

# Q2 2016

## WesternZagros Resources Ltd.

Second Quarter Interim Report  
for the period ended June 30, 2016

### Message to Shareholders

WesternZagros Resources Ltd. (TSX-V – WZR) (“WesternZagros” or the “Company”) provides its financial results for the period ended June 30, 2016, as well as key operational highlights and activities to date.

Commenting on the second quarter results and subsequent events, WesternZagros’s Chief Executive Officer Simon Hatfield said:

“A significant key milestone was reached with the approval of the Garmian Field Development Plan confirming the commercial potential of this project. The Sarqala-1 well has now produced over 3 million barrels of light oil to date with no indications of formation water and no hydrogen sulphide. In parallel, the Kurdamir project continues to advance with the submission of the Kurdamir Field Development Plan in conjunction with Repsol’s Topkhana Field Development Plan which envisions surface facilities shared between Kurdamir and Topkhana”

We believe the quality and scale of our oil and gas assets provide opportunities to realize the fundamental inherent value related to our long-life, low-decline assets and significant long-term oil and gas potential related to the Kurdamir and Garmian projects. We are encouraged by the leadership demonstrated by our co-venturers, Repsol and Gazprom Neft, to progress our respective major development and growth projects.”

### Financial and Operating Highlights

- **Development Plans** – WesternZagros and its co-venturer, Gazprom Neft Middle East B.V. (“Gazprom Neft”) received approval of the Garmian Block Field Development Plan (“Garmian FDP”) from the Kurdistan Regional Government (“KRG”) on May 26, 2016. The Garmian FDP is focused on the development of the Jeribe/Upper Dhiban reservoir. With the approval of the Garmian FDP, the Company paid its share of the first production bonus due to the KRG in accordance with the terms of the Garmian PSC of \$1.0 million.

On May 27, 2016, the Company and Talisman (Block K344) B.V., a wholly owned subsidiary of Repsol S.A. (“Repsol”) submitted the revised Kurdamir Block Field Development Plan (“Kurdamir FDP”) to the KRG to develop the Block’s significant oil and gas resources. Phase 1 is focused on the development of the Oligocene oil and gas discovery and includes a 150 million cubic feet per day (“mmcf/d”) central processing facility (“CPF”) shared equally between the Kurdamir Block and Repsol’s adjacent Topkhana Block.

- **Financial** – The Company ended the second quarter with \$34.0 million in cash and cash equivalents and an undrawn \$200 million credit facility.

The Company entered into a second letter agreement with Crest Energy International LLC (“Crest”) on April 26, 2016 to further extend the timing to draw the US\$200 million unsecured credit facility to better meet the Company’s capital expenditure profile and reduce near term financing costs.

- **Production** – Second quarter gross oil sales averaged 4,884 barrels of light oil per day (“bbl/d”), of which WesternZagros’s net oil sales were 1,317 bbl/d. Gross production averaged approximately 5,500 bbl/d over 80 days in the second quarter. Production was down a total of eleven days during the second quarter due to

marketing restrictions and equipment upgrades. Total gross oil sales delivered in the quarter were approximately 444,000 barrels (“bbl”) for the Sarqala field, 120,000 bbl net to the Company.

- **Revenue** – Revenue recognized by WesternZagros was \$4.3 million for approximately 120,000 bbl, (net) oil sales delivered during the second quarter with an average realized price of \$36.01/bbl, of which \$1.9 million has been realized by the Company with \$2.4 million outstanding.
- **Cost Reduction Initiatives** – WesternZagros’s ongoing cost reduction initiatives drove efficiencies across the Company in the second quarter. The Company will continue to maintain a conservative approach to capital spending for the remainder of 2016. The Company has done a prudent job in reducing G&A and capital costs over the past 18 months. Many of the cost savings have become permanent and the overall cost structure of the Company has been permanently reduced.
- **Corporate** – The restructuring of senior management intended to align the organization structure with the current business environment resulted in the elimination of the position of Vice President Human Resources.

In announcing the change to senior management, Simon Hatfield acknowledged the contributions of Mary Benassi, former Vice President Human Resources, who left the Company in May, 2016. “I want to thank Mary for her leadership role during a time of considerable change for WesternZagros – especially for preserving the distinct culture of the Company and for the example she set in her effective and respectful focus on people. We wish Mary all the best in her future endeavours,” said Hatfield.

WesternZagros continues to review strategic initiatives to improve financial flexibility including but not limited to potentially accessing the debt and/or equity markets or seeking additional partnerships, farmouts or other strategic arrangements.

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## **Management’s Discussion and Analysis**

The following Management’s Discussion and Analysis (“MD&A”) reviews WesternZagros Resources Ltd.’s (“WesternZagros” or the “Company”) financial condition, activities and results of operations for the three and six month periods ended June 30, 2016. It should be read in conjunction with the Company’s unaudited condensed consolidated interim financial statements prepared in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, prepared using policies consistent with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and the related notes for the period ended June 30, 2016. Certain information and disclosures normally included in the notes to the interim financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, this MD&A should also be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2015, which were prepared in accordance with IFRS as issued by the IASB.

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

This MD&A is dated August 10, 2016.

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## **Basis of Presentation**

### **Reporting and Functional Currency**

The Company has prepared its June 30, 2016, unaudited condensed consolidated interim financial statements in accordance with IFRS, as issued by the IASB, and interpretations issued by the IFRS Interpretations Committee (“IFRIC”) that were published at the time of preparation and that were effective on December 31, 2015. Comparative information for 2015, including that utilized in this MD&A, has been prepared in accordance with the Company’s IFRS accounting policies, which have been consistently applied to all periods presented. Where

necessary, prior period comparative figures have been adjusted to conform to presentation changes in the current year.

The reporting and functional currency of the Company is the United States ("U.S.") dollar. All references herein to US\$ or to \$ are to U.S. dollars.

## **Overview**

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WesternZagros is a publicly-traded, Calgary-based, international company focused on acquiring, exploring, developing and producing crude oil and natural gas in the Kurdistan Region of Iraq ("Kurdistan Region"). WesternZagros holds two production sharing contracts ("PSCs") with the KRG that are on trend with, and adjacent to, a number of prolific oil and gas discoveries. WesternZagros has completed the exploration phase under both PSCs and is continuing the appraisal and development of its crude oil and natural gas discoveries.

WesternZagros's goal is to develop the resources associated with its discoveries on both blocks:

- Appraise and develop 366 million barrels ("MMbbl") of unrisks Contingent Resources of oil, 1.8 trillion cubic feet ("Tcf") of unrisks Contingent Resources of gas, 55 MMbbl of unrisks Contingent Resources of condensate, and delineate the 1 billion barrels ("Bbbl") of unrisks Prospective Resources of oil and 1 Tcf of natural gas (all Gross Block P50 estimates), in the Oligocene reservoir on the Kurdamir Block.
- Develop 13 MMbbl of Proved plus Probable ("2P") light oil Reserves (Gross Block) and appraise and develop an additional 66 MMbbl of unrisks Prospective Resources of oil, Gross Block P50 estimate, in the Jeribe/Upper Dhiban reservoir on the Garmian Block.

The Kurdamir PSC ("Kurdamir Block") is operated by Repsol with a 40 percent working interest. WesternZagros holds a 40 percent working interest and the KRG holds a 20 percent carried interest. A Declaration of Commerciality was filed in August, 2014 and a revised Kurdamir FDP was submitted for approval in May, 2016 that includes the development of the Oligocene oil and gas discovery utilizing a shared 150 mmcf/d CPF to process the produced oil and gas from the Kurdamir block and the neighbouring Topkhana block, both operated by Repsol, to optimize capital costs. Each block will conduct its own drilling program. The co-venturers are conducting a number of activities, including front-end engineering of the necessary shared facilities and future wells and negotiating agreements for the sale of gas, oil and condensate production, in support of the final approval of the Kurdamir FDP to the KRG. Since discussions are ongoing with the KRG with respect to approval of the FDP for Kurdamir, Reserves have not yet been recognized by a qualified independent reserves evaluator.

The Company holds a 40 percent working interest in the Garmian PSC ("Garmian Block"). The KRG holds a 20 percent interest and the remaining 40 percent interest is held by Gazprom Neft. Pursuant to the terms of the Garmian PSC, operatorship was transitioned from WesternZagros to Gazprom Neft on February 29, 2016. WesternZagros filed a Declaration of Commerciality for the Sarqala discovery in December 2013 and the Garmian FDP, focused on the development of the Jeribe/Upper Dhiban reservoir, was approved by the KRG in May, 2016.

## **Strategy**

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WesternZagros's objective is to advance the development of its discoveries into production in a phased manner to maximize the value of the Kurdamir and Garmian blocks for the Company, the KRG, the peoples of the Kurdistan Region of Iraq, and shareholders. In light of the ongoing oil price environment, WesternZagros will maintain focus on fiscal control, safety and environmental stewardship, and risk management. The Company continues to implement strict cost reduction efforts that have meaningful impact to the bottom line, including optimizing capital investment, renegotiating contracts with service companies and reducing discretionary expenditures. The Company's priorities are to manage capital spending to profitably grow production and funds flow through operational execution and maintaining prudent and conservative financial discipline.

The Company will continue to monitor oil and natural gas prices and the market conditions that exist within the Kurdistan Region as it determines its levels of development activity.

As the Company prepares for the advancement of the Kurdamir and Garmian development plans, in December 2015, the Board commenced a full review of financing opportunities available to the Company. TD Securities has been engaged to support this review.

## **Operational Updates**

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WesternZagros's operations and activities to August 10, 2016, include the following:

### **Operations**

WesternZagros's assets comprise two contract areas, the Kurdamir and Garmian blocks, with significant oil and natural gas discoveries.

### **Garmian Block**

#### **Garmian Block Field Development Plan Approval**

- WesternZagros and its co-venturer, Gazprom Neft received approval for the Garmian FDP for the Sarqala Field from the KRG on May 26, 2016.
- The Garmian FDP is focused on the development of the Jeribe/Upper Dhiban reservoir which is estimated to contain 13 MMbbl of 2P oil Reserves and 66 MMbbl of unrisks P50 Prospective oil Resources (both Gross Block). The first phase of development includes the continuation of production from the Sarqala-1 well, and the drilling of two additional development wells to increase production and to convert prospective resources into reserves.
- The Sarqala-2 well is anticipated to spud in the first half of 2017 and is planned to target a fractured portion of the reservoir identified on the 3D seismic. The Sarqala-3 well is planned to follow with similar objectives. The potential for further development of the Jeribe/Upper Dhiban reservoir will be assessed following the results from this first phase.

#### **Garmian Block Production**

- Second quarter gross oil sales for the Sarqala field averaged 4,884 bbl/d of light oil, of which WesternZagros's net oil sales were 1,317 bbl/d. Gross production averaged approximately 5,500 bbl/d over 80 days in the second quarter. Production was down a total of eleven days during the second quarter due to marketing restrictions and equipment upgrades. Total gross oil sales delivered in the quarter were approximately 444,000 bbl for the Sarqala field, 120,000 bbl net to the Company. The Sarqala-1 well has now produced over 3 MMbbl of light oil to date with no indications of formation water and no hydrogen sulphide.

### **Kurdamir Block**

#### **Kurdamir Block Field Development Plan Submission**

- WesternZagros and its co-venturer, Repsol, submitted a revised Kurdamir FDP to the KRG on May 27, 2016 to develop the significant oil and gas resources discovered on the Kurdamir Block.
- The Kurdamir FDP is a phased development that will be executed over a period of several years. Phase 1 is focused on the development of the Oligocene oil and gas discovery and includes a CPF shared equally between the Kurdamir Block and Repsol's adjacent Topkhana Block. The facility will have a capacity of 150 mmcf/d of gas per day with liquids handling for condensate and oil. Repsol is the operator of both the Topkhana and Kurdamir blocks.
- The co-venturers and the KRG continue to negotiate a gas sales agreement to provide Phase 1 gas from the Kurdamir and Topkhana blocks to the domestic market. Future phases are anticipated to provide gas to the export market. In addition, the KRG is responsible for the construction of a gas pipeline from the Kurdamir/Topkhana block boundary to a tie in point at Chemchemical. A final investment decision to advance the project is anticipated upon completion of the gas sales negotiations, the pipeline engineering, procurement and construction award and approval of the Kurdamir FDP.

## **Health, Safety, Environment and Security and Corporate Social Responsibility**

- WesternZagros continues to have an unwavering commitment to safety and security and, as non-operator will work in cooperation with the operators of the Kurdamir and Garmian blocks to ensure all operations focus on best practices in the areas of health, safety, environment and security, corporate social responsibility programs and related management systems, organizational and staffing needs.

## **Kurdistan Region Updates**

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- The KRG implemented a reform program in 2015 aimed at cutting allowances to government employees and reducing fuel and electricity subsidies. With the continued fall in oil prices throughout 2015 and the subsequent decline in KRG oil revenue, the KRG continues its lobbying efforts with the Government of Iraq (“GOI”) to receive its share of International Monetary Fund (“IMF”) funding in an effort to counter its fiscal deficit. The KRG received a \$150 million loan from Turkey in the first quarter of 2016 and the United States has pledged to help fund the Peshmerga salaries in the fight against the Islamic State of Iraq and Syria. Funding from the IMF would assist the KRG as it seeks economic stability and development of its gas and oil infrastructure projects.
- On May 26, 2016, the GOI announced it had reached a \$5.3 billion standby agreement with IMF that could unlock potentially \$15 billion more in international assistance over the next three years. To meet the terms outlined in the IMF’s standby agreement, the GOI has suggested a new version of an oil and revenue deal between the GOI and the KRG. The proposed deal considers netting out the KRG oil revenue from fiscal transfers outlined in Iraq’s 2016 budget law. Effectively, whatever the KRG earns from its independent oil sales would be deducted from money payable to it under Iraq’s budget. The KRG has stated its intention to independently audit its oil revenue starting in July, 2016 to provide a set of agreed figures to work from.
- The KRG continues to express its commitment to develop the Kurdistan Region’s natural gas resources with an initial emphasis being fuel for domestic electricity generation and export. The KRG has identified certain fields, including the Oligocene oil and gas resources in the Kurdamir and Topkhana blocks, as development projects to provide near term gas to the domestic market with the potential for future volumes to supply both domestic and export markets.

## **Corporate & Financial Updates**

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### **Corporate Management**

- The restructuring of senior management intended to align the organization structure with the current business environment has resulted in the elimination of the position of Vice President Human Resources. Mary Benassi left the Company in May 2016 after overseeing the difficult but necessary realignment and reduction of its workforce resulting from the transition of operatorship on the Garmian Block that was completed on February 29, 2016.
- During the second quarter of 2016, the Company remained focused on executing its plans to maintain production and minimize costs. Sustainability during the prolonged volatile market environment remains a key objective.
  - WesternZagros continues to review strategic initiatives to improve financial flexibility including but not limited to potentially accessing the debt and/or equity markets or seeking additional partnerships, farmouts or other strategic arrangements.

### **Financial**

- As at June 30, 2016, WesternZagros had \$34.0 million in cash and cash equivalents and an undrawn \$200 million credit facility, which is available in two tranches and subject to certain conditions precedent to drawdown: Tranche 1 - \$150 million and Tranche 2 - \$50 million.
- On April 26, 2016, the Company and Crest entered into a second letter agreement to extend the deadline date by which the Company must deliver to Crest the first drawdown notice for each of the two tranches under the Loan Agreement and to reverse the ordering of these tranches to better align with the Company’s anticipated capital needs. The drawdown deadline for the \$50M Tranche has been extended from the original date of June 1, 2016 to November 1, 2016. In addition, the maturity date for this tranche has also been extended from June 1, 2018 to November 1, 2018. The drawdown deadline for the \$150M Tranche has been extended from May 1,

2016 to April 1, 2017, with a corresponding extension of the maturity date for this tranche from October 1, 2017 to April 1, 2019.

- Revenue recognized was \$4.3 million for approximately 120,000 bbl (net) oil sales delivered during the second quarter with an average realized price of \$36.01/bbl. Based on the new payment arrangements implemented by the KRG in 2016, the Company realized \$1.9 million with \$2.4 million of revenue outstanding.
- The Company capitalized \$3.6 million of exploration and evaluation (“E&E”) for the quarter, related mainly to WesternZagros’s 60 percent share of Kurdamir Block appraisal costs.
- The Company capitalized its 50 percent share of applicable oil and natural gas assets expenditures to property, plant and equipment related to Garmian Block activities of \$4.8 million, which was comprised of Sarqala-2 planning costs, production facilities upgrades, related in-country supervision and office costs, and the first production bonus due to the KRG of \$1 million upon approval of the Garmian FDP in accordance with the terms of the Garmian PSC. Costs related to Sarqala-1 well operations and the operation of production facilities have been accounted for as operating costs.

### Production and Oil sales

Production and oil sales from Sarqala-1 are summarized as follow:

	Three months ended June 30, 2016		Three months ended June 30, 2015		Six months ended June 30, 2016		Six months ended June 30, 2015	
	bbl	bbl/d	bbl	bbl/d	bbl	bbl/d	bbl	bbl/d
Gross oil production <sup>(1)</sup>	444,418	4,884	493,854	5,427	508,513	2,794	749,661	4,142
Working interest oil production <sup>(2)</sup>	177,767	1,953	197,542	2,171	203,405	1,118	299,864	1,657
Royalties <sup>(3)</sup>	(57,898)	(636)	(64,340)	(707)	(67,723)	(372)	(97,665)	(540)
Net oil production <sup>(4)</sup>	119,869	1,317	133,202	1,464	135,682	746	202,199	1,117

(1): Represents gross crude oil production attributable to 100 percent of the Garmian Block, without any adjustment for the Company working interest or the KRG’s entitlements pursuant to the Garmian PSC.

(2): Represents WesternZagros’s 40 percent working interest of gross oil production. This presentation format within the MD&A was changed in comparison to the interim quarters of 2015 to align with the presentation of working interest volumes, future revenue and royalties as presented within the Company’s “Statement of Reserves and Other Oil and Gas Information” in the Annual Information Form dated March 16, 2016 (“AIF”). Previously, the interim quarters of 2015 working interest oil sales reflected the Company’s net entitlements plus 50 percent of the KRG’s entitlements rather than only the Company’s 40 percent working interest. There was no change to net oil sales for this change in presentation.

(3): Royalties represents the difference between the Company’s working interest oil production and the Company’s net entitlements.

(4): Net oil production represents WesternZagros’s net entitlements for cost recovery and profit oil. For 2015, net oil production was also net of unpaid portion of entitlements under an interim payment mechanism established by the KRG that was in effect during the year.

### Field Netback

Revenue recognized during 2016 was based on volumes delivered and in accordance with the commercial terms of the Garmian PSC. Revenue recognized was \$4.3 million for approximately 120,000 bbl (net) oil sales delivered during the second quarter with an average realized price of \$36.01/bbl. Based on the new payment arrangements implemented by the KRG in 2016, the Company realized \$1.9 million with \$2.4 million of revenue outstanding.

Operating expense for Sarqala-1 and related production facilities is relatively fixed in nature. Field netback, revenue net of operating expenses, is summarized below. Operating expense per barrel as reflected in the following chart is based on the Company’s net oil sales volumes. Operating costs for the three months ended June 30, 2016, and 2015, reflecting gross production basis from the Sarqala field, were \$6.89 and \$6.61 per barrel, respectively, which is a more appropriate correlation to operating expense on a gross production basis.

	Three months ended June 30, 2016		Three months ended June 30, 2015		Six months ended June 30, 2016		Six months ended June 30, 2015	
	\$000’s	\$/bbl	\$000’s	\$/bbl	\$000’s	\$/bbl <sup>(3)</sup>	\$000’s	\$/bbl
Working interest oil sales <sup>(1)</sup>	\$6,401	\$36.01	\$8,239	\$41.71	\$7,316	\$35.97	\$12,508	\$41.71
Royalties <sup>(2)</sup>	\$(2,085)	\$36.01	(2,684)	\$41.71	\$(2,435)	\$35.97	\$(4,074)	\$41.71

Revenue <sup>(3)</sup>	\$4,316	\$36.01	\$5,555	\$41.71	\$4,881	\$35.97	\$8,433-	\$41.71
Operating expense <sup>(4)</sup>	\$(1,532)	\$(12.78)	\$(1,633)	\$(12.26)	\$(2,500)	\$(18.42)	\$(2,594)	\$(12.83)
Field Netback <sup>(5)</sup>	\$2,784	\$23.23	\$3,922	\$29.45	\$2,381	\$17.55	\$5,839	\$28.88

- (1): Represents WesternZagros's 40 percent working interest. This presentation format within the MD&A was changed in comparison to the interim quarters of 2015 to align the presentation of working interest volumes and, future revenue and royalties as presented within the Company's "Statement of Reserves and Other Oil and Gas Information" in the AIF. Previously, the interim quarters of 2015 working interest oil sales reflected the Company's net entitlements plus 50% of the KRG's entitlements rather than only the Company's 40% working interest. There was no change to Revenue for this presentation change.
- (2): Royalties represents the difference between the Company's working interest oil sales and the Company's net entitlements. Refer to the section in this MD&A entitled "Kurdamir and Garmian Production Sharing Contracts: Commercial Terms".
- (3): Revenue represents WesternZagros's net entitlements for cost recovery and profit oil which is net of royalties associated with the KRG's entitlements comprised of the following components: royalty oil, the KRG's portion of profit oil, the KRG's share of the contractor group portion of profit oil, the capacity building bonus and the milestone production bonus. For 2015, revenue was also net of unpaid portion of entitlements under an interim payment mechanism established by the KRG that was in effect during the year.
- (4): Operating expenses are comprised of WesternZagros's working interest operating expenses plus 50 percent of the KRG's carried interest operating expenses.
- (5): Field netback is a non-IFRS measure; see the "Non-IFRS Measures" section of the MD&A.

### General and Administrative Expenses

For the three and six months ended June 30, 2016, WesternZagros expensed \$2.6 million and \$4.7 million in general and administrative expenses ("G&A"), respectively, as compared to \$1.0 million and \$4.6 million for the comparable periods in 2015. G&A expenses were slightly higher in 2016 due to higher professional fees, partially offset by lower staff expenses and a favourable U.S. exchange rate with the majority of the Company's G&A costs incurred in Canadian dollars.

For the three months ended June 30, 2016, WesternZagros capitalized \$0.3 million of G&A (Q2 2015: \$1.2 million), including the capitalized portion of share-based payments. For the six months ended June 30, 2016 the Company capitalized a total of \$1.1 million of G&A (June 30, 2015: \$2.0 million). The amounts capitalized are directly related to the supervision of the Company's development and exploration and evaluation activities and are lower in 2016 due to staffing reductions carried out in 2016 in connection with the transfer of operatorship to Gazprom Neft on February 29, 2016.

In light of the significant decline in oil price, the current capital market conditions and the transfer of operatorship on the Garmian Block, the Company continued to focus on strict cost management which included reducing staff and renegotiating contracts with service suppliers to further lower G&A costs for the remainder of 2016.

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

For the quarter ended June 30, 2016, WesternZagros had \$3.2 million of depletion of oil and gas assets and depreciation related to certain administrative assets, compared to \$4.6 million during the comparable quarter of 2015. For the six months ended June 30, 2016, the Company had \$3.7 million of depletion and depreciation, compared to \$6.9 million for the same period of 2015. Depletion on a unit of production basis was recognized in relation to the oil and gas assets, based on recognized proved plus probable reserves associated with Sarqala, reflecting the lower production in the first half of 2016 due mainly to restricted pipeline and market availability during the first quarter of 2016 as compared to 2015.

### Share Based Compensation

The Company recognizes the expense associated with share-based payments on a graded vesting basis for all stock options granted. For the quarter ended June 30, 2016, WesternZagros recorded \$0.1 million in stock based compensation expense (Q2 2015: \$0.1 million) and a negligible amount as part of capitalized G&A (Q2 2015: negligible), with a corresponding increase to contributed surplus. For the six month period ended June 30, 2016, the Company recorded \$0.2 million in stock based compensation expense (June 30, 2015: \$0.2 million) with a corresponding increase to contributed surplus.

### **Restricted Share Units (“RSUs”)**

The Company recognizes the expense associated with RSUs on a graded vesting basis for all RSUs granted with the fair value calculated in relation to the twenty-day weighted-average trading price of WesternZagros common shares as at each reporting date. For the three and six months ended June 30, 2016, WesternZagros recorded a negligible amount of share based RSU compensation expense. For the same periods of 2015, the Company recognized \$0.3 million in stock based RSU compensation expense.

### **Foreign Exchange**

WesternZagros adopted the U.S. dollar as its measurement and reporting currency since the majority of its expenditures are directly denominated in U.S. dollars and to facilitate a more direct comparison to other international crude oil and natural gas exploration and development companies.

As at June 30, 2016, WesternZagros held approximately 98 percent of its cash and cash equivalents and short-term investments in U.S. dollar accounts and U.S. dollar overnight and term deposits. The Company holds Canadian dollar balances for the purpose of funding WesternZagros’s Canadian dollar expenditures, which are mainly related to the costs associated with general and administrative costs for its head office. For financial statement presentation purposes, WesternZagros converts other currencies to U.S. dollars at the end of each period resulting in foreign exchange gains and losses.

During the three and six month periods ended June 30, 2016, WesternZagros recorded a negligible foreign exchange loss (Q2 2015: \$0.7 million loss; June 30, 2015: \$2.8 million gain). The exchange gains and losses recognized in 2015 were mainly due to the change in the U.S. dollar value of the Canadian denominated convertible notes originally issued in 2013, partially offset by the foreign exchange loss associated with the Canadian-denominated cash and investments held by the Company. The convertible notes were repaid at the end of 2015. As at June 30, 2016, had the U.S. Dollar exchange rate changed by one percent against the Canadian dollar, with all other variables held constant, the Company’s net foreign exchange gain or loss would have been negligible (June 30, 2015: \$0.8 million, including the impact of the convertible notes).

### **Net Loss**

For the quarter ended June 30, 2016, WesternZagros recorded a net loss of \$3.1 million compared to a net loss of \$82.8 million for the same period of 2015. The decreased net loss in 2016 is primarily due to a non-cash E&E impairment charge recognized during the second quarter of 2015.

For the six months ended June 30, 2016, the Company recorded a net loss of \$6.2 million compared to a net loss of \$86.2 million for the same period of 2015. The decreased loss in 2016 was primarily due to a non-cash E&E impairment charge recognized in 2015, as well as reduced revenue recognized in 2016.

### **Capital Expenditures**

WesternZagros’s share of capital expenditures included 60 percent of Kurdamir Block costs and 50 percent of Garmian Block costs. Reserves have not yet been recognized by a qualified independent reserves evaluator for the Kurdamir Block. Accordingly, all capital expenditures that pertain to the Kurdamir Block continue to be capitalized in accordance with the Company’s exploration and evaluation accounting policy. During the third quarter of 2014, initial Reserves were recognized by an independent reserves evaluator for the first time in relation to the Sarqala light oil discovery on the Garmian Block. Since that time, capital expenditures in relation to Garmian Block activities have been included as either oil and gas assets within PP&E or as E&E expenditures, depending on the type of expenditure.

For the three and six months ended June 30, 2016, WesternZagros’s share of E&E expenditures for the PSC activities and other related capitalized costs was \$3.6 million and \$5.1 million, respectively, mainly for appraisal activities related to the Kurdamir Block, comprised of local office costs, other appraisal and development planning activities and other PSC-related costs.

By comparison, for the quarter ended June 30, 2015, WesternZagros’s share of E&E expenditures for the PSC activities and other related capitalized costs was \$11.0 million. The Company’s portion of drilling-related costs was \$7.0 million related to Hasira-1 completion, testing and suspension activities on the Garmian Block. The Company’s portion of all other appraisal and development costs for both Blocks was \$4.0 million, which included \$2.4 million

for local office costs and \$1.6 million for other appraisal and development planning activities and other PSC-related costs. For the six months ended June 30, 2015, WesternZagros's share of E&E expenditures for the PSC activities and other related capitalized costs was \$26.7 million. The Company's portion of drilling-related costs was \$15.1 million related to Hasira-1 completion, testing and suspension activities on the Garmian Block. The Company's portion of all other appraisal and development costs for both Blocks was \$11.6 million, which included \$5.2 million for local office costs and \$6.4 million for other appraisal and development planning activities and other PSC-related costs. During the second quarter of 2015, a non-cash impairment charge of \$77 million was recognized in the Garmian Block for the amount by which its E&E expenditures exceeded its recoverable amount. No impairment was recognized in regards to the Kurdamir Block CGU.

For the three and six months ended June 30, 2016, the Company's share of oil and gas assets capital expenditures was \$4.8 million and \$9.4 million, respectively, which was comprised of Sarqala-2 planning costs, production facilities upgrades, related in-country supervision and office costs, and the first production bonus due to the KRG of \$1 million upon approval of the Garmian FDP, in accordance with the terms of the Garmian PSC. Costs related to Sarqala-1 well operations and the related production facilities are treated as operating costs.

By comparison, for the second quarter of 2015, the Company's share of oil and gas assets capital expenditures was \$3.5 million, which was comprised of planning and design costs related to the next Sarqala development well and the future expansion of production facilities. All costs related to Sarqala-1 well operations and the operation of related production facilities were treated as operating costs. For the six month period ended June 30, 2015, the Company's share of oil and gas assets capital expenditures was \$7.0 million, which was comprised of upgrades to the Sarqala production site as well as planning and design costs related to the next Sarqala development well and the future expansion of production facilities. Subsequent to the commencement of production, costs related to Sarqala-1 well operations and the operation of related production facilities were treated as operating costs.

#### Quarterly Information

The following table summarizes key financial information on a quarterly basis for the fiscal periods indicated:

US\$ thousands, unless otherwise specified	Three month periods ended			
	June 30, 2016	Mar 31, 2016	Dec 31, 2015	Sep 30, 2015
Revenue	4,316	565	4,629	4,870
Operating expense	1,532	968	1,036	1,022
Net Income(Loss)	(3,059)	(3,097)	(5,306)	(144,603)
Net Income(Loss) Per Share (US\$ Per Share) (Basic and Fully Diluted)	\$(0.01)	-	\$(0.01)	\$(0.18)
E&E Expenditures <sup>(1)</sup>	3,612	1,515	3,935	8,704
PP&E Expenditures <sup>(1)</sup>	4,821	4,626	3,879	1,716
Total Assets	371,288	373,095	376,007	455,399
Total Non-Current Liabilities	20,643	19,444	16,875	12,559
Dividend (US\$ per Share)	Nil	Nil	Nil	Nil

US\$ thousands, unless otherwise specified	Three month periods ended			
	June 30, 2015	Mar 31, 2015	Dec 31, 2014	Sep 30, 2014
Revenue	5,555	2,878	-	-
Operating expenses	1,633	961	-	-
Net Income (Loss)	(82,750)	(3,486)	(13,858)	3,608
Net Income (Loss) Per Share (US\$ Per Share) (Basic and Fully Diluted)	\$(0.11)	-	\$(0.03)	\$0.01
E&E Expenditures <sup>(1)</sup>	11,008	15,659	19,006	18,673
PP&E Expenditures	3,543	3,477	6,619	2,040
Total Assets	605,531	686,858	704,331	541,438
Total Non-Current Liabilities	12,271	12,849	12,024	83,933

Dividend (US\$ per Share)	Nil	Nil	Nil	Nil
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(1): E&E expenditures as presented are prior to change in non-cash investing capital and disposals.

### Outstanding Share Data

As at June 30, 2016, and as at the date of this MD&A, there were 511,944,803 common shares issued and outstanding. The number of common shares reserved for issuance pursuant to options granted will not exceed 10 percent of the issued and outstanding common shares.

As at June 30, 2016, and as at the date of this MD&A, there were 274,755,015 preferred shares issued and outstanding which are convertible in accordance with the terms and conditions thereof into 274,755,015 common shares. The preferred shares issued are: non-voting; non-interest bearing; entitled to receive dividends in parity with common shares (currently \$Nil dividend); and are convertible into common shares on a one to one basis upon certain conditions being met, with the conversion ratio subject to adjustments in certain circumstances.

During the first six months ended June 30, 2016, there were 22,925,000 options granted, 7,151,917 options forfeited and 3,938,700 options expired for officers, directors, employees or contractors bringing the total stock options outstanding to 43,918,834 at June 30, 2016. Subsequent to June 30, 2016 1,000,000 options were granted to officers, directors, employees or contractors to bring the options outstanding to 44,918,834 as at the date of this MD&A.

For the six months ended June 30, 2016, there were 2,367,667 restricted share units ("RSUs) which vested and were paid to, 1,661,243 RSUs forfeited by, and 130,000 RSU's granted to officers, directors, or employees bringing the RSUs outstanding to 3,500,939 as at June 30, 2016. Subsequent to June 30, 2016, there were 2,333 RSU's vested and paid, to bring the total RSU's outstanding to 3,498,606 as at the date of this MD&A. RSUs are not convertible into common shares but instead are settled via cash payment with the amount based on the weighted-average trading price of common shares for the twenty day period immediately preceding the applicable vesting date.

### PSC's, Commitments and Liquidity & Capital Resources

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#### Kurdamir and Garmian Production Sharing Contracts: Summary and Commitments

Under the terms of its Kurdamir and Garmian PSCs, WesternZagros has a 40 percent working interest in each PSC and the KRG has a 20 percent working interest in both PSCs. The remaining 40 percent working interest in the Kurdamir PSC is held by Repsol and the remaining interest in the Garmian PSC is held by Gazprom Neft. The "Contractor Group" is comprised of WesternZagros, the KRG and Repsol for the Kurdamir PSC and WesternZagros, the KRG, and Gazprom Neft for the Garmian PSC.

The Company concluded the second exploration sub-period of the Kurdamir PSC with the Declaration of Commerciality ("DoC") filed on August 19, 2014. Following submission of the DoC, the Company and its co-venturer submitted a FDP on August 31, 2014, for which the KRG had a 60 day period, on a best efforts basis, to approve the plan. The KRG subsequently requested changes to the Kurdamir FDP, which was submitted by the Kurdamir Joint Venture on May 27, 2016. Until the KRG approves the Kurdamir FDP, the terms of the PSC allow for an extension of the development period based on the number of days required to approve the plan beyond the aforementioned 60 day period. The Company has committed to expenditures of approximately \$2 million, under an approved joint venture budget to meet its 60 percent funding requirement related to ongoing development planning.

The Garmian FDP was approved by the KRG on May 26, 2016. The expiration of the initial 20 year production period, pursuant to the terms of the PSC is October 1, 2035. The Company has committed to expenditures of approximately \$12 million, under an approved joint venture budget, to meet its 50 percent funding requirement for ongoing development activities.

In accordance with the terms of the PSCs, the Company has certain annual payment commitments. During the respective development periods, the Company's portion of these annual PSC payments is \$1.1 million.

### **Kurdamir and Garmian Production Sharing Contracts: Production**

The Kurdamir and Garmian PSCs provide each respective Contractor Group with the exclusive right to develop and produce any commercial discoveries. A development area encompasses any discoveries made prior to the end of the exploration period. The development period for producing a commercial discovery is an initial term of 20 years from the date of declaring a commercial discovery with a further automatic right to a five year extension. If commercial production is possible at the end of the last period then the Contractor Group shall be entitled to an extension of a further five years under the same terms as in the applicable PSC if a request is made by the Contractor Group at least six months before the end of the first five year extension.

Pursuant to the terms of the Kurdamir and Garmian PSCs, WesternZagros maintains the right to market its share of oil on the world market. There is an obligation under the Kurdamir and Garmian PSCs to make oil production available to meet regional market demand at world market price. Pursuant to the terms of the Kurdamir PSC, the price for natural gas is based on the actual price obtained at the delivery point, and ultimate sales contracts and final sales prices are subject to KRG approval. Under the Garmian PSC, the KRG has the right to develop the gas resources. Limited markets exist for natural gas within Iraq and there is limited infrastructure for export. The KRG has prioritized the expansion of its domestic electricity generation and the export of gas to Turkey to expand markets and increase the demand for natural gas. On the Kurdamir Block, the co-venturers are negotiating a domestic gas sales contract to provide gas from the initial development phase to the KRG.

### **Kurdamir and Garmian Production Sharing Contracts: Commercial Terms**

The sharing of oil production occurs as follows: of the total oil produced, operations oil is available to the Contractor Group for use in carrying out its obligations under the PSCs; the remaining oil is subject to a 10 percent royalty payable to the KRG (the residual is considered to be "net available oil"). Up to 45 percent of the net available oil is available for cost recovery with the remainder as "profit oil". Costs subject to cost recovery include all costs and expenditures incurred by the Contractor Group for exploration, development, production and decommissioning operations, as well as any other expenditures incurred directly or indirectly with these activities. The portion of profit oil available to the Contractor Group is based on a sliding scale from 35 percent to 16 percent depending on a calculated R-Factor. The R-Factor is established by reference to the ratio of cumulative revenues over cumulative costs. When the ratio is below one, the Contractor Group is entitled to 35 percent of the profit oil. The percentage is then reduced on a linear sliding scale to a minimum of 16 percent at an R-Factor ratio of two or greater. As a result of the R-Factor calculation, after cost pools have been recouped in future, the Company's overall net entitlements would be reduced accordingly in conjunction with the impact on reduced cost and profit oil.

The production sharing terms for non-associated natural gas are the same as the oil production sharing terms except that the net available gas available for cost recovery is 55 percent and the profit sharing component is on a different scale. For natural gas, the portion of profit natural gas available for the Contractor Group is based on a sliding scale from 40 percent to 20 percent depending on a calculated R-factor. The R-Factor is established by reference to the ratio of the Contractor Group's cumulative revenue over cumulative costs. When the R-Factor is below one, the Contractor Group is entitled to 40 percent of the profit oil. The Contractor Group's percentage is then reduced on a linear scale to a minimum of 20 percent at a ratio of 2.75 or greater. Under the Kurdamir PSC, the production sharing terms for associated natural gas are included as part of the oil production sharing terms, except such associated gas sales are exempt from the 10 percent royalty. Under the Garmian PSC, the KRG has the right to develop the gas resources.

As at June 30, 2016, the Company had approximately \$236 million relating to the Kurdamir PSC and \$302 million related to the Garmian PSC, both net to WesternZagros, of "Petroleum Costs" (as defined in each PSC) which the Company has incurred and that may ultimately be recovered from future crude oil or natural gas sales in accordance with the production sharing terms of the PSCs. These cost pools relate only to the calculation of the Company's share of any future revenue received in accordance with the economic terms of the PSCs and are subject to government audit. The realization of these cost pools over time is subject to certain risks and uncertainties, which include but are not limited to, the approval of development plans, future costs incurred in accordance with the approved development plans, achieving commercial production necessary to fully recoup the available costs pools, the future sales prices that may be received and the results of future government audits, all of which may ultimately impact the Company's ability to fully realize the benefit of these cost pools over time in accordance with the commercial terms of each PSC.

## Other Commitments

The following table summarizes the Company's contractual obligations at June 30, 2016:

	For the Years Ending December 31, U.S.\$(000)'s unless otherwise specified,					
	2016	2017	2018	2019	2020+	Total
Office and other	\$505	\$1,142	-	-	-	\$1,647
	\$505	\$1,142	-	-	-	\$1,647

## Off-Balance Sheet Arrangements

The Company does not presently utilize any off-balance sheet arrangements to enhance its liquidity and capital resource positions, or for any other purpose. During the interim period ended June 30, 2016, WesternZagros did not enter into any off-balance sheet transactions.

## Liquidity and Capital Resources

As at June 30, 2016, WesternZagros had \$34.0 million in cash and cash equivalents and an undrawn \$200 million debt facility provided by Crest in a loan agreement between the parties dated August 14, 2014, as previously amended on December 21, 2015 (the "Loan Agreement"), which is available in two tranches and subject to certain conditions precedent: Tranche 1 - \$150 million and Tranche 2 - \$50 million.

On April 26, 2016, the Company and Crest entered into a letter agreement (the "Amending Agreement") to further amend the Loan Agreement. The Amending Agreement extends the date by which the Company must deliver to Crest the first drawdown notice (the "Drawdown Deadline") for each of the two tranches under the Loan Agreement and reverses the ordering of these tranches to better align with the Company's anticipated capital needs.

Pursuant to the terms of the Loan Agreement, Crest agreed to provide debt financing to the Company of up to US\$200 million in two tranches. The original first tranche is for up to US\$150 million (the "\$150M Tranche") and the original second tranche is for up to US\$50 million (the "\$50M Tranche"). Once an initial draw has been made under either tranche, the drawn amounts on the \$150M Tranche and the \$50M Tranche accrue interest at 12 and 14 percent per annum, respectively, and the undrawn amount under such tranches accrues a commitment fee of 8 percent per annum.

Pursuant to the Amending Agreement, the Drawdown Deadline for the \$50M Tranche has been extended from the original date of June 1, 2016 to November 1, 2016. In addition, the maturity date for this tranche has also been extended from June 1, 2018 to November 1, 2018. The Drawdown Deadline for the \$150M Tranche has been extended from May 1, 2016 to April 1, 2017, with a corresponding extension of the maturity date for this tranche from October 1, 2017 to April 1, 2019. If the initial draws under the Tranches are not made by the respective Drawdown Deadline dates, the respective tranches are cancelled.

All other terms of the Loan Agreement remain in effect unchanged, including interest rates and commitment fees and the condition precedent to drawdown that nothing has occurred since the closing of the Loan Agreement on November 18, 2014 (the "Closing Date") which could reasonably be expected to have a material adverse effect on the Company (as defined in the Loan Agreement).

The development budget for the Garmian Block for 2017 and the development plan for the Kurdamir Block have not yet been approved by the KRG and, as such, the anticipated level of capital expenditures required by the Company and the associated timing of such spending is uncertain at this time. As the Company advances the execution of its development activities it will continually evaluate both its capital resources and capital structure. The Company in this evaluation will monitor and assess all relevant factors, including the following:

- The expected timing and scope of development activities based upon an appropriate phasing reflective of the approved development plans, current market conditions, and the political and security situation within Iraq;
- The ability to export or to sell into the domestic market oil and natural gas in accordance with the economic terms of the PSCs;
- The level of cash flow generated from sales of crude oil;
- The continued participation of its co-venturers in development activities;

- The availability and suitability of the Crest debt facility in accordance with its terms;
- The current conditions of the oil and gas industry given the recent significant decline in world oil prices and the impact on further investment in the industry;
- The current conditions in the financial markets, including the potential for further market instability; and
- The ability to access other sources of funding for development activities in Kurdistan.

With the existing capital resources on hand, anticipated revenue and access to the debt facility, the Company anticipates that it is fully funded for currently planned activities for the next twelve months. However, additional funding will be required by the Company in the future as the Company advances the execution of its development activities. The quantum of, and timing for, such funding will be dependent upon the factors identified above, and particularly the outcome of the negotiations and final approvals of the Garmian development budget and the Kurdamir FDP. The Company may also delay certain phases of its development plans if the ability to export or sell into the domestic market oil and natural gas, and receive payment therefor, in accordance with the economic terms of the PSCs is restricted or unavailable, or if the political and security situation within Iraq is not suitable. The sources for such additional funding may include the existing Crest debt facility but, as previously announced, the Company is also exploring all other financing alternatives to allow for optimum alignment of capital availability with the development plan needs of the Company. This could include potentially accessing the debt and/or equity markets or seeking additional partnerships, farmouts or other strategic arrangements. The Company has retained TD Securities to act as its financial advisor.

## Outlook

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WesternZagros continues to focus on advancing development of the approved FDP on the Garmian Block and securing KRG approval of the phased development plan for the Kurdamir Block despite the challenging market conditions.

For the remainder of 2016, the Company anticipates the average daily productive capacity of Sarqala-1 will be approximately 5,000 bbl/d. Assuming continuous production and an average Brent price of \$40 to \$50 per barrel, WesternZagros estimates revenues for the remainder of 2016 to be \$7 to \$9 million.

The Company has \$34.0 million in cash and cash equivalents as at June 30, 2016 to advance the field development plans with its co-venturers. The Company estimates spending for the remainder of the year of approximately \$20 million to operate the Sarqala production operations, advance the respective development of the Kurdamir and Garmian blocks with its co-venturers and the WesternZagros head office. The first Garmian development well is anticipated to spud in the first half of 2017.

As previously announced, the Company has extended the timing for the draw down dates under the Crest Loan Agreement providing the Company with additional flexibility and reducing potential financing costs as it works to finalize its development plans and capital programs. The Company has completed its organizational re-structuring and has implemented strict cost management. In addition, the Company is reviewing all financing alternatives including but not limited to, the completion of an alternative debt financing or equity financing, or the farm down or sale of some of the assets of the Company to advance the developments. The Company will provide further guidance on the anticipated quantum and timing of capital expenditures for the respective Kurdamir and Garmian projects as the field development plans and related development budgets are finalized and approved.

## Other Considerations

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### Risk Factors

The oil and gas industry is very competitive and is subject to many risks. Many of these risks are outside of WesternZagros's control. The ability of WesternZagros to successfully carry out its business plan is primarily dependent upon the continued support of its shareholders, the discovery of economically recoverable reserves, the continued participation of the Company's co-venturers to the PSCs, meeting all commitments under the PSCs,

obtaining approval of development plans, the resolution of remaining political disputes in Iraq, the stability of security within the region, the ability to export oil and natural gas from the Kurdistan Region or sell oil and natural gas in the domestic market and receive payment in accordance with the economic terms under the PSCs and the availability of the debt financing in accordance with the Crest Loan Agreement, or the ability of WesternZagros to access alternative financing as required to develop reserves.

Management of WesternZagros has identified certain key risks, including the foregoing, and their potential impact on WesternZagros's operations. For further information on risk factors affecting the business of WesternZagros, see "Risk Factors" relating to the Company as referenced in the March 16, 2016, AIF.

### **Critical Accounting Estimates**

WesternZagros's critical accounting estimates are defined as those estimates that have a significant impact on the portrayal of its financial position and operations and that require management to make judgments, assumptions and estimates in the application of IFRS. Judgments, assumptions and estimates are based on historical experience and other factors that management believes to be reasonable under current conditions. As events occur and additional information is obtained, these judgments, assumptions and estimates may be subject to change. The critical accounting estimates used in the preparation of its condensed consolidated interim financial statements for the period ending June 30, 2016, are consistent with those as described in Note 5 of the audited annual consolidated financial statements for the year ended December 31, 2015.

### **Use of Estimates**

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates relate to unsettled transactions and events as of the date of the condensed consolidated interim financial statements. Accordingly, actual results may differ from these estimated amounts as future confirming events occur.

### **Significant Accounting Policies**

The significant accounting policies used in the preparation of the condensed consolidated interim financial statements are consistent with the policies as described in the audited annual consolidated financial statements for the year ended December 31, 2015, other than the following.

### **Revenue:**

Commencing in January 2016, the KRG implemented a payment mechanism for crude oil sales such that monthly payments are to be made based on the contractor's PSC entitlements and paid in the month following delivery. Based on this new payment mechanism and the consistent payments received to date, the Company has recognized revenue for the interim period ended June 30, 2016, based on volumes delivered at the point of loading directly at the production facilities since the significant risks and rewards of ownership (i.e. title) have passed to the buyers and the associated value of the revenue can be reliably measured.

### **Forward-Looking Information**

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This discussion offers management's analysis of the financial and operating results of WesternZagros and contains certain forward-looking statements relating to, but not limited to, expected working capital, expected capital and other commitments and the timing thereof, expectations regarding the necessity for further funding and the timing and potential sources thereof, operational information, future development concepts and plans and capacity of facilities and expected production rates, revenues, field netback, and petroleum costs (as defined in each Production PSC). Forward-looking information typically contains statements with words such as "anticipate", "estimate", "expect", "potential", "could", or similar words suggesting future outcomes. The Company cautions readers and prospective investors in the Company's securities to not place undue reliance on forward-looking information as, by its nature, it is based on current expectations regarding future events that involve a number of assumptions, inherent risks and uncertainties, which could cause actual results to differ materially from those anticipated by WesternZagros.

Forward looking information is not based on historical facts but rather on management's current expectations as well as assumptions made by, and information currently available to management, concerning, among other things, development plans and concepts, future capital and other expenditures (including the amount, nature and sources of funding thereof), the ability to identify appropriate financing transactions, the outcomes of future well operations, results of drilling activity and testing, future capital and other expenditures (including the amount, nature and sources of funding thereof), the availability of debt financing or access to alternate financing, the continued ability to sell production in the domestic or export markets and the payments to be received in connection therewith, anticipated operating costs, future economic conditions, future currency and exchange rates, continued political stability, continued security in the Kurdistan Region, timely receipt of any necessary co-venturer, government or regulatory approvals, the successful resolution of any disputes, the Company's continued ability to employ qualified staff and to obtain equipment in a timely and cost efficient manner and the participation of the Company's co-venturers in joint activities. In addition, budgets are based upon WesternZagros's current development plans and anticipated costs, both of which are subject to change based on, among other things, the outcome of negotiations with co-venturers and the government, the actual outcomes of well operations and the installation and commissioning of facilities, unexpected delays, availability of future financing and changes in market conditions. Although the Company believes the expectations and assumptions reflected in such forward-looking information are reasonable, they may prove to be incorrect. Forward-looking information involves significant known and unknown risks and uncertainties. A number of factors could cause actual results to differ materially from those anticipated by WesternZagros including, but not limited to, risks associated with the oil and gas industry (e.g. operational risks in development and production; inherent uncertainties in interpreting geological data; changes in plans with respect to capital expenditures; interruptions in operations together with any associated insurance proceedings; the uncertainty of estimates and projections in relation to timing, costs and expenses and health, safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, risks relating to domestic refining capacity and continuing ability to access the domestic market, risks relating to the ability to access export markets and receive payments in accordance with the PSC terms on a timely basis, the uncertainty associated with any dispute resolution proceedings, the uncertainty associated with negotiating with foreign governments and risk associated with international activity, including the lack of federal petroleum legislation and ongoing political disputes and recent terrorist activities in Iraq in particular.

Readers are cautioned that the foregoing list of important factors is not exhaustive and that these factors and risks are difficult to predict. The forward-looking statements contained in this MD&A are made as of the date of this MD&A and, except as required by law, WesternZagros does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. See the "Risk Factors" section of the Company's AIF dated March 16, 2016 filed on SEDAR at [www.sedar.com](http://www.sedar.com) for a further description of these risks and uncertainties facing WesternZagros. Additional information relating to WesternZagros is also available on SEDAR at [www.sedar.com](http://www.sedar.com), including the Company's AIF.

#### **Non-IFRS Measures**

Field netback is a non-IFRS measure that represents the Company's working interest share of oil sales, after deducting royalties and operating expenses. Management believes that the field netback is a useful measure to analyze operating performance and provides an indication of the Company's results of business activities prior to other income and expenses. Field netback does not have a standard meaning under IFRS and may not be comparable to similar measures used by other companies. It should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS such as total income (loss) or cash flow from (used in) operating activities. See the "Financial Performance" section of this MD&A for a reconciliation of field netback.

#### **Reserves and Resources Advisory**

In addition, statements relating to reserves and other resources contained herein are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources described can be economically produced in the future. Future net revenue values are estimated values only and do not represent fair market value. There is no assurance that the forecast prices and cost assumptions, the initial phases of the development plans as submitted to the KRG and anticipated future phases contemplated in completing the full field development utilized in such estimated values will be attained and variances could be material. The reserve and resource estimates provided herein are estimates only and there is no assurance that the estimated

reserves and other resources will be recovered. Actual reserves and other resources may be greater than or less than the estimates provided herein. Terms related to resource classifications referred to herein are based on the definitions and guidelines in the Canadian Oil and Gas Evaluation Handbook which are as follows. The reserves have been evaluated by Sproule International Limited ("Sproule"). Resources other than reserves have been estimated by the Company and audited by Sproule.

"Reserves" are estimated remaining quantities of oil and natural gas and related substances anticipated to be recoverable from known accumulations, as of a given date, based on (a) analysis of drilling, geological, geophysical and engineering data, (b) the use of established technology and (c) specified economic conditions which are generally accepted as being reasonable and shall be disclosed. Reserves are classified as Proved, Probable or Possible according to the degree of certainty associated with the estimates. "Proved Reserves" are those Reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated Proved Reserves. If probabilistic methods are used, there should be at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved Reserves. "Probable Reserves" are those additional Reserves that are less certain to be recovered than Proved Reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated Proved plus Probable (2P) Reserves. If probabilistic methods are used, there should be at least a 50 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated 2P Reserves. "Possible Reserves" are those additional Reserves that are less certain to be recovered than Probable Reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated Proved plus Probable plus Possible (3P) Reserves. If probabilistic methods are used, there should be at least a 10 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated 3P Reserves.

"Contingent Resources" are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. Contingent Resources have an associated chance of development (economic, regulatory, market and facility, corporate commitment or political risks). The Contingent Resources estimates referred to herein have not been risked for the chance of development. There is no certainty that the Contingent Resources will be developed and, if developed, there is no certainty as to the timing of such development or that it will be commercially viable to produce any portion of the Contingent Resources.

"Prospective Resources" are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective Resources have both an associated chance of discovery (geological chance of success) and a chance of development (economic, regulatory, market, facility, corporate commitment or political risks). The chance of commerciality is the product of these two risk components. Unless otherwise indicated, the estimates referred to herein have not been risked for either the chance of discovery or the chance of development. There is no certainty that any portion of the Prospective Resources will be discovered. If a discovery is made, there is no certainty that it will be developed or, if it is developed, there is no certainty as to the timing of such development or that it will be commercially viable to produce any portion of the Prospective Resources.

Gross Block resource estimates presented herein represent the total volumes for the indicated reservoirs attributable to 100 percent of the relevant block, without any adjustment for the Company's working interest therein whereas the Working Interest (Gross) or Company Gross resource estimates presented represent the Company's 40 percent working interest (operating or non-operating) share before deduction of royalty petroleum, profit petroleum, production bonuses and capacity building support payments pursuant to the provisions of the applicable Production Sharing Contract.

Best Estimate (P50) or (2C) is considered to be the best estimate of the quantity that will actually be recovered. It is equally likely that the actual remaining quantities recovered will be greater or less than the best estimate. If probabilistic methods are used, there should be at least a 50 percent probability that the quantities actually recovered will equal or exceed the best estimate.

A barrel of oil equivalent (BOE) is determined by converting a volume of natural gas to barrels using the ratio of 6 thousand cubic feet (Mcf) to one barrel. BOEs may be misleading, particularly if used in isolation. A BOE conversion

ratio of 6 Mcf:1 BOE is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

The section "Statement of Reserves and Other Oil and Gas Information" (including Schedule A) contained in the Company's AIF dated March 16, 2016 filed on SEDAR at [www.sedar.com](http://www.sedar.com), contains additional detail with respect to the Company's resource assessments and the estimates of net present value associated with its Reserves. This section includes the significant risks and uncertainties associated with the volume estimates and the recovery and development of the resources, the forecast prices and cost assumptions, descriptions of the applicable projects and FDPs and the specific contingencies which prevent the classification of the Contingent Resources as Reserves.

As indicated above, unless otherwise indicated, the estimates of Contingent Resources and Prospective Resources contained in this document are presented on an unrisks basis. Readers should refer to the AIF for the associated risks estimates of Contingent Resources and Prospective Resources. Such risks estimates are based upon the Company's estimates of chance of commerciality set forth therein which involves assessing various risks based upon a number of assumptions and other factors. While the Company believes that such estimates and underlying assumptions are reasonable, many of these assumptions are beyond the Company's control, are subject to change and may not, over time, prove to be accurate. As such, the actual level of various risks (including those currently identified and additional risks which may be identified in the future) could prove to be greater and the chance of commerciality lower than currently estimated and such differences could be material.

No additional projects have been defined at this time in respect of the Contingent Resources and Prospective Resources pertaining to other reservoirs for the Garmian and Kurdamir blocks since these reservoirs do not form part of the initial phases of the field development plans.

**Condensed consolidated interim statements of financial position**  
**(thousands of United States dollars)**  
(Unaudited)

	Note	June 30, 2016	December 31, 2015
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	7	<b>\$34,028</b>	\$48,395
Trade and other receivables	8	<b>1,707</b>	6,589
Prepaid expenses		<b>1,062</b>	1,153
Total current assets		<b>36,797</b>	56,137
<b>Non-current assets</b>			
Property, plant and equipment	9	<b>26,405</b>	20,268
Exploration and evaluation expenditures	10	<b>308,086</b>	299,602
Total non-current assets		<b>334,491</b>	319,870
<b>Total assets</b>		<b>\$371,288</b>	\$376,007
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	11	<b>\$12,186</b>	\$14,708
Provision for restricted share units	14	<b>87</b>	132
Deferred revenue		<b>-</b>	46
Total current liabilities		<b>12,273</b>	14,886
<b>Non-current liabilities</b>			
Provision for decommissioning obligations	12	<b>20,573</b>	16,751
Provision for restricted share units	14	<b>70</b>	124
Total non-current liabilities		<b>20,643</b>	16,875
<b>Total liabilities</b>		<b>32,916</b>	31,761
<b>Equity</b>			
<b>Equity attributable to shareholders</b>			
Common share capital	13	<b>496,554</b>	496,554
Preferred share capital	13	<b>156,226</b>	156,226
Contributed surplus	14	<b>19,166</b>	18,884
Accumulated deficit		<b>(333,574)</b>	(327,418)
<b>Total equity</b>		<b>338,372</b>	344,246
<b>Total equity and liabilities</b>		<b>\$371,288</b>	\$376,007
Commitments and contingencies (Note 20)			

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

**Condensed consolidated interim statements of comprehensive income (loss)**  
**(thousands of United States dollars)**  
(Unaudited)

	Note	Three months ended June 30,		Six months ended June 30,	
		2016	2015	2016	2015
Oil sales		<b>\$6,401</b>	\$8,239	<b>\$7,316</b>	\$12,507
Royalties		<b>(2,085)</b>	(2,684)	<b>(2,435)</b>	(4,074)
<b>Revenue</b>		<b>4,316</b>	5,555	<b>4,881</b>	8,433
<b>Expenses</b>					
Operating expenses		<b>1,532</b>	1,633	<b>2,500</b>	2,594
General and administrative expenses	15	<b>2,594</b>	1,017	<b>4,727</b>	4,604
Depreciation and depletion	9	<b>3,173</b>	4,626	<b>3,674</b>	6,914
Impairment of exploration and evaluation expenditures		-	77,000	-	77,000
Accretion on decommissioning obligations	12	<b>79</b>	56	<b>164</b>	106
Derivative liabilities (gain) loss		-	(4)	-	(27)
Foreign exchange (gain) loss		<b>14</b>	733	<b>53</b>	(2,840)
Total expenses		<b>7,392</b>	85,061	<b>11,118</b>	88,351
<b>Finance costs</b>					
Financing costs		-	3,442	-	6,680
Interest capitalized		-	(142)	-	(219)
Interest income		<b>(17)</b>	(56)	<b>(81)</b>	(143)
Net finance costs		<b>(17)</b>	3,244	<b>(81)</b>	6,318
Loss before taxation		<b>3,059</b>	82,750	<b>6,156</b>	86,236
<b>Taxation</b>					
Current		-	-	-	-
Deferred		-	-	-	-
Total taxation (recovery)		-	-	-	-
<b>Total loss and comprehensive loss attributable to shareholders</b>		<b>\$3,059</b>	\$82,750	<b>\$6,156</b>	\$86,236
<b>Net loss per share - basic and diluted</b>	17	<b>\$0.01</b>	\$0.11	<b>\$0.01</b>	\$0.11

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

**Condensed consolidated interim statements of changes in equity**  
**(thousands of United States dollars)**  
**(Unaudited)**

	Note	Number of Common Shares	Number of Preferred Shares	Common Share Capital	Preferred Share Capital	Contributed Surplus	Accumulated Deficit	Total equity
<b>Balance January 1, 2015</b>		511,944,803	274,755,015	\$496,554	\$156,226	\$17,864	\$(91,273)	\$579,371
Share based payments	14, 15	-	-	-	-	208	-	208
Income (loss) for the period		-	-	-	-	-	(86,236)	(86,236)
<b>Balance June 30, 2015</b>		511,944,803	274,755,015	496,554	156,226	18,072	(177,509)	493,343
Share based payments	14, 15	-	-	-	-	812	-	812
Income (loss) for the period		-	-	-	-	-	(149,909)	(149,909)
<b>Balance December 31, 2015</b>		511,944,803	274,755,015	496,554	156,226	18,884	(327,418)	344,246
Share based payments	14, 15	-	-	-	-	282	-	282
Income (loss) for the period		-	-	-	-	-	(6,156)	(6,156)
<b>Balance June 30, 2016</b>		511,944,803	274,755,015	\$496,554	\$156,226	\$19,166	\$(333,574)	\$338,372

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

**Condensed consolidated interim statements of cash flow**  
**(thousands of United States dollars)**  
**(Unaudited)**

	Note	Three months ended June 30,		Six months ended June 30,	
		2016	2015	2016	2015
<b>Cash flow from operating activities</b>					
Net income (loss) before taxation		\$(3,059)	\$(82,750)	\$(6,156)	\$(86,236)
Adjustments for					
Impairment of exploration and evaluation expenditures		-	77,000	-	77,000
Finance costs		-	3,442	-	6,680
Unrealized foreign exchange (gain) loss		-	1,164	-	(5,278)
Unrealized derivative liability loss (gain)		-	(4)	-	(27)
Depletion and depreciation	9	3,173	4,626	3,674	6,914
Accretion on decommissioning liabilities	12	79	56	164	106
Share based payments, options	14, 15	98	34	219	152
Deferred revenue		-	550	(46)	859
Provision for restricted share units, non-current		21	147	(54)	147
Change in non-cash operating working capital	19	174	430	1,223	(2,948)
Net cash from (used in) operating activities		486	4,695	(976)	(2,631)
<b>Cash flow from investing activities</b>					
Expenditures on exploration and evaluation activities	10	(3,612)	(11,008)	(5,127)	(26,667)
Additions to property, plant and equipment	9	(4,821)	(3,543)	(9,447)	(7,020)
Capitalized interest	9	-	(142)	-	(219)
Change in non-cash investing working capital	19	(1,404)	(2,424)	1,183	(14,415)
Net cash from (used in) investing activities		(9,837)	(17,117)	(13,391)	(48,321)
<b>Cash flow from financing activities</b>					
Interest paid, convertible notes		-	(1,603)	-	(1,603)
Net cash from (used in) financing activities		-	(1,603)	-	(1,603)
<b>Change in cash and cash equivalents</b>					
		(9,351)	(14,025)	(14,367)	(52,555)
Cash and cash equivalents, beginning of period		43,379	158,612	48,395	197,142
<b>Cash and cash equivalents, end of period</b>		<b>\$34,028</b>	<b>\$144,587</b>	<b>\$34,028</b>	<b>\$144,587</b>

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

**Notes to the condensed consolidated interim financial statements**  
**For the three and six months ended June 30, 2016**  
**(thousands of United States dollars)**  
**Unaudited**

**1. General information**

WesternZagros Resources Ltd. (the “Company” or “WesternZagros”) is headquartered in Calgary, Canada. The Company is incorporated under the laws of the Province of Alberta, Canada. The address for the Company is Suite 600, 440 – 2<sup>nd</sup> Avenue S.W., Calgary, Alberta, T2P 5E9.

WesternZagros is a publicly-traded, Calgary-based, international oil and gas company focused on acquiring properties and exploring for, developing and producing crude oil and natural gas in Iraq. WesternZagros holds two Production Sharing Contracts (“PSCs”) with the Kurdistan Regional Government (“KRG”) in the Kurdistan Region of Iraq. The Kurdamir and Garmian PSCs each govern separate contract areas. The Kurdamir contract area is operated by Talisman (Block K44) B.V., a wholly owned subsidiary of Repsol S.A. (“Repsol”) with a 40 percent working interest, WesternZagros holds a 40 percent working interest and the KRG holds a 20 percent working interest. The Company holds a 40 percent interest in the Garmian PSC, the KRG holds a 20 percent interest and the remaining 40 percent interest is held by Gazprom Neft Middle East B.V. (“Gazprom Neft”). The Garmian contract area was previously operated by WesternZagros and pursuant to the terms of the Garmian PSC, operatorship transferred from WesternZagros to Gazprom Neft on February 29, 2016. The Company has its listing on the TSX Venture Exchange under the symbol “WZR.V”.

**Authorization of financial statements**

These condensed consolidated interim financial statements for the period ended June 30, 2016 were authorized for issuance in accordance with a resolution of the Audit Committee of the Board of Directors on August 10, 2016.

**2. Basis of preparation and adoption of IFRS**

These condensed consolidated interim financial statements, including prior year comparative information, have been prepared in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, using policies consistent with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”), that are applicable to interim financial statements. These condensed consolidated interim financial statements have been prepared following the same accounting policies and method of computation as the audited annual consolidated financial statements for the year ended December 31, 2015. Certain information and disclosures normally included in the notes to the audited annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these condensed consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2015, which were prepared in accordance with IFRS as issued by the IASB. Where necessary, prior period comparative figures have been adjusted to conform to presentation changes in the current year.

### **3. Significant accounting policies**

The significant accounting policies used in the preparation of these condensed consolidated interim financial statements are consistent with the policies as described in the audited annual consolidated financial statements for the year ended December 31, 2015, other than the following:

#### **Revenue:**

Commencing in January 2016, the KRG implemented a payment mechanism for crude oil sales such that monthly payments are to be made based on the contractor's PSC entitlements and paid in the month following delivery. Based on this new payment mechanism and the consistent payments received to date, the Company has recognized revenue for the interim period ended June 30, 2016, based on volumes delivered at the point of loading directly at the production facilities since the significant risks and rewards of ownership (i.e. title) have passed to the buyers and the associated value of the revenue can be reliably measured.

### **4. Financial risk management**

The Company's financial instruments consist of cash and cash equivalents, trade and other receivables, trade and other payables and restricted share units liability. Cash and cash equivalents and trade and other receivables are classified as loans and receivables and are measured at amortized cost using the effective interest method. Trade and other payables and restricted share units liability are classified as other financial liabilities and are measured at amortized cost using the effective interest method. Due to their short-term nature, the fair value of cash and cash equivalents, trade and other receivables and trade and other payables approximate their carrying value.

The main risks that could adversely affect the Company's financial instruments are credit risk, liquidity and funding risk, and market and interest rate risk. Risk management is carried out by senior management, and is reviewed regularly by the Board of Directors. The Company's risk management program concentrates mainly on securing the necessary financial resources required to minimize the potential risk that the Company is not able to meet its ongoing obligations and commitments. The risk management policies employed by the Company are discussed below:

#### **Credit risk**

Credit risk is the risk of loss associated with the counterparty's inability to fulfill its payment obligations. The Company is currently exposed to credit risk on its cash and cash equivalents to the extent these balances are invested with various institutions. The Board of Directors of the Company has approved an Investment Policy to dictate the various types of instruments and institutions that can be invested in and monitors these against this policy on a regular basis. Currently, the Company has entered into transactions for cash equivalents with major Canadian financial institutions with investment grade credit ratings.

Under the auspices of the KRG, all sales of crude oil during the year ended December 31, 2015 were into the local Kurdistan Region domestic market and the majority of the Company's entitlements per the commercial terms of the Garmian PSC were prepaid in advance by the buyers in accordance with an interim payment mechanism established by the KRG. Consequently, there is credit risk associated with the remaining unpaid portion of the Company's entitlements per the commercial terms of the Garmian PSC.

Commencing in January 2016, the KRG implemented a payment mechanism for crude oil sales such that monthly payments are to be made based on the contractor's PSC entitlements and paid in the month following delivery. Sales price is to be based on average daily Brent, less discounts for transportation and quality adjustment. Based on this new payment mechanism and the consistent payments made to date by the KRG, the Company has recognized \$2.4 million of revenue and associated receivables for the interim period ended June 30, 2016, based on volumes delivered but not yet paid. Consequently, there is credit risk associated with any unpaid portion of the Company's entitlements per the commercial terms of the Garmian PSC and the timing of payments received for any ongoing oil sales is uncertain.

With respect to the Company's financial assets, the maximum exposure to credit risk due to default of a counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is as follows:

<b>As at</b>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Cash and cash equivalents	<b>\$34,028</b>	\$48,395
Trade and other receivables	<b>1,707</b>	6,589
<b>Total</b>	<b>\$35,735</b>	\$54,984

The Company evaluates any receivables which are greater than 90 days old for potential impairment. As at the reporting date, the Company has recorded a \$0.1 million provision for impairment of other receivables for which timing of collection is uncertain. Trade and other receivables relate mainly to the Company's portion of uncollected oil sales as at the reporting date partially offset by joint venture payables due to the operator of the Garmian Block.

#### Liquidity and funding risk

Liquidity and funding risk is the risk that the Company may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost-effective manner to meet its commitments as they become due. The Company funds its share of commitments from existing cash balances, future net proceeds from any sales of oil and gas production and if required, by accessing additional sources of funding from debt or equity markets. Significant liquidity and funding events during 2015 and during the interim period ended June 30, 2016, included the following:

- On December 22, 2015, the Company announced that an agreement had been reached with Crest Energy International LLC ("Crest") to defer the latest allowable first drawdown notice under the first tranche of the \$200 million unsecured debt facility from the original date of January 1, 2016, to May 1, 2016. This increased the flexibility of the debt facility in order to reduce commitment fees and interest costs to the Company.
- On April 27, 2016, the Company announced that an agreement had been reached with Crest to further amend the \$200 million unsecured credit facility to extend the date by which the Company must deliver to the first drawdown notice for each tranche and to reverse the ordering of the first and second tranches, summarized as follows:
  - i. Pursuant to an amending agreement entered into by the parties, the previous drawdown deadline for the second tranche of \$50 million was extended from the original date of June 1, 2016, to November 1, 2016. The maturity date of this tranche was also extended from June 1, 2018, to November 1, 2018.
  - ii. The previous drawdown deadline for the first tranche of \$150 million has been further extended from May 1, 2016, to April 1, 2017, with a corresponding extension of the maturity date from October 1, 2017, to April 1, 2019.
  - iii. All other terms of the loan agreement remain unchanged, including the condition precedent to drawdown that nothing has occurred since the closing date of the loan agreement on November 8, 2014, which could reasonably be expected to have a material adverse effect on the Company (as defined in the loan agreement).

As at the reporting date, the field development plan for the Kurdamir Block has been submitted but not yet approved by the KRG. The anticipated level of future funding required by the Company and the associated timing of such anticipated spending may be impacted upon approval of the development plan.

On May 26, 2016, the Company and its co-venturer, Gazprom Neft, received approval from the KRG for the Garmian Block field development plan. The anticipated level of future funding required by the Company and the associated timing of such anticipated spending is still dependent upon approval of future work plans and budgets and the associated level and timing of activities pursued by the Company.

At the reporting date, financial liabilities included trade and other payables and provision for restricted share units.

The Company also has certain commitments related to the Kurdamir and Garmian PSCs as well as other commitments (refer to Note 20 “Commitments and contingencies” for a further description of the Company’s commitments).

The Company will adjust its capital structure to manage its programs through the issuance of shares, the issuance of debt and adjustments to capital spending. The Company’s objectives when managing its capital structure are as follows:

- i. Ensure adequate levels of available cash and cash equivalents and short-term investments to meet the Company’s commitments under the Kurdamir and Garmian PSCs (also refer to Note 20 “Commitments and contingencies”); and
- ii. To prudently fund expenditures related to the acquisition of properties, and for exploration, appraisal and development of crude oil and natural gas properties.

In general, the Company’s ability to continue operations and appraisal and development activities is dependent upon the continued participation by the Company’s co-venturers for their respective share of costs incurred in relation to each of the PSCs, the Company’s ability to sell and receive payment for any of its oil and gas production and its ability to access additional funding over time as required, including its ability to draw on the Crest credit facility which is subject to certain conditions precedent. The Board of Directors regularly reviews the Company’s cash and cash equivalents and estimates the need and timing for additional financing. This review includes estimating the potential net proceeds to be derived from crude oil sales. With available working capital as at the reporting date, estimated revenue to be received and access to the debt facility, the Company anticipates that it is fully funded for currently planned activities over the next twelve months. However, additional funding will be required by the Company in the future. The quantum of, and timing for, such funding will be dependent upon the approved development budget for the Garmian Block and the approved development plan for the Kurdamir Block, the associated level and timing of activities pursued by the Company, the funding requirements of the Company under the relevant PSCs and the quantum and timing of proceeds received by the Company from sales of oil production. As previously announced, the Company is exploring all financing activities to allow for optimum alignment of capital availability with the development plan needs of the Company. The sources for such additional funding may include, but are not limited to, the existing Crest credit facility, the completion of an alternative debt or equity financing, or the farm down or sale of some of the assets of the Company.

#### Market and interest rate risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates and equity or commodity prices received from both the export market or from the local Kurdistan Region domestic market. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact interest earned on the Company’s cash and cash equivalents.

The Company is exposed to foreign exchange risk to the extent that the majority of costs are anticipated to be incurred in U.S. dollars while the funds it will have available may be in other currencies. The Company's Investment Policy dictates the various types of instruments and institutions that can be invested in and monitors these against this policy on a regular basis. The Board of Directors has also approved a Foreign Exchange Policy to dictate the currencies held by the Company and the instruments that can be utilized by the Company to meet its day to day requirements. This Foreign Exchange Policy requires the Company to hold the majority of its cash and cash equivalents and short term investments in U.S. dollars and sets out the type and duration of instruments that can be used to meet the Company's day to day foreign exchange requirements. The Foreign Exchange Policy does allow the Company to hold other balances, mainly Canadian dollars, to meet its funding needs for general and administrative and other spending requirements in these currencies. Neither aforementioned policy permits the Company to enter into any economic hedging as it relates to interest or foreign exchange risks. Due to the Canadian dollars held at the reporting date, had the U.S. dollar changed by one percent against the Canadian dollar as at June 30, 2016, with all other variables held constant, the Company's foreign exchange gain (loss) would have been negligible (December 31, 2015: negligible).

The Company is subject to both market conditions and commodity price fluctuations. In general, both crude oil and natural gas prices are subject to wide fluctuation. During the eighteen month period ended June 30, 2016, Brent daily spot crude prices ranged in value between \$66 and \$26 per barrel, reaching the lowest price in early 2016 and then strengthening to \$48 per barrel as at June 30, 2016.

In addition, the marketability and price for any ongoing oil sales is, and will continue to be, affected by numerous factors beyond the Company's control including the impact that the various levels of government may have on the ultimate price received for crude oil and natural gas sales. The Company's ability to market its crude oil and natural gas may depend on its ability to secure transportation. The Company may also be affected by deliverability uncertainties related to the proximity of its potential production to pipelines and processing facilities and operational problems affecting such pipelines and facilities as well as potential government regulation relating to price, the export of crude oil and natural gas and other aspects of the crude oil and natural gas business.

## **5. Critical accounting judgements, estimates and assumptions**

The preparation of these condensed consolidated interim financial statements in conformity with IFRS requires the use of critical accounting estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as at the reporting date, as well as the reported amounts of revenues and expenses during the interim reporting period. Such estimates relate to unsettled transactions and events as at the reporting date. Accordingly, actual results may ultimately differ from the estimated amounts as future confirming events occur. Areas that involve a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the condensed consolidated interim financial statements are consistent with those as described in the audited annual consolidated financial statements for the year ended December 31, 2015.

## **6. Segment reporting**

For the purposes of segment reporting, the Company has one significant asset related to its interest in the PSCs with the KRG in respect of its project in the Kurdistan Region of Iraq. Accordingly, the Company has identified one segment for operational activities carried out in the country of Iraq. Refer to Note 20 "Commitments and contingencies" for a description of the PSCs.

## 7. Cash and cash equivalents

<u>As at</u>	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Bank balances	\$2,099	\$7,448
Term deposits	31,929	40,947
<b>Total cash and cash equivalents</b>	<b>\$34,028</b>	<b>\$48,395</b>

## 8. Trade and other receivables

<u>As at</u>	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Joint venture receivables	\$1,361	\$4,685
Other receivables, net of impairment	346	1,904
<b>Total trade and other receivables</b>	<b>\$1,707</b>	<b>\$6,589</b>

As at December 31, 2015, joint venture receivables were made up entirely of amounts owing from Gazprom Neft, the Company's co-venturer. On February 29, 2016, operatorship of the Garmian contract area transferred from WesternZagros to Gazprom Neft pursuant to the terms of the Garmian PSC. As at the reporting date, joint venture receivables include the Company's portion of uncollected oil sales which has been recognized as revenue in excess of joint venture expenditures outstanding on the Garmian Block since the Company's share of oil sales are paid to Gazprom Neft as operator of the Garmian Block. For the quarter, the Company's share of oil revenues was \$4.3 million, of which \$1.9 million has been collected and \$2.4 million has been recorded in accounts receivables. Net of payables owed to Gazprom Neft for costs incurred in respect of ongoing Garmian Block operations, the net receivable related to Garmian Block activities is \$1.4 million as at the reporting date.

## 9. Property, plant and equipment

As at the reporting date, property, plant and equipment comprised of oil and gas assets and other assets. Other assets include leasehold improvements, furniture and fixtures as well as office and computer equipment.

<u>Costs</u>	<u>Oil and gas assets</u>	<u>Other assets</u>	<u>Total</u>
January 1, 2015	\$41,858	\$3,044	\$44,902
Additions	14,557	29	14,586
Capitalized interest	435	-	435
<b>December 31, 2015</b>	<b>56,850</b>	<b>3,073</b>	<b>59,923</b>
Additions	<b>9,811</b>	-	<b>9,811</b>
<b>June 30, 2016</b>	<b>\$66,661</b>	<b>\$3,073</b>	<b>\$69,734</b>

<b>Depreciation and depletion</b>	<b>Oil and gas assets</b>	<b>Other assets</b>	<b>Total</b>
January 1, 2015	\$(11,650)	\$(2,282)	\$(13,932)
Depreciation and depletion	(13,747)	(296)	(14,043)
Impairment	(11,680)	-	(11,680)
December 31, 2015	<b>(37,077)</b>	(2,578)	(39,655)
Depreciation and depletion	<b>\$(3,525)</b>	<b>(149)</b>	<b>(3,674)</b>
June 30, 2016	<b>\$(40,602)</b>	<b>\$(2,727)</b>	<b>\$(43,329)</b>
Net book value December 31, 2015	\$19,773	\$495	\$20,268
<b>Net book value June 30, 2016</b>	<b>\$26,059</b>	<b>\$346</b>	<b>\$26,405</b>

For the interim period ended June 30, 2016, future development costs for proved and probable reserves of \$63.5 million (December 31, 2015: \$63.5 million) were included within the depletion calculation, while costs incurred in association with future facilities expansion of \$5.2 million (December 31, 2015: \$3.3 million) were excluded from the depletion calculation until such time that the assets are ready for their intended use.

Included in oil and gas assets as at June 30, 2016, was \$3.9 million (December 31, 2015: \$3.6 million) related to provisions for decommissioning liabilities. During the first six months of 2016, the Company recognized \$Nil capitalized interest (year ended December 31, 2015: \$0.4 million) for qualifying assets related to future facilities and development costs. For the six months ended June 30, 2016, the Company capitalized \$0.8 million of general and administrative costs, including a negligible amount of share-based compensation costs (June 30, 2015: \$Nil) directly related to development activities.

#### 10. **Exploration and evaluation expenditures**

<b>As at</b>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Costs	<b>\$308,086</b>	\$299,602
Net book value	<b>\$308,086</b>	\$299,602
	<b>Six months ended</b>	<b>Twelve months ended</b>
<b>Period ended</b>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Opening net book value	<b>\$299,602</b>	\$466,994
Additions	<b>8,484</b>	42,188
Impairment of E&E expenditures	-	(209,580)
Closing net book value	<b>\$308,086</b>	\$299,602

The Company and its co-venturer and operator, Repsol, submitted a Declaration of Commerciality (“DoC”) to the KRG on August 19, 2014 for the oil and gas discovery on the Kurdamir Block. The Company and its co-venturers also submitted an initial development plan on August 31, 2014, for KRG approval. The KRG subsequently requested changes to the development plan for which a revised plan was submitted on May 27, 2016. The Company does not yet believe that it has demonstrated the commercial viability and technical feasibility of its properties in relation to the Kurdamir Block as at the reporting date, since the KRG has not yet approved the development plan, a gas sales agreement remains in negotiation and reserves have not yet been recognized by a qualified independent reserves evaluator as at the reporting date. Accordingly, all E&E expenditures pertaining to the Kurdamir Block continue to be capitalized in accordance with the Company’s exploration and evaluation accounting policy.

The KRG approved the Garmian Block field development plan on May 26, 2016 as submitted by the Company and its co-venturer and operator, Gazprom Neft, outlining how the Sarqala discovery will be developed. Any ongoing E&E expenditures pertaining to the exploration prospects on the Garmian Block within the development area, but without assigned reserves, continue to be capitalized in accordance with the Company's exploration and evaluation expenditures accounting policy.

Included in E&E expenditures as at June 30, 2016 is \$15.6 million related to provisions for decommissioning obligations (December 31, 2015: \$12.3 million). For the six months ended June 30, 2016, the Company capitalized \$0.3 million of general and administrative costs (six months ended June 30, 2015: \$2.0 million) directly related to exploration activities. All E&E expenditures are excluded from depreciation.

## 11. Trade and other payables

<u>As at</u>	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Trade, joint venture and other payables	<b>\$1,574</b>	\$1,690
Accruals	<b>10,612</b>	13,018
<b>Total trade and other payables</b>	<b>\$12,186</b>	\$14,708

As at February 29, 2016, operatorship of the Garmian contract area transferred from WesternZagros to Gazprom Neft pursuant to the terms of the Garmian PSC. Accordingly, Gazprom Neft now bears costs directly and invoices WesternZagros for its share of costs, which are normally included in joint venture payables at the reporting date. As at the reporting date however, the Company was in a net receivable position for Garmian joint venture activities due mainly to the Company's portion of uncollected oil sales. Also refer to Note 8 "Trade and other receivables" for further description.

Trade and other payables are non-interest bearing and are normally settled on 30 to 60 day terms. Accruals relate to E&E expenditures, oil and gas assets expenditures, and corporate expenditures as at the reporting date.

## 12. Provision for decommissioning obligations

As at June 30, 2016, the estimated costs associated with the Kurdamir Block acreage are assumed to be incurred in 2041, dependent upon the timing of KRG final approval of the development plan. The estimated costs associated with the relinquished Garmian Block acreage are assumed to be incurred beyond the next 12 months; and the remaining costs are assumed to be incurred in 2040 in respect of all other well locations and related production facilities. The Company's share of the total undiscounted amount of estimated cash flow required to settle the obligation is \$29.9 million (December 31, 2015: \$26.5 million). As at the reporting date, the Company used a discount rate of 1.72 percent (December 31, 2015: 2.15 percent) and an inflation rate of 2.41 percent (December 31, 2015: 2.41 percent) to calculate the net present value of the future obligations.

The following table presents the reconciliation of the Company's provision for decommissioning liabilities:

	<b>Six months ended June 30, 2016</b>	<b>Twelve months ended December 31, 2015</b>
Balance, beginning of period	<b>\$16,751</b>	\$12,024
Increases in obligations	-	406
Changes in estimates - future costs	<b>2,124</b>	4,699
Changes in estimates - discount rate	<b>1,766</b>	605
Changes in estimates - inflation and estimated timing	<b>(232)</b>	(1,221)
Accretion	<b>164</b>	238
<b>Balance, end of period</b>	<b>\$20,573</b>	\$16,751

### **13. Share capital**

#### **Common shares:**

As at June 30, 2016, the Company is authorized to issue an unlimited number of common shares. The common shares are without nominal or par value.

The common shares issued and outstanding were as follows:

	<b>Number of shares</b>	<b>Amount</b>
Balance as at January 1, 2015	511,944,803	\$496,554
Issuance of common shares, net of costs	-	-
Options exercised for common shares	-	-
Balance December 31, 2015 and June 30, 2016	511,944,803	\$496,554

#### **Preferred shares:**

As at June 30, 2016, the Company is authorized to issue an unlimited number of Class A preferred shares which are issuable in series and an unlimited amount of Class B preferred shares. The preferred shares are without nominal or par value. The only preferred shares which were issued and outstanding as at the reporting date were the Class A Preferred Shares, Series 1.

The preferred shares issued and outstanding were as follows:

	<b>Number of shares</b>	<b>Amount</b>
Balance as at January 1, 2015	274,755,015	\$156,226
Issuance of preferred shares, net of costs	-	-
Balance December 31, 2015 and June 30, 2016	274,755,015	\$156,226

The preferred shares issued to Crest during 2014 are: non-voting; non-interest bearing; entitled to receive dividends in parity with common shares (currently \$Nil dividend); and are convertible into common shares on a one to one basis upon certain conditions being met, with the conversion ratio subject to adjustments in certain circumstances.

## 14. Share based payments

### Options:

Pursuant to the stock option plan, the Board of Directors may grant options to directors, officers, employees and other service providers. The aggregate number of shares that may be reserved for issuance pursuant to stock options may not exceed 10 percent of the issued and outstanding common shares of the Company on a non-diluted basis as at the time of granting. Stock options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and the option vesting period is determined at the discretion of the Board of Directors when granted. These options are equity settled share based payment transactions.

The following tables present the reconciliation of stock options granted:

<b>For the six months ended June 30, 2016</b>	<b>Number of options</b>	<b>Weighted average exercise price (\$Cdn)</b>
Outstanding, beginning of period	32,084,451	\$0.50
Granted	22,925,000	0.07
Forfeited	(7,151,917)	0.44
Expired	(3,938,700)	0.49
Outstanding , end of period	43,918,834	\$0.29
Exercisable at June 30, 2016	12,658,001	\$0.68

<b>For the year ended December 31, 2015</b>	<b>Number of options</b>	<b>Weighted average exercise price (\$Cdn)</b>
Outstanding, beginning of year	20,903,551	\$0.74
Granted	18,033,000	0.28
Forfeited	(4,119,200)	0.72
Expired	(2,732,900)	0.51
Outstanding , end of year	32,084,451	\$0.50
Exercisable at December 31, 2015	12,576,618	\$0.74

The fair value of all options granted have been estimated at the grant date using the Black-Scholes option pricing model and are summarized in the following table:

	<b>Six months ended June 30, 2016</b>	<b>Twelve months ended December 31, 2015</b>
Weighted average fair value of stock options granted	<b>\$0.03</b>	\$0.09
Average Risk Free Interest Rate	<b>0.58%</b>	0.65%
Expected Life	<b>3 years</b>	3 years
Average Expected Volatility	<b>84%</b>	59%
Dividend Per Share	<b>Nil</b>	Nil

The average expected volatility used to estimate the fair value of options granted was based on the Company's actual three-year historical share volatility (WZR.V). In addition, the estimated forfeiture rate used in the calculation of share-based payment expense was based on the actual three-year historical forfeiture rate for unvested options, which was 10 percent for the six months ended June 30, 2016 (six percent for the year ended December 31, 2015).

**Restricted share units:**

Pursuant to the restricted share unit plan, unless otherwise determined by the Board of Directors, one-third of the total RSUs granted shall vest each year on the first, second and third anniversaries of the grant date. Upon vesting, the RSUs are settled via cash payment with the amount based on the weighted-average trading price of Common Shares for the twenty day period immediately preceding the applicable vesting date. The RSU activity is summarized as follows:

<b>For the six months ended June 30, 2016</b>	Number of RSU's	Fair value per RSU (Cdn\$)	Fair value per RSU (\$USD thousands)
Balance, beginning of period	7,399,849	0.10	\$518
Granted	130,000	0.10	\$10
Vested and paid	(2,367,667)	0.09	(160)
Forfeited	(1,661,243)	0.10	(123)
Change in value	-	-	70
<b>Balance, end of period</b>	<b>3,500,939</b>	<b>0.12</b>	<b>\$315</b>

<b>For the year ended December 31, 2015</b>	Number of RSU's	Fair value per RSU (Cdn\$)	Fair value per RSU (\$USD thousands)
Balance, beginning of year	266,898	0.44	\$101
Granted	7,308,200	0.31	1,813
Vested and paid	(63,324)	0.12	(6)
Forfeited	(111,925)	0.40	(35)
Change in value	-	-	(1,355)
<b>Balance, end of year</b>	<b>7,399,849</b>	<b>0.10</b>	<b>\$518</b>

During the six months ended June 30, 2016, the Company recognized a negligible amount of share-based compensation costs relating to RSUs (six months ended June 30, 2015: \$0.3 million). Note that the portion of the provision for restricted share units related to tranches that vest more than 12 months after the reporting date have been classified as a non-current liability.

## **15. General and administrative expenses, by nature**

<b>For the six months ended June 30</b>	<b>2016</b>	<b>2015</b>
Staff expenses	<b>\$3,070</b>	\$4,750
Share-based payments - options	<b>219</b>	152
Share-based payments - RSU's	<b>39</b>	296
Travel expenses	<b>383</b>	258
Professional fees	<b>2,102</b>	1,529
Office costs	<b>746</b>	1,016
Regulatory and corporate project costs	<b>65</b>	175
Impairment of receivables	<b>140</b>	-
Other administrative expenses	<b>361</b>	244
Less general and administrative costs recovered	<b>(1,292)</b>	(1,775)
Less capitalized general and administrative costs	<b>(1,106)</b>	(2,041)
<b>Total administrative expenses</b>	<b>\$4,727</b>	\$4,604

Key management personnel have been identified as the Board of Directors and the Executive Management Team. Details of key management remuneration are shown in Note 16 "Related party transactions and balances".

## **16. Related party transactions and balances**

The key management personnel of the Company includes the Directors, Chief Executive Officer, Senior Vice President Finance and the Vice President Operations and Engineering. During the six months ended June 30, 2016, the number of key management personnel has been reduced from twelve people to eight people as part of the overall reduction in staffing carried out during the year. The remuneration of the key management personnel (June 30, 2015: thirteen key management personnel), is set out below in aggregate:

<b>For the six months ended June 30</b>	<b>2016</b>	<b>2015</b>
Salaries and wages	<b>\$790</b>	\$1,794
Severance	<b>855</b>	-
Short-term benefits	<b>19</b>	33
Share-based compensation (expensed portion)	<b>200</b>	188
Share-based compensation (capitalized portion)	<b>14</b>	55
<b>Total</b>	<b>\$1,878</b>	\$2,070

As at the reporting date, the Company had an aggregate total of \$1.9 million (December 31, 2015: \$2.3 million) in contractual commitments with key management personnel relating to terminations of employment without just cause. In the case of a change of control of the Company as at the reporting date, the contractual commitment then increases to an aggregate total of \$2.3 million (December 31, 2015: \$2.8 million).

## **17. Loss per share, basic and diluted**

The basic (income) loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of common and preferred shares issued during the period. In computing the diluted per share amounts for the three and six month periods ended June 30, 2016, all of the Company's options, which totaled 43,918,834 (June 30, 2015: 36,380,618) were excluded as anti-dilutive. Accordingly no additional common shares were added to the basic weighted average shares outstanding to account for dilution.

The basic and diluted loss per share, based on the combined total of common and preferred shares, was calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Loss for the period	\$3,059	\$82,750	\$6,156	\$86,236
Weighted-average shares (000's) - basic	786,700	786,700	786,700	786,700
Weighted-average shares (000's) - diluted	786,700	786,700	786,700	786,700
Loss per share - basic and diluted	\$0.01	\$0.11	\$0.01	\$0.11

## 18. Shareholder rights plan

On October 18, 2007, the Company adopted a shareholder rights plan (the "Plan") which was reconfirmed in 2010 and extended by amendment on June 6, 2013 and June 8, 2016. Under the Plan, one right has been issued in respect of each currently issued common share and one right will be issued with each additional common share which is issued. The rights remain attached to the common shares and are not exercisable or separable unless one or more of certain specified events occur. If a person or group acting in concert acquires 20 percent or more of the common shares of the Company, the rights will entitle the holders thereof (other than the acquiring person or group) to purchase common shares at a substantial discount from the then market price. The rights are not triggered by a "Permitted Bid" as defined in the Plan. The Plan will remain in effect until termination of the annual meeting of shareholders in 2019, unless extended by resolution of the shareholders at such meeting.

## 19. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
<b>Related to operating activities</b>				
Trade and other receivables	\$251	\$(190)	\$1,837	\$(206)
Prepaid expenses	(30)	(3)	91	(908)
Trade and other payables	(47)	623	(705)	(1,834)
	\$174	\$430	\$1,223	\$(2,948)
<b>Related to investing activities</b>				
Trade and other receivables	\$(1,350)	\$(411)	\$3,045	\$(2,886)
Prepaid expenses	-	220	-	288
Trade and other payables	(54)	(2,233)	(1,862)	(11,817)
	\$(1,404)	\$(2,424)	\$1,183	\$(14,415)

## 20. Commitments and contingencies

### A. PSC commitments

WesternZagros holds two PSCs with the KRG in the Kurdistan Region of Iraq. The Kurdamir and Garmian PSCs each govern a separate contract area. The Kurdamir contract area is operated by Repsol with a 40 percent working interest, WesternZagros holds a 40 percent working interest and the KRG holds a 20 percent working interest. The Company holds a 40 percent interest in the Garmian PSC, the KRG holds a 20 percent interest and the remaining 40 percent working interest is held by Gazprom Neft. The Garmian contract was operated by WesternZagros as at December 31, 2015, however as at February 29, 2016, operatorship of the Garmian contract area was transferred to Gazprom Neft pursuant to the terms of the Garmian PSC.

The contracting party to the Kurdamir and Garmian PSCs is WesternZagros Limited, a wholly-owned subsidiary of the Company. In accordance with the terms of the PSCs, there are certain restrictions, mainly related to obtaining the KRG's prior consent on the ability of the wholly-owned subsidiary to sell, transfer,

assign or otherwise dispose of all or part of the rights, obligations and interests under each of the PSCs, or where there is a change in control for the wholly-owned subsidiary itself.

The Company concluded the second exploration sub-period of the Kurdamir PSC with the DoC filed on August 19, 2014. Following submission of the DoC, the Company and its co-venturer submitted a development plan on August 31, 2014 for which the KRG had a 60 day period, on a best efforts basis, to approve the plan. The KRG subsequently requested changes to the Kurdamir development plan, which was then submitted on May 27, 2016. Until the KRG approves the Kurdamir development plan, the terms of the PSC allow for an extension of the development period based on the number of days required to approve the plan beyond the aforementioned 60 days. The Company has committed to expenditures of approximately \$2 million, under an approved joint venture budget to meet its 60 percent funding requirement mainly related to ongoing development planning.

The Garmian field development plan was approved by the KRG on May 26, 2016. The expiration of the initial 20 year production period, pursuant to the terms of the PSC is October 1, 2035. The Company has committed to expenditures of approximately \$12 million, under an approved joint venture budget, to meet its 50 percent funding requirement for ongoing development activities.

In accordance with the terms of the PSCs, the Company has certain annual payment commitments. During the respective development periods, the Company's portion of these annual PSC payments is \$1.1 million.

## **B. Other commitments**

The following table summarizes other contractual obligations at June 30, 2016 (U.S. \$000's):

	<b>For the Years Ending December 31,</b>					
	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020+</b>	<b>Total</b>
Office and other	\$505	\$1,142	-	-	-	\$1,647
	\$505	\$1,142	-	-	-	\$1,647

## **C. Contingencies**

### **i. Litigation**

From time to time, the Company may become involved in legal or administrative proceedings in the normal conduct of business.

### **ii. Regulatory and other**

Oil and gas operations are subject to extensive controls and regulations imposed by various levels of government that may be amended from time to time. The Company's operations may require licenses and permits from various governmental authorities in the countries in which it operates. Under the Kurdamir and Garmian PSCs, the KRG is obligated to assist in obtaining all permits and licenses from any government agencies in the Kurdistan Region and from any other government administration in Iraq. There can be no assurance that the Company or its co-venturers will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development of its projects.

The political and security situation in Iraq is unsettled and volatile. The Kurdistan Region is the only "Region" of Iraq that is constitutionally established pursuant to the Iraq Constitution, which expressly recognizes the Kurdistan Region. The political issues of federalism and the autonomy of the Regions of Iraq are matters about which there are major differences between the various political factions in Iraq. These differences could adversely impact the Company's interest in the Kurdistan Region including the ability to export any hydrocarbons as a result of the Company's activities.

In addition, the Islamic State of Iraq and al-Sham (“ISIS”) attacked Central and Northern Iraq during 2014. To date, the Company’s assets within the Kurdistan Region are safe and secure. However, the Company’s interest in the Kurdistan Region could be adversely impacted if hostilities were to expand in the future, which may then create a material uncertainty about the continuation of the Company’s operations.

## **21. Substantial investor and debt provider**

Although Crest does not control the Company, Crest’s relationship with the Company is significant as a debt provider and shareholder.

During 2014, Crest funded an aggregate of Cdn\$183.7 million of the proceeds from a rights offering and related equity backstop agreement and holds 101,867,066 million (19.9 percent) of the outstanding common shares and 100 percent of the non-voting preferred shares which are convertible into common shares on a one to one basis upon certain terms and conditions, including a restriction on any conversion which would cause Crest’s holdings of common shares to exceed 19.9 percent. In addition, Crest agreed to provide debt financing to the Company of up to \$200 million, available to be drawn in two separate tranches subject to certain conditions precedent: \$150 million beginning October 2015 and a further \$50 million beginning in June 2016.

On April 27, 2016, the Company announced that an agreement had been reached with Crest to further amend the \$200 million unsecured credit facility to extend the date by which the Company must deliver to Crest the first drawdown notice for each tranche and to reverse the ordering of the first and second tranches. Pursuant to an amending agreement entered into by the parties, the previous drawdown deadline for the second tranche of \$50 million was extended from the original date of June 1, 2016, to November 1, 2016. The maturity date for this tranche was also extended from June 1, 2018 to November 1, 2018. The previous drawdown deadline for the first tranche of \$150 million has been extended from May 1, 2016, to April 1, 2017, with a corresponding extension of the maturity date from October 1, 2017, to April 1, 2019. All other terms of the loan agreement between the parties dated August 14, 2014, and as amended on December 21, 2015, remain unchanged, including the condition precedent to drawdown that nothing has occurred since the closing date of the loan agreement on November 18, 2014, which could reasonably be expected to have a material adverse effect on the company (as defined in the loan agreement). The Company has not yet drawn any amounts under this debt facility.

The WesternZagros Board of Directors is currently comprised of five non-executive directors and one executive director, none of which have been nominated on behalf of Crest. Crest currently maintains the right to nominate two directors to the Board of Directors of WesternZagros. Once WesternZagros draws any portion of the debt facilities provided by Crest in the future, Crest would then have the right to nominate a third director to the Board of Directors of WesternZagros. The Company’s articles permit it to have a maximum of ten directors.

The Company believes that Crest is not in a position of control over WesternZagros due to the percentage of common shares currently held, the non-voting nature of the preferred shares, the limitations which exist on the conversion of preferred shares into common shares and the limited number of directors which Crest may nominate in comparison to the maximum number of directors which the Company may have.

## Officers

**M. Simon Hatfield**  
Chief Executive Officer

**Tony Kraljic**  
Senior Vice President Finance

**Lianne Tysowski**  
Corporate Secretary

## Directors

**David Boone**  
Chairman  
WesternZagros Resources Ltd.  
Calgary, Alberta

**Fred Dymont**  
Independent Businessman  
Calgary, Alberta

**John Frangos**  
Independent Businessman  
Calgary, Alberta

**M. Simon Hatfield**  
Chief Executive Officer  
WesternZagros Resources Ltd.  
Calgary, Alberta

**James Houck**  
Independent Businessman  
Calgary, Alberta

**Randall Oliphant**  
Executive Chairman and Director  
New Gold Inc.  
Toronto, Ontario

**William Wallace**  
Independent Businessman  
Glenwood Springs, Colorado

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## Auditors

PricewaterhouseCoopers LLP  
Calgary, Alberta

## Resource Evaluators

Sroule International Limited  
Calgary, Alberta

## Legal Counsel

Torys LLP  
Calgary, Alberta

Norton Rose Canada LLP  
Calgary, Alberta

King & Spalding LLP  
Houston, Texas

## Transfer Agent And Registrar

Computershare Trust Company of Canada  
Calgary, Alberta

## Stock Exchange Listing

TSX Venture Exchange  
Common Shares: WZR