the Company to assess impairment of financial assets includes quoted market prices for similar financial assets and historical collection rates for loans and receivables. The calculations for the net present value of estimated future cash flows related to derivative financial assets requires the use of estimates and assumptions, including forecasts of commodity prices, marketing supply and demand, product margins and expected production volumes, and it is possible that the assumptions may change, which may require a material adjustment to the carrying value of financial assets.

#### 7.2.2. CGUs

The Company's assets are grouped into CGUs, which is the smallest identifiable group of assets, liabilities and associated goodwill that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The determination of the Company's CGUs is subject to management's judgment.

#### 7.2.3. Joint Arrangements

Joint arrangements represent activities where the Company has joint control established by a contractual agreement. Joint control requires unanimous consent for financial and operational decisions. A joint arrangement is either a joint operation whereby the parties have rights to the assets and obligations for the liabilities or a joint venture whereby the parties have rights to the net assets.

Determining the type of joint arrangement as either joint operation or joint venture is based on management's assumptions of whether it has joint control over another entity. The considerations include, but are not limited to, determining if the arrangement is structured through a separate vehicle and whether the legal form and contractual arrangements give the entity direct rights to the assets and obligations for the liabilities within the normal course of business. Management also assesses the entity's rights to the economic benefits, other facts and circumstances and its involvement and responsibility for settling liabilities associated with the arrangement.

The Company and CCL's participation in the development and production activities of LS36-1 is through a joint operation without establishing a separate legal entity for this arrangement. The joint operation has engaged CNOOC China Limited Lishui Operating Company ("**LOC**"), which is a non-legal entity wholly owned by CCL, as the Operator for the project. LOC is accountable to the JMC, in which both CCL and the Company have equal voting rights and decision-making power. The LOC's executive decisions are to be made jointly by chief representatives from both partners. The Company shares 49% of the results, assets and liabilities in LS36-1 under the joint operation, which are incorporated in the consolidated financial statements using the proportionate method of accounting in which the Company recognises, on a line –by – line basis, its share of the assets, liabilities, revenues and expenses of this joint operation incurred jointly with other parties from the date when control passes to the Company.

#### 7.2.4.RMB as Functional Currency

Functional currency is the currency of the primary economic environment in which the Company and its subsidiaries operate and is normally the currency in which the entity primarily generates and expends cash. The designation of RMB as the Company's functional currency is a management judgment based on the composition of revenues and costs in the locations in which it operates.

#### 7.2.5. Exploration and evaluation costs ("**E&E**")

Costs directly associated with an exploration project are initially capitalized as exploration and evaluation assets. Such E&E costs may include undeveloped land acquisition, geological, geophysical and seismic modelling, exploratory drilling and completion, testing, decommissioning and directly attributable internal costs.

Expenditures related to wells that do not find reserves or where no future activity is planned are expensed as exploration and evaluation expenses. Exploration and evaluation costs are excluded from costs subject to depletion until technical feasibility and commercial viability is assessed or production commences. At that time, costs are either transferred to property, plant and equipment or their value is impaired. Impairment is charged

directly to net earnings. Drilling results required operating costs and capital expenditure and estimated reserves are important judgments when making this determination and may change as new information becomes available.

E&E costs are not depleted and are carried forward until technical feasibility and commercial viability of extracting an oil and gas resource is determined. The technical feasibility and commercial viability of an oil and gas resource is established when all the following conditions are met - proved and/or probable reserves are determined to exist, the decision to proceed with development has been approved by the Board of Directors, regulatory approval to develop the project is received, and the Company has sufficient funds to complete or participate in the project. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the exploratory activity. When this is no longer the case, the impairment costs are charged to exploration and evaluation expense.

Upon determination that the technical feasibility and commercial viability of an oil and gas resource is established, E&E assets attributed to those reserves are first tested for impairment and then reclassified to oil and gas development and production assets within property, plant and equipment, net of any impairment. Expired land costs are also expensed to exploration and evaluation expense as they occur.

E&E assets are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount, and upon transfer to property, plant and equipment they are allocated to CGUs based on geographical proximity and other factors.

#### 7.2.6. Accounting for take or pay contracts

Under take or pay contracts, the Company makes a long-term supply commitment in return for a commitment from the buyer to pay for minimum quantities, whether the customer takes delivery.

## 8. Recent Accounting Standards and Changes in Accounting Policies

### 8.1 Recent Accounting Standards

The following new standards, amendments to standards and interpretations are not yet effective or have otherwise not yet been adopted by the Company. The Company is evaluating the impact adoption of the standards will have on the disclosures in the Company's interim consolidated financial statements, if any:

(i) *IFRS 9 Financial Instruments ("IFRS 9")*

IFRS 9, 'Financial Instruments', addresses the classification, measurement and recognition of the financial assets and financial liabilities. IFRS 9 was issued in November 2009 and 2010 and is effective for the periods commencing on or after January 1, 2018, with earlier adoption permitted. It replaces parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements.

The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company is set to assess IFRS 9's full impact. The Company will also consider the impact of the remaining phases of IFRS 9 when the Board completes assessment.

(ii) *IFRS 15 Revenue from Contracts with Customers ("IFRS 15")*

The IASB issued IFRS 15 in May 2014. This IFRS replaces IAS 18 Revenue, IAS 11 Construction Contracts and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework, which requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. The new standard is effective for the periods commencing on or after January 1, 2018, with earlier adoption permitted. The Company is currently evaluating the impact of adopting IFRS 15 on the interim consolidated financial statements.

(iii) *IFRS 16 Leases (“IFRS 16”)*

The IASB issued IFRS 16 in January 2016. This IFRS will result in all leases being recognized on the statement of financial position as lessees, except those that meet the limited exception criteria. The standard is effective for the periods commencing on or after January 1, 2019, with earlier adoption permitted.

## 8.2. Changes in Accounting Policies

There were no changes in accounting policies in the period under review and a detailed listing of the Company’s significant accounting policies is provided in Note 4 to the interim consolidated financial statements for the quarter ended December 31, 2016, prepared in accordance with IFRS.

## 9. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer of the Company will file a Venture Issuer Basic Certificate with respect to the financial information contained in the unaudited interim condensed financial statements and the audited annual financial statements and respective accompanying MD&A.

In contrast to the certificate for non-venture issuers under National Instrument 52-109 (Certification of disclosure in an Issuer’s Annual and Interim Filings) (“**NI 52-109**”), the Venture Issuer Basic Certification does not include representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in NI 52-109.

Disclosure controls and procedures (“**DC&P**”) are intended to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management. Internal controls over financial reporting (“**ICFR**”) are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with Canadian generally accepted accounting principles.

TSX-V listed companies are not required to provide representations in the interim and annual filings relating to the establishment and maintenance of DC&P and ICFR, as defined in NI 52-109. In particular, the CEO and CFO certifying officers do not make any representations relating to the establishment and maintenance of (a) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and (b) a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer’s GAAP.

The issuer’s certifying officers are responsible for ensuring that processes are in place to provide them with sufficient knowledge to support the representations they are making in their certificates regarding the absence of

misrepresentations and fair disclosure of financial information. Investors should be aware that inherent limitations on the ability of certifying officers of a TSX-V issuer to design and implement on a cost-effective basis DC&P and ICFR as defined in NI 52-109 may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

The Company has a website at [www.primelineenergy.com](http://www.primelineenergy.com) or [www.pehi.com](http://www.pehi.com). The site features information on PEHI, new releases, background information and a technical summary of the project.

Additional information related to the Company, including the Company's AIF, is available on SEDAR under the Company's profile at [www.sedar.com](http://www.sedar.com)