

**Iona Energy Inc.**  
**Management's Discussion and Analysis**

**FINANCIAL & OPERATING HIGHLIGHTS**

*(in United States dollars (tabular amounts in thousands) except as otherwise noted)*

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	Change	2014	2013	Change
<b>Financial</b>						
Crude oil and natural gas revenues	\$ 27,100	\$ 11,843	129%	\$ 62,748	\$ 13,701	358%
Cost of sales	(11,103)	(5,610)	98%	(17,611)	(6,406)	175%
Depletion, Depreciation & Amortization	(16,670)	(4,451)	275%	(35,598)	(5,417)	557%
Gross Profit	(673)	1,782	(85%)	9,539	1,878	408%
Gross Profit before DD&A	15,997	6,233	157%	45,137	7,295	519%
Income (loss) Before Tax	(24,065)	9,415	(353%)	(23,348)	(12,748)	83%
Income (loss) After Tax	(28,027)	9,117	(69%)	(28,365)	(2,828)	903%
Per share – basic (\$)	(0.08)	0.02		(0.08)	(0.01)	
Per share – diluted (\$)	(0.08)	0.02		(0.08)	(0.01)	
Funds Flow <sup>(1)(2)</sup>	3,345	3,911	(14%)	30,433	2,160	1,309%
Per share – basic (\$)	0.01	0.01		0.08	0.01	
Per share – diluted (\$)	0.01	0.01		0.08	0.01	
Adjusted EBITDA <sup>(1)(2)</sup>	9,647	3,001	228%	36,790	6,282	209%
Per share – basic (\$)	0.03	0.01		0.10	0.02	
Per share – diluted (\$)	0.03	0.01		0.10	0.02	
			<b>June 30,</b>			<b>December 31,</b>
			<b>2014</b>			<b>2013</b>
Cash and cash equivalents		\$	32,819		\$	19,808
Restricted cash			82,387			85,114
Working capital surplus <sup>(1)</sup>			88,847			79,075
Secured bonds			264,868		\$	262,450
Common shares, end of period			366,831			366,831
Fully diluted, end of period <sup>(1)</sup>			366,831			369,225
Weighted average common shares - basic			366,831			360,849
Weighted average common shares - fully diluted			366,831			363,078
			<b>Three months ended</b>			<b>Six months ended</b>
			<b>June 30,</b>			<b>June 30,</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Operational</b>						
Crude oil and natural gas production (boepd) <sup>(3)</sup>						
Crude oil	2,284	1,179	94%	2,876	1,179	144%
Natural gas	475	655	(27%)	556	487	14%
Total	2,759	1,834	50%	3,432	1,666	106%
Realized sales prices						
Crude oil (\$/boe)	109.10	102.00	7%	108.42	102.00	6%
Natural gas (\$/mmcf)	7.77	10.00	(22%)	8.78	10.00	(12%)
Average (\$/boe)	101.20	86.99	16%	99.33	89.72	11%
Operating costs <sup>(1)</sup> (\$/boe)	38.69	40.07	(3%)	27.39	38.02	(28%)
Netback <sup>(1)</sup> (\$/boe) <sup>(4)</sup>	62.51	46.92	33%	71.94	51.70	39%

(1) Non-GAAP measure – see “non-IFRS Measures” section within MD&A.

(2) See reconciliation on page 5 & 6.

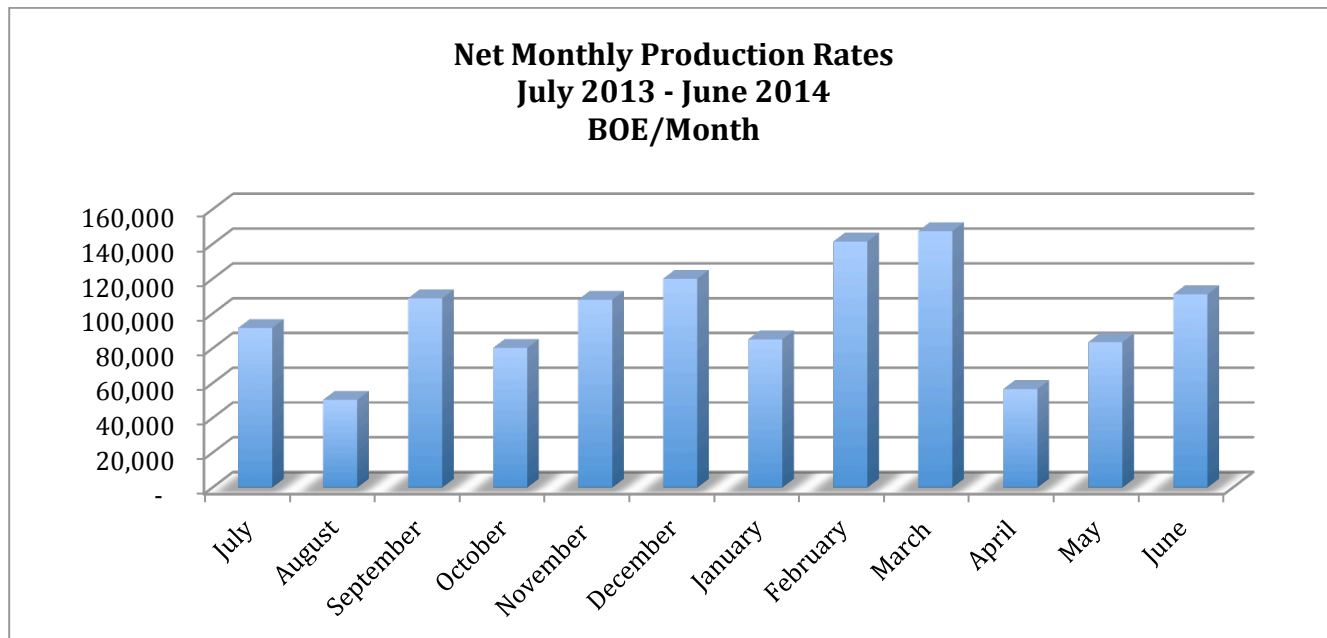
(3) Based on 17.55% economic interest of volumes from Huntington.

(4) 23% reduction in Q2 three month ended June 30, 2014 netback compared to Q1 three month netback mainly relates to 34% decrease in production.

## KEY PROJECT UPDATES

### Huntington (17.55% Economic Interest)

- Iona's Q2 2014 average production at Huntington decreased 34% over Q1 2014, from 3,896 boepd to 2,563 boepd, resulting from unplanned shutdowns of the Voyager FPSO and within the Central Area Transmission System ("CATS").



- Average production at Huntington increased 147% for the six month period ended June 30, 2014 to 3,204 boepd compared to average production during the same period in 2013 of 1,197 boepd (adjusted for production commencing on April 12, 2013).
- From April 12 to April 24, 2014, Huntington production was suspended as the Voyager FPSO underwent repairs to its inert gas system, work that was completed ahead of schedule, and production resumed on April 25, 2014. On April 26, 2014, the Huntington partnership was notified of an unplanned shutdown of the Central Area Transmission System's ("CATS") riser platform, shutting in multiple fields that export across the system. Huntington resumed production on May 11, 2014 and the field has been producing largely uninterrupted for the remainder of quarter at below peak rates.
- As of June 29, 2014, Huntington had offloaded 29 cargoes and produced 7.8 million barrels of oil equivalent with Iona's net share of production being above 1.3 million barrels of oil equivalent. Across Q2, Brent pricing remained strong averaging \$109.67/bbl while UK gas prices softened to \$7.59/mcf.
- After some remedial work on the Voyager FPSO in early July, Huntington resumed full production on July 8, 2014 with relatively stable albeit restricted production due to CATS. As per instructions from the CATS operator Huntington production was shut in on July 31, 2014. Planned maintenance was completed at Huntington during the shut in with production resuming on August 26, 2014. During the shut in significant scale deposits were removed from the first stage separator and the inlet pipework which should enable production to resume to maximum production, under the current CATS restriction, of approximately 25,000 boepd.
- The Huntington partnership has commenced its final engineering phase ("Concept Definition") of the Maxwell development with the operator of the Voyager FPSO. Iona supports the drilling of Maxwell in 2015.

### Trent & Tyne (20% Working Interest, increasing to 100% working interest upon closing of SPA)

- During the quarter the Company, through its wholly owned UK subsidiary, Iona UK Developments Co Limited, entered into a Sale and Purchase Agreement ("SPA") with Perenco UK Limited ("Perenco"), to purchase Perenco's remaining 80% working interest, rights, and obligations in the Trent & Tyne fields (including the Trent East Discovery

Area). This acquisition will constitute a business combination. The acquisition is expected to close, upon satisfaction of certain conditions as set out in the SPA, including financing and Department of Energy & Climate Change (“DECC”) approval.

- Across the quarter, production at Trent & Tyne continued to be severely reduced resulting from planned and unplanned maintenance outages at the fields and at the Bacton terminal, in addition to continued intermittent well performance. The net average daily production rate from Trent & Tyne to Iona during the three and six months ended June 30, 2014 was 1.2 MMcf/d and 1.4 MMcf/d compared to 3.9 MMcf/d and 2.9 MMcf/d average during the three and six months ended June 30, 2013. Stable production resumed near the end of July 2014 with the fields averaging 14 MMcf/d gross 100% interest, 2.3 MMcf/d net 20% interest, of which the 100% interest relates to the working interest Iona intends to hold upon the completion of the acquisition of the further 80% interest.
- On June 9th, the Company announced that it had signed a Transition Services Agreement with Wood Group PSN Ltd. (“Wood Group”) and Senergy Wells Ltd. (“Senergy”) in support of its acquisition of the remaining working interest in Trent & Tyne from Perenco. The agreements cover work required receive consent from the DECC” for the transfer of operatorship, assignment of the interests, and other regulatory approvals to enable Iona to operate the two fields and the associated EAGLES pipelines which transport production to the Bacton terminal. The transition plan also includes working with the current operator to identify and implement well work to increase production from existing well stock and to mature opportunities drilling fresh gas accumulations. Transfer of operatorship to Iona is expected to take place upon closing.

#### **Orlando (75% Working Interest)**

- During the quarter, Iona’s Orlando Development project team, in coordination with the Company’s contracted project manager ADIL, continued to implement the project activities for the subsea tie back to the Ninian Central platform.
- Iona continues to be in discussion with the Operator of the Ninian Central Platform and DECC regarding specific timing of infrastructure access which drives the exact timing of first oil delivery.

#### **Ronan & Oran (100% Working Interest)**

- The Company completed key reservoir, seismic, and development studies that defined the contingent resource potential of 1C 47MMbbls, 2C 61MMbbls and 3C 84MMbbls for the two oil discoveries referred to as Ronan & Oran. A further 22 MMBoe potential, prospective resource has been identified to lie to the north west in an area of limited seismic coverage. An appraisal well is planned in 2015 to further evaluate the reservoir (including a flow test) with the intention of converting some of the currently defined contingent resources to reserves, and to enable a Field Development Plan to be submitted. Please refer to “Notes Regarding Oil and Gas Disclosure” for further information.

#### **CORPORATE HIGHLIGHTS**

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- The Company, through its wholly owned UK subsidiary, Iona UK Developments Co Limited, entered into a Sale and Purchase Agreement (“SPA”) with Perenco UK Limited (“Perenco”), to purchase Perenco’s remaining 80% working interest, rights, and obligations in the Trent & Tyne fields (including the Trent East Discovery Area). Upon satisfaction of certain conditions as set out in the SPA, the Company shall pay to Perenco, a further sum of \$18,000,000, as adjusted pursuant to any adjustments as per the SPA and assume all decommissioning liabilities in relation to Licenses being purchased. Payment shall be made no later than six (6) calendar months after the date of the SPA or on such later date as agreed in writing.
- On May 6, 2014 the bondholders of Iona’s September 2013 bond issuance voted in favour of amending the bond agreement to include restricted cash within the definition of cash and cash equivalents. The amendment is applied retroactively from the date of issue so that the amendment applies to the covenant calculation as at March 31, 2014 and December 31, 2013.
- The Company realized revenue for the three and six months ended June 30, 2014 of \$27.1 and \$62.7 million and received netbacks of \$62.51/boe and \$71.94/boe respectively. Netbacks in Q2 were impacted by decreased production due to CATS restrictions at Huntington as the majority of operating costs remained fixed.
- The Company has tax pools of approximately \$331 million and does not expect to pay UK taxes until 2017 or later.

- The Company's current production is not subject to any crown or third party royalties on any revenues, now or in the foreseeable future.

## OUTLOOK

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During August 2014, two significant efforts were finalized which the Company's management believe will increase future cash flow and profitability.

Foremost, the first stage separator of Huntington's Voyageur FPSO, which across the second quarter had restricted production at the field due to scale build-up, has been entered and cleaned out. This remedial work took place during the August shutdown at the Central Area Transmission System ("CATS"), under which Huntington's production was curtailed, and the field is now expected to resume to maximum production rates, under the current CATS restriction, of approximately 25,000 boepd.

Secondly, the Company retired the remaining 3,658,051 calls (effective April 2014 through March 2018) sold to Britannic Trading Limited ("BTL") in February of 2013. The Company will settle this transaction through two equal payments of \$13,250,000, paid on August 18, 2014 and February 10, 2015. Simultaneously, the company entered into a Zero Cost Producer Collar with BTL, whereby Iona UK purchased 458,352 puts (effective August 2014 through July 2015) at a strike price of \$90.00 per barrel, and sold to BTL 1,650,000 calls (effective October 2018 through March 2020) at a strike price of \$90.00 per barrel. This trade allows Iona to partake in today's strong Brent pricing while providing downside protection across the coming year, in addition to decreasing its financial exposure to the previous structure while development continues at Trent & Tyne, Orlando, and Kells. The Company will settle this transaction using currently escrowed and interest-bearing funds that were otherwise restricted under its Bond Agreement.

## MANAGEMENT DISCUSSION AND ANALYSIS

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### Change in presentation currency

This Management discussion and Analysis is presented in United States dollars ("US dollars"). In 2013, the Company changed its presentation currency from the Canadian dollars ("CAD") to the US dollar. The change in presentation currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the oil and gas industry. In making this change to the US dollar presentation currency, the Company followed the guidance in IAS 21 *The Effects of Changes in Foreign Exchange Rates* and have applied the change retrospectively as if the new presentation currency had always been the Company's presentation currency. In accordance with IAS 21, the financial statements for all years and periods presented have been translated to the new US dollar presentation currency. For the 2013 comparative balances, assets and liabilities have been translated into the presentation currency (US dollars) at the rate of exchange prevailing at the reporting date. Items impacting income (loss) or comprehensive income (loss) were translated at the average exchange rates for the reporting period, or at the exchange rates prevailing at the date of transactions.

### Business of the Company

Iona is an oil and natural gas acquisition, appraisal, and development corporation active through its 100% wholly owned United Kingdom subsidiary Iona Energy Company (UK) Limited ("Iona UK") in the United Kingdom's Continental Shelf ("UKCS").

The Company has continued its efforts to acquire strategically aligned assets for its UK portfolio. Iona seeks low-cost, proven undeveloped acquisition targets that are proximate to infrastructure willing and able to accept its future production, and where sub-sea tiebacks can be utilized. Employing this strategy facilitates the Company's pursuit of profitable oil and gas production through the effective management of finding and development costs, initial capital expenditure, and lower long-term per barrel operating expenditure and tariffs.

The following Management's Discussion and Analysis ("MD&A") of Iona Energy Inc. ("Iona" or "the Company") have been prepared in accordance with International Financial Reporting Standards ("IFRS") and should be read in conjunction with the consolidated financial statements and accompanying notes of the Company as at and for the period ended June 30, 2013, the Annual Information Form ("AIF") for the year ended December 31, 2013, the MD&A for the year ended December 31, 2013 and the audited consolidated financial statements as at and for the year ended December 31, 2013. Copies of these documents and additional information about Iona are available on SEDAR at [www.sedar.com](http://www.sedar.com).

This MD&A is dated August 28, 2014. All currency amounts are expressed in United States Dollars ("\$\$") unless otherwise stated.

Statements throughout this MD&A that are not historical facts may be considered “forward-looking statements”, including without limitation, statements regarding Iona’s plans and timelines for the development of its properties, statements regarding estimates of the proved reserves, probable reserves, possible reserves and contingent and prospective resources, as well as estimates of the net present value of future net revenue of proved reserves, probable reserves, and possible reserves, future obligations under Iona’s bond agreement and hedging arrangements including the Payment Swap (as defined herein), statements regarding potential increases in working interests, and statements regarding estimated production rates. These forward-looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company’s objectives, goals or future plans are forward-looking statements. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties and actual results could differ materially from those currently anticipated. These risks and uncertainties include, but are not limited to: the risk that Iona’s development plans change as a result of new information or events, the risk that drilling results differ materially from management’s current estimates, the risk that actual production rates will be significantly lower than estimated peak production rates, the risk that Iona is not able to access the proceeds of the Bond offering, changes in market conditions, law or government policy, the risk that the anticipated increase in Trent & Tyne working interest is not completed, operating conditions and costs, operating performance, demand for oil and gas and related products, price and exchange rate fluctuations, commercial negotiations or other technical and economic factors. Forward-looking statements are based on current expectations, estimates and projections of future production and capital spending as at the date of this MD&A and the Company assumes no obligation to update or revise forward-looking statements to reflect new events or circumstances, except as required by law.

Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management’s assessment of the relevant information currently available. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

### Non-GAAP Financial Measures

Throughout this MD&A, the Company uses the terms “funds flow”, “funds flow per share - basic”, “funds flow per share – diluted”, “Adjusted EBITDA”, “Adjusted EBITDA per share - basic”, “Adjusted EBITDA per share – diluted”, “working capital” and “operating netback”. These terms do not have any standardized meaning as prescribed by IFRS and, therefore, may not be comparable with the calculation of similar measures presented by other issuers. Management uses working capital and operating netback measures. Working capital is calculated as current assets less current liabilities, and is used to evaluate the Corporation’s financial leverage. Operating netback is a benchmark common in the oil and gas industry and is calculated as total petroleum and natural gas sales, less production and transportation expenses, calculated on a per barrel equivalent (“boe”) basis of sales volumes using a conversion. Operating netback is an important measure in evaluating operational performance as it demonstrates field level profitability relative to current commodity prices. Working capital and operating netback as presented do not have any standardized meaning prescribed by IFRS and therefore may not be comparable with the calculation of similar measures for other entities.

Funds flow is calculated based on cash flow from operating activities before changes in non-cash working capital. Adjusted EBITDA is calculated as net income before finance costs, derivative gains and losses, taxes, depletion, depreciation and amortization. Funds flow or Adjusted EBITDA per share - basic and funds flow or Adjusted EBITDA per share - diluted are calculated as funds flow or Adjusted EBITDA divided by the number of weighted average basic and diluted shares outstanding, respectively. Management utilizes funds flow and Adjusted EBITDA as key measures to assess the ability of the Company to finance dividends, operating activities, capital expenditures and debt repayments. Funds flow and Adjusted EBITDA as presented are not intended to represent cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with IFRS.

The following table reconciles cash flow used in operating activities to funds flow:

	Six months ended June 30,	
	2014	2013
Cash flow used in operating activities	\$ 27,101	3,748
Changes in non-cash working capital balances:		
Accounts receivable	5,185	4,167
Prepaid expenses	593	(396)
Inventory	(561)	-
Accounts payable and accrued liabilities	(1,885)	(5,359)
Funds Flow	\$ 30,433	2,160

The following table reconciles net income to Adjusted EBITDA:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income	\$ (28,027)	9,117	\$ (28,365)	(2,828)
Income tax recovery (expenses)	3,962	298	5,017	(9,920)
Finance costs	8,284	3,001	16,072	3,800
Finance Income	(4)	(3)	(6)	(11)
Loss / (gain) on risk management contracts	8,762	(13,863)	8,474	9,824
Depletion, depreciation and amortization	16,670	4,451	35,598	5,417
Adjusted EBITDA	\$ 9,647	3,001	\$ 36,790	6,282

The terms “boe” and per barrel equivalent per day “boepd” are used in this MD&A. Boe and boepd may be misleading, particularly if used in isolation. A boe conversion ratio of cubic feet of natural gas to barrels of oil equivalent is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In this MD&A we have expressed boe using a conversion standard of 6 Mcf: 1 boe which is standard in the industry.

## PRODUCTION & OPERATIONS UPDATE

### Producing Assets

- *Huntington crude oil and gas production (17.55% Economic Interest)*

Iona's Q2 2014 average production at Huntington decreased 34% over Q1 2014, from 3,896 boepd to 2,563 boepd, resulting from unplanned shutdowns of the Voyageur FPSO and within the Central Area Transmission System (“CATS”). Average production at Huntington increased 147% for the six month period ended June 30, 2014 to 3,204 boepd compared to average production during the same period in 2013 of 1,197 boepd (adjusted for production commencing on April 12, 2013).

On April 12, 2014, Huntington production was suspended as work commenced to replace a number of straub couplings that are part of the inert gas system on the floating production, storage and offloading (“FPSO”) facility. On April 24, 2014, the Operator, E.ON E&P UK Ltd, informed the partners that the replacement work had been completed ahead of schedule and that production restart had commenced. However, on April 26, 2014 the Huntington partnership was advised that due to an unplanned shutdown issue involving the Central Area Transmission System (“CATS”) riser system, multiple fields producing through the system were shut in until May 10, 2014. Huntington resumed production on May 11, 2014 and the field produced largely uninterrupted for the remainder of quarter at below peak rates.

As of June 29, 2014, Huntington had offloaded 29 cargos and produced 7.8 million barrels of oil equivalent with Iona's net share of production being above 1.3 million barrels of oil equivalent. Across Q2, Brent pricing remained strong averaging \$109.67/bbl while UK gas prices softened to \$7.59/mcf.

After some remedial work on the Voyageur FPSO in early July, full production resumed on July 8, 2014, with relatively stable albeit restricted production due to CATS. As per instructions from the CATS operator Huntington production was shut in on July 31, 2014. Planned maintenance was completed at Huntington during the shut in with production resuming on August 26, 2014. During the shut in significant scale deposits were removed from the first stage separator and the inlet pipework which should enable production to resume to maximum production, under the current CATS restriction, of approximately 25,000 boepd.

Effective as of December 31, 2013 GCA evaluated the reserves and net present values of future revenue associated therewith, using forecast prices and costs. The proved and probable reserves from Huntington net to Iona based on a 15.75% interest (15% working interest and 0.75% differential lifting entitlement) are 4.59 MMboe (4.02 MMbbls of oil and 3.44 Bscf of gas), not including the additional royalty interest of 1.8%. By comparison, GCA had assigned 4.58 MMboe (4.14 MMbbls and 2.64 Bscf of gas) as at December 31, 2012, prior to the field producing approximately 640,000 boe net Iona in 2013. At this time, reserves will only be assigned to the Paleocene Forties and the Fulmar formation (“Maxwell”), which has been developed through four production and two water-injection wells to achieve the aforementioned capacity figures and to the Maxwell where a well is being planned (see below).

- *Huntington Jurassic Fulmar ("Maxwell") (17.55% Economic Interest)*

Relating to the Maxwell discovery which lies in the Fulmar horizon beneath the producing Huntington Forties field, a further phase of development has been commenced by the Huntington joint venture partners including evaluation and engineering work in 2014, with a first oil target in 2016. Further appraisal and development of the Jurassic Fulmar horizon may follow depending on the geoscience evaluation of the overall extent of this reservoir including the undrilled extension of Iona's 100% owned Block 22/14d ("Lobe 3").

During June 2014, an AFE which covers Concept Definition of the Maxwell development was issued by the operator of the Huntington field and approved by the Huntington joint venture partners. The Concept Definition study has since commenced.

- *Trent & Tyne gas production (20% Working Interest, increasing to 100% working interest upon closing of SPA)*

The T6 well reached total depth in December 2012 and was tied-in to the production system in January 2013. The well commenced production at rates exceeding Iona's expectations, as announced by Iona in January 2013. The net average daily production rate from Trent & Tyne to Iona during the three months ended March 31, 2014 was 1.6 MMcf/d compared to 2.1 MMcf/d average during the three months ended December 31, 2013. Trent & Tyne production continues to be severely reduced due to the intermittent performance of the fresh water maker at Tyne and the efficiency of the fresh water injection system at T6. On April 16, 2014 the Tyne 44/18-T6 ("T6") well resumed production at 13 MMcf/d. The well has been subsequently choked back to 3MMscfpd in order to manage salt deposition within the capacity constraints of the fresh water system. Iona is currently investigating mitigation measures.

In the operating envelope of the Tyne field, and in particular the T6 well, salt deposition in the wellbore tubulars is a significant risk to production. When super-saline formation water enters the wellbore tubulars it experiences a drop in both temperature and pressure. This causes salt to drop out of solution and deposit in the well. It is a well-known issue in the gas fields of the UK Southern Gas Basin and elsewhere with highly saline formation waters. Standard industry practice is to install a water washing system to the wells. Fresh water is pumped down the wells to dissolve salt deposits. A water maker takes seawater and, by reverse osmosis, generates fresh water for the water washing system. Salt build-up is sufficiently quick to preclude producing wells such as T6 without continual water washing or cyclic production to allow a fresh water soak period. It is routine procedure to suspend production while the water maker is out of commission. Operational improvements to enhance the performance and reliability of the Tyne water maker are being implemented.

On April 29, 2014, the Company, through its wholly owned UK subsidiary, Iona UK Developments Co Limited, entered into a Sale and Purchase Agreement ("SPA") with Perenco UK Limited ("Perenco"), to purchase Perenco's remaining 80% working interest, rights, and obligations in the Trent & Tyne fields (including the Trent East Discovery Area).

Upon satisfaction of certain conditions as set out in the SPA, the Company shall pay to Perenco an additional sum of \$18,000,000, as adjusted pursuant to any adjustments as per the SPA and assume all decommissioning liabilities in relation to assets being purchased. Payment shall be made no later than six (6) calendar months after the date of the SPA or on such later date as agreed in writing, subject to normal conditions of closing, including financing and DECC approval. These amounts will be recorded upon closing of the transaction. For further information please see the Company's April 29, 2014 news release, available on the Company's website and SEDAR.

Across the quarter, production at Trent & Tyne continued to be severely reduced resulting from planned and unplanned maintenance outages at the fields and at the Bacton terminal, in addition to continued intermittent performance of the Tyne fresh water system effecting production at the T6 well. The net average daily production rate from Trent & Tyne to Iona during the three and six months ended June 30, 2014 was 1.4 MMcf/d and 1.2 MMcf/d compared to 3.9 MMcf/d and 2.9 MMcf/d average during the three and six months ended June 30, 2013. Stable production resumed near the end of July 2014 with the fields averaging 14 MMcf/d gross 100% interest, 2.3 MMcf/d net 20% interest, of which the 100% interest relates to the working interest Iona intends to hold upon the completion of the acquisition of the further 80% interest.

During the month of June, Iona signed a Transition Services Agreements with the Wood Group and Senergy in support of the Company's agreement to acquire Perenco's remaining 80% operated working interests. These agreements cover work required to receive consent from the DECC for the transfer of operatorship, assignment of the interests, and other regulatory approvals to enable Iona to operate the two fields and the associated EAGLES pipelines which transport production to the Bacton terminal. All transition workstreams continue to progress and Iona expects the transfer of operatorship to occur in Q4 2014.

The Trent and Tyne transition plan also includes working with the Wood Group, Senergy, and Perenco to identify and implement well work to increase production from the existing well stock and to mature opportunities for drilling fresh gas accumulations located within reach of the infrastructure.

Effective as of December 31, 2013, GCA evaluated the reserves and net present values of future revenue associated therewith, using forecast prices and costs. The proved and probable reserves from Trent & Tyne net to Iona is 9.33 Bscf of gas based on its 20% working interest and will rise to 46.65 Bscf on completion of the SPA and resulting in a 100% net interest to the Company.

## Developments

- *Orlando – A proven undeveloped oil discovery (75% Working Interest)*

The Orlando Field Development Plan (“FDP”) was approved by DECC on April 16, 2013. The development plan contemplates the re-entering and drilling of the suspended 3/3b-13z well as a 3,000 foot horizontal producer, to be completed with dual electric submersible pumps. Additionally, a subsea pipeline, power supply and control umbilical are to be laid between the well-head and the Ninian Central Platform (“NCP”) approximately 10 km to the south west of the Orlando field. Engineering modifications at the NCP will allow tie-in and first production shortly after completion of the development well. The manufacture of line pipe and Xmas trees is substantially finished. The copper cores for the umbilical are also complete and delivered to the umbilical assembly plant. Manufacture of the control system is ongoing and contractual arrangements for the balance of the project supply chain are in the process of being finalized. Additionally, piping tie-ins to the NCP have now been done.

It was originally contemplated that field development would be completed by 2015, enabling first oil from Orlando in the second half of the year. During the quarter, the Company has determined that some deliverables will not be completed during 2014 and 2015, and Iona aims to achieve first oil from Orlando as early as possible in 2016. Iona continues to be in discussion with the Operator of the Ninian Central Platform and DECC regarding specific timing of infrastructure access which drives the exact timing of first oil delivery. The Company has commissioned a joint study with the owners of the Ninian Central Platform, conducted by the Wood Group and Atkins for the detailed design of the peripheral elements of the platform modification required to accept the Orlando riser and control systems. Upon the completion of this work due in late 2014 and early Q1 2015, greater definition of the timing on logistical elements that require the emplacement of the subsea pipeline and controls currently anticipated to be installed 2016.

Iona is operator and holds a 75% working interest in the Orlando field. Atlantic Petroleum North Sea Limited (formerly Volantis Exploration Limited), a wholly owned subsidiary of Atlantic Petroleum, owns the remaining 25% working interest following its acquisition from Iona on February 21, 2013.

During the quarter, Iona's Orlando Development project team, in coordination with the Company's contracted project manager ADIL, continued to implement the project activities for the subsea tie back to the Ninian Central platform.

- *Kells – Redevelopment of a proven field (75% Working Interest)*

Kells is slated for development through NCP following the tie-in of Orlando to the same facility. The Kells development plan comprises two subsea production wells, an oil pipeline, a control umbilical, and some pipework modifications at NCP. A draft FDP has been prepared and project activity will be phased through 2015 and 2016, with first oil expected in the second half of 2017. A subsequent water injection project is planned to unlock additional reserves. This 2017 project will involve the laying of water injection and gas lift lines, and the conversion of the second well to water injection service.

In addition to Iona's previously disclosed intention to export Kells production across the Ninian Central Platform, the Company, has entered into exploratory discussions with the owners of the Alwyn Platform regarding the feasibility of a tieback of the Kells developments across that facility.

- *West Wick – Oil Discovery (58.73% Working Interest)*

Iona completed the acquisition of a 58.73% working interest in West Wick in August 2012 and is the operator on the block. West Wick is programmed for a three well subsea development. The development will comprise two producers and one injector. The most likely development is via offset field infrastructure; however, Iona is also considering stand-alone facilities and is in consultation with both the joint venture and the supply chain and engineering studies are ongoing. The Company expects to select a development approach and submit the associated FDP in 2014.



The Company commissioned Crondall to conduct some preliminary engineering studies and to establish within the current market and supply chain the availability of independent floating production and storage solutions. Based on the range of solutions the Company is confident that a number of development strategies are feasible.

- *Ronan & Oran – Oil Discovery awaiting conversion to Reserves (100% Working Interest)*

Detailed subsurface mapping has been undertaken that has confirmed the extent of the Ronan and Oran Oil Discoveries within which oil-water contacts have yet to be established. This work has also matured the potential through appraisal drilling to add significant additional resources below the existing known oil levels and the potential deeper oil-water contacts out to the mapped spill points. Development concepts are under review.

Iona is currently contemplating the drilling of an appraisal well to locate the potential deeper oil-water contact and has initiated the permitting, site survey, and procurement of a semi-submersible rig to potentially commence drilling as early as Q1 2015.

The Company has re-evaluated all pertinent well data on these discoveries with correlation to the surrounding producing Brent province fields and has completed a full development planning study by Axis (an Aberdeen based production technology and subsurface consultancy). The results of this study has highlighted that the volume of the potential contingent resources in the range (1C 47MMbbls, 2C 61MMbbls and 3C 84MMbbls) may be economic under various development options that range from a stand alone floating production system to a sub sea tie back to a nearby platform. The Company commissioned Crondall to conduct some preliminary engineering studies and to establish within the current market and supply chain the availability of independent floating production and storage solutions. Based on the range of solutions the Company is confident that a number of solutions are feasible. Please refer to “Notes Regarding Oil and Gas Disclosure” for further information.

The Company has also commenced seismic reprocessing study of the existing 3D seismic that covers Ronan and Oran such that the final subsurface location and well trajectory can be located. The 3D seismic processing results are estimated to be completed in September 2014. The Company also anticipates that through the improvement in the quality of the seismic data, that subject to a satisfactory test of the planned appraisal well, at least some of the hydrocarbons currently defined as contingent resources can accurately be converted to defined reserves and will enable the earliest application for a Field Development Plan. Engineering studies have also been conducted to enable the synergistic development of the Kells field via an independent Ronan & Oran development.

- *Exploration*

The Company’s portfolio of assets will continue to grow through acquisitions, farm-ins and participation in license rounds.

## **CORPORATE TRANSACTIONS**

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On April 28, 2014, through its wholly owned UK subsidiary, Iona UK Developments Co Limited, Iona entered into a Sale and Purchase Agreement (“SPA”) with Perenco UK Limited (“Perenco”), to purchase Perenco’s remaining 80% operated working interests, rights, and obligations in the producing Trent & Tyne fields (including the Trent East gas discovery). Upon satisfaction of certain conditions as set out in the SPA, the Company shall pay to Perenco, a further sum of \$18,000,000, as adjusted pursuant to any adjustments as per the SPA and assume all decommissioning liabilities in relation to Licenses being purchased. Payment shall be made no later than six (6) calendar months after the date of the SPA or on such later date as agreed in writing. The effective date of the transaction is January 1, 2014 and between then and completion, Iona will assume 100% of the financial benefits and obligations associated with the increased working interest. Completion of the acquisition and transfer of operatorship is anticipated to occur in Q4 2014. Costs for transferring operatorship from Perenco to Iona are shared equally between the companies.

In addition to the Trent & Tyne acquisition, Iona entered into a SPA with Ithaca Energy (UK) Limited (“Ithaca”) for a 33.33% non-operated interest in Blocks 42/20a, 42/25b, 43/16, and 43/21c of License P.2107, potential gas accumulations to the northwest of the Trent field. The total consideration paid to Ithaca by Iona was £79,094. The partners in the blocks are Parkmead (E&P) Limited (33.33% operator) and Bridge Energy (SNS) Limited (33.33%). The current work programme contemplates the near-term acquisition of seismic over the area, and a drill or drop requirement by 2018.

On May 6, 2014 the bondholders voted in favour of amending the Bond agreement to clarify that restricted cash is included in the definition of cash and cash equivalents. The amendment was effective from the date of issue of the Bonds.

Subsequent to the quarter end on August 15, 2014, the Company, through its wholly owned subsidiary Iona UK, retired the remaining 3,658,051 calls (effective April 2014 through March 2018) sold to Britannic Trading Limited (“BTL”), a subsidiary of BP Oil International Limited, in February of 2013. The Company will settle this transaction through two equal payments of \$13,250,000, paid on August 18, 2014 and February 10, 2015. Simultaneously, the company entered into a Zero Cost Producer Collar with BTL, whereby Iona UK purchased 458,352 puts (effective August 2014 through July 2015) at a strike price of \$90.00 per barrel, and sold to BTL 1,650,000 calls (effective October 2018 through March 2020) at a strike price of \$90.00 per barrel.

## Q2 2014 RESULTS OF OPERATIONS

Revenue was generated from the Trent & Tyne gas fields and from the Huntington oil field as discussed in *Key Projects Update*. There was minimal revenue generated from operations in the first quarter of 2013 as Huntington commenced production on April 12, 2013, while all revenues from Trent & Tyne accrued into a restricted cash account between the economic date of the Trent & Tyne acquisition and the completion of the T6 well in January 2013.

## PRODUCTION AND PRICING

		Three months ended June 30,			Six months ended June 30,		
		2014	2013	% Change	2014	2013	% Change
<b>Total Petroleum and natural gas production by product &amp; project</b>							
<b>Huntington</b>							
Crude Oil	bbl	<b>207,866</b>	93,140	123%	<b>520,590</b>	93,140	459%
Natural Gas	boe	<b>25,331</b>	1,461	1,634%	<b>59,392</b>	1,461	3,965%
<b>Trent &amp; Tyne</b>							
Natural Gas	boe	<b>17,927</b>	58,185	(69)%	<b>41,155</b>	86,666	(53)%
<b>Total petroleum and natural gas production</b>							
	boe	<b>251,124</b>	152,786	64%	<b>621,137</b>	181,267	243%
<b>Average Daily Production by product</b>							
Crude Oil	bopd	<b>2,284</b>	1,179	94%	<b>2,876</b>	1,179	145%
Natural Gas	boepd	<b>475</b>	655	(27)%	<b>556</b>	487	14%
<b>Total average daily production</b>							
	boepd	<b>2,759</b>	1,834	50%	<b>3,432</b>	1,666	106%

Average net production for the three and six months ended June 30, 2014 was 2,759 boepd and 3,432 respectively compared to average net production during the comparable periods in 2013 of 1,834 boepd and 1,666 boepd respectively. The increase in crude oil production to 2,284 bopd during the three months and 2,876 during the six months ending June 30, 2014 compared to 1,799 bopd during the three months and 1,179 during the six months ended June 30, 2013 was a result of improved production from the Huntington field as a result of better weather and limited gas transportation restrictions from the operator of CATS. Also has Huntington did not begin production until April 11, 2013 the first quarter of 2013 would have no crude oil production. Quarter over quarter average production at Huntington decreased 34%, from 3,896 boepd in Q1 2014 to 2,563 in Q2 2014 as a result of unplanned shutdowns of the Voyageur FPSO and within the Central Area Transmission System (“CATS”). Natural gas production increased during the second quarter of 2014 to 475 boepd per day compared to 358 boepd per day due to increased production from Huntington, this was offset by decreased production from Trent & Tyne due to intermittent well performance.

Of the total revenues of \$27.1 million and \$62.7 million for the three and six months ended June 30, 2014 (\$11.8 million and \$13.7 million for the three and six months ended June 30, 2013), \$23.9 million, 88% of total revenue and \$52.8 million, 84% of total revenue, was generated from oil production (2013 - \$8.8 million, 75% of total revenue and \$8.8 million, 64% of total revenue), respectively, \$1.1 million, 4% of total revenue and \$5.3 million, 9% of total revenue, was generated from gas production (2013 - \$2.6 million, 22% of total revenue and \$4.4 million, 32% of total revenue), respectively, \$2,308 and \$241,000 from condensate (2013 - \$33,000 and \$100,000 respectively) and \$2.1 million, 8% of

total revenue and \$4.4 million, 7% of total revenue, was generated through a gross overriding royalty interest in the Huntington field (2013 - \$368,000, 3% of total revenue and \$368,000, 4% of total revenue), respectively.

The average realized oil price for the three and six months ended June 30, 2014 was \$109.10 and \$108.42 respectively per bbl (three and six months ended June 30, 2013 - \$102.00 and \$102.00 respectively) compared to average Brent oil prices in the period of \$109.67 per bbl. The average realized gas price for the three and six months ended June 30, 2014 was \$7.77 per mcf and \$8.78 per mcf respectively (three and six months ended June 30, 2013 - \$10.00 per mcf and \$10.00 per mcf respectively) compared to average gas prices in the period of \$7.59 per mcf.

## REVENUE

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	% Change	2014	2013	% Change
<b>Petroleum and natural gas sales by product</b>	\$			\$		
Crude oil	23,861	8,813	171%	52,775	8,813	499%
Natural gas	1,159	2,629	(56)%	5,299	4,420	20%
Royalty interest	2,080	368	465%	4,433	368	1,104%
Condensate	-	33	-	241	100	141%
Total	\$ 27,100	11,843	129%	\$ 62,748	13,701	358%

Revenue was \$27.1 million and \$62.7 million for the three and six months ended June 30, 2014 (June 30, 2013 - \$11.8 and \$13.7) respectively.

Oil sales volumes increased from the same period in the previous year as a result of improved production from the Huntington field during the second quarter of 2014 compared to the second quarter of 2013. The decrease in gas sales in the second quarter of 2014 compared to the second quarter of 2013 was due to a reduction in the Trent & Tyne gas volumes due to shut downs experienced since the third quarter of 2013 partially offset against gas production increases from Huntington.

## INVENTORY

Inventory for the quarter ended June 30, 2014 was \$58,000 (Dec 31, 2013 - \$1.8 million). Inventory relates to the Company's share of stock remaining in the FPSO storage tanks at June 30, 2014 as there was a lifting at the end of the quarter stock was reduced resulting in the decrease in the inventory from December 31, 2013 to June 30, 2014. As such \$0.8 million and \$1 million was expensed as operating costs and depletion, respectively, in the six months ended June 30, 2014. Inventories of crude oil are valued at the lower of cost, using the average cost method, and net realizable value. Costs include direct and indirect expenditures incurred in bringing an item or product to its existing condition and location.

## COST OF SALES

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Operating costs	\$ 11,103	5,610	98%	\$ 17,611	6,406	175%
Depletion and depreciation	16,670	4,451	275%	35,598	5,417	557%
Total	\$ 27,773	10,061	176%	\$ 53,209	11,823	350%

Operating expenses were \$11.1 million and \$17.6 million compared to \$5.6 million and \$6.4 million during the three and six months ended June 30, 2014 respectively. The increase in operating costs from the second quarter 2013 is due to the June 30, 2014 inventory adjustment, costs spent on attempting to resolve the T6 water maker issue in addition to acid washes of the Huntington wells to remove depositions on the tubing. Depletion increased during the three and six months ended June 30, 2014 to \$16.7 million and \$35.6 million respectively compared to \$4.5 million and \$5.4 million respectively during the three and six months ended June 30, 2013. The increase in depletion for the three and six months ended June 30, 2013 is a result of increased production from the Huntington field.

The costs were generated from the Huntington and Trent & Tyne fields as discussed in *Key Projects, Production and Operations Update*.

## OPERATING NETBACKS

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	% Change	2014	2013	% Change
	\$/boe	\$/boe		\$/boe	\$/boe	
Average Selling Price	\$ 101.20	86.99	16%	\$ 99.33	89.72	11%
Operating Cost	(38.69)	(40.07)	(3%)	(27.39)	(38.02)	(28%)
Netback from Operations <sup>(1)</sup>	\$ 62.51	46.92	33%	\$ 71.94	51.70	39%

<sup>(1)</sup> 23% reduction in Q2 three month ended June 30, 2014 netback compared to Q1 three month netback mainly relates to 34% decrease in production.

Operating costs include all costs to produce and sell the commodity. Operating costs decreased during the three and six months ended June 30, 2014 to \$38.69 and \$27.39 per boe compared to \$40.07 and \$38.02 per boe during the three and six months ended June 30, 2013 due to the increased production at Huntington where a certain percentage of operating costs are fixed.

Management expects operating costs on a per boe basis to decrease as production continues to increase and stabilize at each producing field.

## GENERAL AND ADMINISTRATIVE EXPENSES

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Consulting fees / wages	\$ 2,139	278	669%	\$ 2,654	1,994	33%
Professional fees	(158)	226	(170%)	62	1,049	(94%)
Stock option expense	81	1,908	(96)	119	2,471	(95%)
Depreciation	11	-	-	25	-	-
Insurance	246	-	-	249	-	-
Travel, office costs and other	895	680	32%	1,451	968	50%
Total	\$ 3,214	3,092	4%	\$ 4,560	6,482	(30%)
Per boe	\$/boe 12.80	22.08	(42%)	7.34	38.58	(81%)

General and administrative costs were \$3.2 million and \$4.6 million for the three and six months ended June 30, 2014 compared to \$3.1 million and \$6.5 million for the three and six months ended June 30, 2013. General and administrative costs increased from the three month comparative period in 2013 mainly as a result of increased consulting fees and wages, offset by a decrease in stock based compensation. Compensation increased partially due to bonuses being granted in Q1 in 2013 compared to Q2 in 2014 and an increase in the number of staff and consultants as Iona prepares to become operator of T&T. Stock option expense decreased due to fewer stock option grants in the quarter and a natural decline in expense due to graded vesting.

General and administrative costs decreased from the six month comparative period in 2013 mainly as a result of decreased professional fees and stock option expense offset by an increase in consulting fees and wages. Professional fees include legal, audit and tax fees which were higher in 2013 due to the acquisition of Huntington. As noted above stock option expense decreased due to fewer stock option grants in the quarter and a natural decline in expense due to graded vesting. Compensation increased due to an increase in the number of staff and consultants as Iona prepares to become operator of T&T.

The stock option charge represents the fair value of the Company's stock options amortized over the respective vesting period via the graded vesting method. Pursuant to the plan, the Board of Directors determines the vesting provisions of the stock options at the date of grant. All of the options granted to date under the plan (other than options granted to a firm providing investor relations activities) vest as follows: ¼ immediately and ¾ vesting on the first, second and third anniversary dates. All unvested options vest upon the change of control of the Company. The options are non-transferable. The minimum exercise price is based on the trading price of the common shares on the date prior to the day of the grant less any applicable discount permitted by the TSX Venture Exchange. The future expense will vary as it is dependent on the number and vesting provisions of future stock option grants.

## FOREIGN EXCHANGE

	Three months ended June 30,			Six months ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Foreign exchange gain / (loss)	\$ (533)	624	185%	\$ (352)	863	141%

During the three and six months ended June 30, 2014, the Company recognized a foreign exchange loss of \$533,000 and \$352,000 (2013 – Gains of \$624,000 and \$863,000). The exchange loss in the quarter arose primarily as a result of the strengthening of the GBP against the USD increasing the value of the GBP payable working capital balances held in Iona UK.

## RELATED PARTY TRANSACTIONS

During the three and six months ended June 30, 2014, the Company was charged \$65,000 (2013 - \$54,000) and \$99,000 (2013 - \$407,000) respectively, in legal fees of which \$NIL (2013 - \$95,500) related to share issuance costs by a law firm, Burstall Winger, Zammit LLP who acts as counsel for the Company, where a director of the Company is a partner, of which \$49,000 is included in accounts payable and accrued liabilities as at June 30, 2014 and \$29,000 as at December 31, 2013.

Included in accounts receivable is \$117,483 (2013 - \$265,000) due from a former officer and director of the Company who resigned from the Company's management team and Board. Of this amount \$117,483 remains to be collected as at June 30, 2014. The amounts owing are non-interest bearing and secured. The Company expects full repayment of the remaining balances in 2014.

Except as disclosed, all related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties and approximates fair value.

## SENIOR DEBT INSTRUMENTS

On September 27, 2013, Iona UK issued \$275 million in senior secured bonds (the "Bonds"), net of discounts of \$6.9 million and transaction cost of \$8 million, for \$260 million. As at June 30, 2014 the fair value of the Bonds were \$272.3 million (December 31, 2013 - \$275 million). The bonds mature on September 30, 2018. The Bonds carry an annual coupon rate of 9.5% payable semi-annually, were issued at 97.5% of par and are callable in whole or in part at the option of Iona UK at any time. Commencing 30 months after September 30, 2013, the Bonds will be repaid at 15% of the face value every six months with a 25% final payment at maturity. The Bonds contain certain early redemption options under which the Company has the option to redeem all or a portion of the Bonds at various redemption prices, which include the principal amount plus accrued and unpaid interest, if any, to the applicable redemption date. The Company reviewed the terms of the Bonds and determined that certain prepayment options were an embedded derivative. The fair value of the embedded derivative at inception was \$1,146,000. At June 30, 2014 the derivative was valued at \$Nil and will be fair valued at each subsequent reporting period. The fair value of the derivative is the residual of the value of similar debt without the derivative less the current fair value of the bonds. The embedded derivative is presented separately from the bonds in statement of financial position as a current derivative instrument. At June 30, 2014 the balance of the Bonds of \$264,868,000 represents the Bonds amortized cost net of transaction costs of \$8 million and the initial fair value of the embedded derivative.

Payment date	Nominal installment amount	Premium on nominal installment
March 2016	41,250,000	5%
September 2016	41,250,000	4%
March 2017	41,250,000	4%
September 2017	41,250,000	3%
March 2018	41,250,000	3%
September 2018 (Maturity)	68,750,000	2%

The Bonds are secured against the assets of the Company and its subsidiaries. Under the Bond Agreement, capital expenditures are limited to assets within the borrowing base (currently Huntington, Trent & Tyne, Orlando, Kells, Ronan and Oran). Additionally, a working interest of at least fifty percent must be maintained in Orlando and Kells. Additionally no sale or disposal of any (direct or indirect) ownership interest in the Huntington Asset shall be permitted during the term of the Bonds as long as any call options are outstanding under the BP Structured Energy Derivative.

Under the Bond Agreement the Company must maintain the following financial covenants, as calculated quarterly:

- minimum liquidity (defined as the restricted group's cash and cash equivalents) of at least \$30 million;
- a leverage ratio (defined as net interest bearing debt divided by twelve months of earnings before interest, taxes, depreciation and amortization ("EBITDA")) of not more than 3.0x; and
- ensure a minimum of both the capital employed ratio (defined as equity divided by the sum of equity and net interest bearing debt) and the restricted capital employed ratio (defined as restricted group equity divided by the sum of restricted group equity and net interest bearing debt) of 40% until December 31, 2016, and a minimum of 50% thereafter.

The restricted group is defined as Iona UK and Iona UK Huntington Ltd.

Under the Bond Agreement an event of default constitutes two consecutive quarterly covenant violations. The quarter ended December 31, 2013 was the first quarter that the Company was required to maintain the leverage ratio.

The Company was in breach of the Leverage Ratio at December 31, 2013. At June 30, 2014, the Company was in compliance with the leverage ratio.

The table below delineates the Company's position with respect to the Bond covenants at June 30, 2014.

	30-June-14	Covenant
Liquidity as defined	\$107,893	Greater than \$30,000
Restricted Group Capital Employed Ratio	57%	Greater than 40%
Group Capital Employed Ratio	57%	Greater than 40%
Leverage Ratio	2.0	Not greater than 3.0x

The above calculation includes restricted cash in the definition of cash as changed in the amendment to the Bond Agreement effected May 6, 2014.

## DERIVATIVE INSTRUMENTS – COMMODITY HEDGING

The details of the hedging contracts entered into by the Company in the quarter are included in *Corporate Transactions*. The Company's derivative financial instruments measured at fair value as of June 30, 2014 are presented in the table below:

	Level 1	Level 2	Level 3	Total Fair Value
<b>Current assets</b>				
Derivative financial assets	\$ -	-	-	\$ -
<b>Current liabilities</b>				
Derivative financial instrument liabilities	-	18,025	-	18,025
<b>Non-current liabilities</b>				
Derivative financial instrument liabilities	\$ -	32,131	-	32,131

The table below presents the total loss on financial instruments that has been disclosed through the consolidated statement of comprehensive income:

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Cost of derivative options	-	-	-	(7,348)
Realized gain / (loss) on commodity hedges	(5,930)	-	(5,930)	-
Unrealized gain / (loss) on commodity hedges	(2,832)	13,863	(2,544)	(2,476)
<b>Total gain / (loss) on commodity hedges</b>	<b>(8,762)</b>	<b>13,863</b>	<b>(8,474)</b>	<b>(9,824)</b>

All other financial assets are classified as loans and receivables and are accounted for on an amortized cost basis. All financial liabilities are classified as other liabilities.

## COMMITMENTS

In addition to the amounts recorded in the condensed consolidated financial statements, based on management's best estimate, the Company has the following contractual obligations:

Contractual Obligations	June 30, 2014				
	Payments Due in Period				
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
U.S. Segment					
Exploration leases	204	17	51	51	85
UK Segment					
Office lease	4,946	495	1,485	1,485	1,481
Equipment leases	41,309	11,408	21,930	7,971	-
Drilling, completion, facility construction	18,013	18,013	-	-	-
<b>Total UK Segment</b>	<b>64,268</b>	<b>29,916</b>	<b>23,415</b>	<b>9,456</b>	<b>1,481</b>
<b>Total Contractual Obligations</b>	<b>64,472</b>	<b>29,933</b>	<b>23,466</b>	<b>9,507</b>	<b>1,566</b>

Excluded from the table above on January 19, 2012, the Company's UK Subsidiary, Iona UK, acquired full ownership and operatorship from Fairfield Cedrus Limited ("Fairfield") of a 100% interest in Block 3/8d containing the Kells Oil Field. Iona UK reimbursed Fairfield on closing for \$8.5 million in pre-development expenditures related to the Kells field. In addition, upon the approval by DECC of a field development plan in respect of Kells, Iona will be obligated to make a cash payment of \$5.0 million to Fairfield and pay a net royalty of \$2.50 per barrel of production from the Kells Oil Field.

Additionally, future staged payments will be made by Iona to Sorgenia and MPX commencing six months after first production from Orlando. The first payment will be \$7.0 million with additional payments of \$7.0 million, \$7.0 million, \$4.0 million, and \$4.0 million made every six months thereafter respectively, amounting to a total payment of \$29.0 million over 3 years.

## LIQUIDITY AND CAPITAL RESOURCES

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The Company manages its capital with the prime objectives of safeguarding the business as a going concern, creating investor confidence, maximizing long-term returns and maintaining an optimal structure to meet its financial commitments and to strengthen its working capital position. At present, the capital structure of the Company is primarily composed of shareholders' equity. The Company's strategy is to access capital, primarily through equity issuances, reserve based lending, and other alternative forms of debt financing. The Company actively manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile.

### *Cashflow from operations*

Cash generated from operating activities, funds flow, during the second quarter of 2014 was \$3.3 million down from \$27 million in the first quarter primarily due to the decline in revenues from production constraints, increase in operating expenses and the semi-annual settlement of the commodity hedges.

### *Cashflow from financing activities*

Cash used in financing activities during the second quarter of 2014 was \$0.3 million compared to 13.1 million in the first quarter primarily due to the Company's interest payment on the Bond in the first quarter.

### *Cashflow from investing activities*

Cash used in investing activities in the second quarter of 2014 was \$818,000 compared to \$65,000 in the first quarter primarily due to the Company settling its accounts payable from the first quarter in the second quarter.

The Company continues to be fully funded, with more than sufficient financial resources to cover its anticipated future commitments from its existing cash balance and forecast cash flow from operations. No unusual trends or fluctuations are expected outside the ordinary course of business.

As at June 30, 2014, the Company had net assets of \$163.5 million, working capital of \$88.8 million and \$29.9 million of commitments due in the next twelve months.

Under the senior secured bonds, capital expenditures are limited to assets within the borrowing base (currently Huntington, Trent & Tyne, Orlando, Kells and Ronan & Oran). Allowable capital expenditures include: a) all cash calls by the Operators; b) all capital costs; c) all costs of producing, lifting, transporting, storing, processing and selling associated hydrocarbons; d) all costs of reinstating damaged facilities; e) all costs of satisfying any liability in respect of seepage, pollution and well control; f) all insurance premiums and all the fees, costs and expenses; g) all exploration and appraisal expenditures; h) all costs of abandonment, and any payments to make provision for abandonment costs; i) all royalties and other amounts payable under any Petroleum production license; j) all general and administrative expenditures; k) loan repayments and finance costs; and l) any other costs, expenses or payments as agreed to by the Lenders.

## FINANCIAL RISKS

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Crude oil and natural gas operations involve certain risks and uncertainties. These risks include, but are not limited to, commodity prices, foreign exchange rates, credit, operational and safety.

Operational risks are managed through a comprehensive insurance program designed to protect the Company from significant losses arising from risk exposures. Risks associated with commodity prices, interest and exchange rates are generally beyond the control of the Company; however, various hedging products may be considered to reduce the volatility in these areas.

Safety and environmental risks are addressed by compliance with government regulations as well as adoption and compliance of the Company's safety and environmental standards policy.

The Company will be exposed to concentration of credit risk as substantially all of the Company's accounts receivable will be with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company mitigates this risk by entering into transactions with long-standing, reputable counterparts and partners. If significant amounts of capital are to be spent on behalf of a joint venture partner, the partner is "cash called" in advance of the capital spending taking place.

All derivative instruments are recorded in the balance sheet at fair value unless they qualify for the expected purchase, sale and usage exemption. All changes in their fair value are recorded in income unless cash flow hedge accounting is



used, in which case changes in fair value are recorded in other comprehensive income until the hedged transaction is recognized in net earnings.

The Company operates on an international basis and therefore foreign exchange risk exposures arise from transactions denominated in currency other than the United States Dollar. The Company is exposed to foreign currency fluctuations as it holds cash and incurs expenditures in property and equipment in foreign currencies. The Company incurs expenditures in Pound sterling, Euros, United States dollars and Canadian dollars and is exposed to fluctuations in exchange rates in these currencies. There are no exchange rate contracts in place as at or during the period ended December 31, 2013, or thereafter.

Assuming all other variables remain constant, a 1% increase or decrease in foreign exchange rates on the foreign cash and restricted cash balances at June 30, 2014 would have impacted the comprehensive loss of the Company for the six month period ended June 30, 2014 by approximately \$26,000 (six months ended June 30, 2013 – \$308,000).

In addition at June 30, 2014, the Company held approximately \$15,112,327 (£8,839,000) (2013 - \$30,053,000 (£19,760,000)) of accounts payable in Pound Sterling. Assuming all other variables remain constant, a 1% increase or decrease in foreign exchange rates at June 30, 2014 would impact the comprehensive loss of the Company for the six month period ended June 30, 2014 by approximately \$151,000 (six months ended June 30, 2013 - \$301,000).

## OUTSTANDING SHARE DATA

The Company has authorized an unlimited number of Common shares, without nominal or par value and unlimited number of preferred shares, issuable in series. The Company, as at the date of this MD&A had 366,830,868 Common Shares, and 28,300,000 stock options outstanding.

The following details the stock option structure as of the date of this MD&A:

<b>Date of Grant</b>	<b>Number Outstanding</b>	<b>Exercise Price CAD\$</b>	<b>Weighted Average Remaining Contractual Life</b>	<b>Date of Expiry</b>	<b>Number Exercisable</b>
May 31, 2011	7,850,000	\$0.60	0.92 years	May 31, 2015	7,850,000
April 13, 2012	13,040,000	\$0.57	2.79 years	April 12, 2017	10,252,500
January 10, 2013	175,000	\$0.59	3.53 years	January 10, 2018	175,000
March 5, 2013	5,110,000	\$0.63	3.68 years	March 5, 2018	2,705,000
July 29, 2013	175,000	\$0.59	4.08 years	July 29, 2018	175,000
October 23, 2013	600,000	\$0.63	4.32 years	October 23, 2018	150,000
May 1, 2014	1,350,000	\$0.54	4.84 years	May 1, 2019	337,500
	<b>28,300,000</b>				<b>21,645,000</b>

On May 1, 2014, Iona Energy issued 1,350,000 stock options to purchase 1,350,000 common shares of the Company to employees of the Company. The options were issued with an exercise price of \$0.54 per share, vest as to one quarter immediately and one quarter on each of the first, second and third anniversaries of the date of grant and have a five year term from the date of issuance.

## SUMMARY OF QUARTERLY RESULTS

(\$ thousands, except per share amounts)

	2014		2013				2012	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	<b>\$27,100</b>	<b>\$35,648</b>	33,797	18,082	11,843	1,858	-	-
Average Daily Production (boepd)								
Crude oil <sup>(1)</sup>	<b>2,284</b>	<b>3,475</b>	2,585	1,799	1,179	-	-	-
Natural Gas	<b>475</b>	<b>680</b>	765	927	655	316	-	-
Total	<b>2,759</b>	<b>4,155</b>	3,350	2,725	1,834	316	-	-
Net income / (loss)	<b>\$(28,027)</b>	<b>\$(338)</b>	31,553	899	9,117	(11,945)	(4,456)	(2,258)
Income / (loss) per share – basic	<b>(0.08)</b>	<b>(0.00)</b>	0.09	0.00	0.02	(0.03)	(0.01)	0.01
Income / (loss) per share – diluted	<b>(0.08)</b>	<b>(0.00)</b>	0.09	0.00	0.02	(0.03)	(0.01)	0.01
Funds Flow	<b>3,345</b>	<b>27,088</b>	28,225	11,397	3,911	(1,751)	(1,649)	(1,448)
Funds Flow per share – basic	<b>0.01</b>	<b>0.07</b>	0.08	0.03	0.01	(0.01)	(0.01)	(0.00)
Funds Flow per share – diluted	<b>0.01</b>	<b>0.07</b>	0.08	0.03	0.01	(0.01)	(0.01)	(0.00)
Adjusted EBITDA	<b>9,647</b>	<b>27,143</b>	27,936	12,737	3,001	3,281	(4,499)	(2,321)
Adjusted EBITDA per share – basic	<b>0.03</b>	<b>0.07</b>	0.08	0.03	0.01	0.01	(0.01)	(0.01)
Adjusted EBITDA per share – diluted	<b>0.03</b>	<b>0.07</b>	0.08	0.03	0.01	0.01	(0.01)	(0.01)
Working capital surplus/ (deficit)	<b>88,847</b>	<b>88,776</b>	79,075	71,247	(155,367)	(47,275)	(34,897)	40,863
Total assets	<b>\$544,072</b>	<b>\$545,159</b>	545,079	631,690	516,606	513,002	204,566	182,253
Weighted average common shares - basic	<b>366,831</b>	<b>366,831</b>	360,849	366,824	377,060	342,597	324,905	324,905
Weighted average common shares – fully diluted	<b>366,831</b>	<b>366,831</b>	363,078	366,824	377,060	342,597	324,905	324,905

<sup>(1)</sup> Q2 2013 production has been adjusted for start of production for Huntington on April 12, 2013.

Comparative information has been restated to reflect the change in presentation currency from Canadian to US Dollar using the average rate in each respective quarter.

Revenue, Funds Flow and Adjusted EBITDA increased substantially throughout 2013, due to a successful drilling program and two business combinations (Huntington and Trent & Tyne) with the Huntington Field sustaining peak production for significant periods in Q4 2013 and Q1 2014. Revenue declined in Q2 2014 as a result of unplanned shutdowns of the Voyageur FPSO and within the Central Area Transmission System (“CATS”). This decrease in revenue significantly impacted net income in Q2 2014. Fluctuations in production and the Brent benchmark price have also contributed to the fluctuations in oil and gas sales.

The significant net income amounts generated in Q4 2014 was primarily due to the recognition of previously unrecognized deferred tax assets in that period. These tax assets were unrecognized as prior to Q4 2013 Huntington had not yet been able to sustain peak production.

## CRITICAL ACCOUNTING ESTIMATES

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The Company's management made judgements, assumptions and estimates in the preparation of the financial statements. Actual results may differ from those estimates. The accounting policies applied by the Company are described in Note 3 of the audited consolidated financials statements as at and for the year-ended December 31, 2013.

The preparation of financial statements requires management to make estimates and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future periods could require a material change in the financial statements. Accordingly, actual results may differ from the estimated amounts as future confirming events occur. Significant estimates and judgments made by management in the preparation of these consolidated financial statements are as follows:

The operations of the Company are complex, and regulations and legislation affecting the Company are continually changing.

The financial statements include accruals based on the terms of existing joint venture agreements. Due to varying interpretations of the definition of terms in these agreements the accruals made by management in this regard may be different from those determined by the Corporation's joint venture partners. The effect on the consolidated financial statements resulting from such adjustments, if any, will be reflected prospectively.

The Company's operations change significantly each reporting period, this change can impact the functional currencies of the Company and its subsidiaries. Management makes judgements each reporting period as to the appropriateness of the existing functional currencies and makes changes when the facts and circumstances warrants. These changes could have material impact on the consolidated financial statements in future periods.

Amounts that will be recorded for depletion and depreciation and amounts used for impairment calculations are based on estimates of petroleum and natural gas reserves. By their nature, the estimates of reserves, including the estimates of future prices, costs, discount rates and the related future cash flows, are subject to measurement uncertainty. Accordingly, the impact to the consolidated financial statements in future periods could be material.

Oil and natural gas assets are aggregated into cash-generating units based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's cash-generating units is subject to Management's judgment.

The decision to transfer assets from exploration and evaluation to property, plant and equipment is based on the estimated recoverable reserves used in the determination of an area's technical feasibility and commercial viability. As such there is judgment in determining the timing of these transfers.

Compensation costs recognized for share based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as the Black-Scholes model which is based on significant assumptions such as volatility, dividend yield and expected term. These are recognized over the vesting term and the underlying options.

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such income taxes are subject to measurement uncertainty.

Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

## CHANGE IN FUNCTIONAL AND PRESENTATION CURRENCY

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These consolidated financial statements are presented in United States dollars ("US dollars"). The functional currency of Iona Energy Inc. is Canadian dollars. The functional currencies of the Company's foreign subsidiaries are US dollars. The Company changed the functional currency of Iona Energy Company (UK) Limited ("Iona UK") from Pounds Sterling to US dollars with effect from October 1, 2013. This change was triggered by the achievement of plateau oil and gas production in the Huntington field and the issuance of \$275 million of US denominated debt by Iona UK. Oil and gas prices received by the Company are benchmarked against the US Dollar Brent oil standard. The statement of financial position of Iona UK was translated to US dollars at the October 1, 2013 rate of 1.6204 GBP per 1 USD. Transactions impacting the statement of operations and comprehensive income were translated to US dollar using rates which

approximate the rates at the date of transaction. The resulting gains and losses were recorded in the statement of comprehensive income.

In 2013, the Company changed its presentation currency from the Canadian dollars ("CAD") to the US dollar. These consolidated financial statements are presented in US dollars, which is the Company's presentation currency. The change in presentation currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the oil and gas industry. In making this change to the US dollar presentation currency, the Company followed the guidance in IAS 21 The Effects of Changes in Foreign Exchange Rates and have applied the change retrospectively as if the new presentation currency had always been the Company's presentation currency. In accordance with IAS 21, the financial statements for all years and periods presented have been translated to the new US dollar presentation currency. For the 2013 comparative balances, assets and liabilities have been translated into the presentation currency (US dollars) at the rate of exchange prevailing at the reporting date. The statements of comprehensive income (loss) were translated at the average exchange rates for the reporting period, or at the exchange rates prevailing at the date of transactions. Exchange differences arising on translation were taken to the foreign currency translation reserve in shareholders' equity.

## **ACCOUNTING POLICY CHANGES**

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### *Changes in accounting policies*

As of January 1, 2014, the Company adopted several new IFRS interpretations and amendments in accordance with the transitional provisions of each standard. A brief description of each new accounting policy and its impact on the Company's financial statements follows below.

- IAS 36 "Impairment of Assets" has been amended to reduce the circumstances in which the recoverable amount of cash generating units "CGUs" is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact Iona's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.
- IAS 39 "Financial Instruments: Recognition and Measurement" has been amended to clarify that there would be no requirement to discontinue hedge accounting if a hedging derivative was novated, provided certain criteria are met. The retrospective adoption of the amendments does not have any impact on Iona's financial statements.
- IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation does not have any impact on Iona's financial statements.

### *Future Changes in Accounting Policies*

Iona has reviewed new and revised accounting pronouncements that have been issued but are not yet effective. The Company is currently evaluating the impact of the adoption of these standards and amendments. The adoption of these standards and amendments are not expected to significantly impact the Company.

In February 2014, the IASB tentatively decided to require an entity to apply IFRS 9 "Financial Instruments" for annual periods beginning on or after January 1, 2018. IFRS 9 is still available for early adoption. The full impact of the standard on Iona's financial statements will not be known until changes are finalized.

## **RISKS AND UNCERTAINTIES**

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Management defines risk as the evaluation of probability that an event might happen in the future that could negatively affect the financial condition and/or results of operations of Iona. The following section describes specific and general risks that could affect the Company. The following descriptions of risk do not include all possible risks, as there may be other risks of which management is currently unaware. Moreover, the likelihood that a risk will occur or the nature and extent of its consequences if it does occur, are not possible to predict with certainty, and the actual effect of any risk or its consequences on the business could be materially different from those described below.

### *Reliance on Third Parties*

To the extent Iona is not the operator of its oil and natural gas properties, Iona will be dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators including the operators with respect to the Huntington and Trent & Tyne properties.

### *Foreign Operations*

Presently, all of Iona's oil and gas operations and assets are located in foreign jurisdictions. As a result, Iona is subject to political, economic and other uncertainties, including but not limited to changes, sometimes frequent and applied retroactively, in energy policies or the personnel administering them, nationalization, expropriation of property without fair compensation, cancellation or modification of contract rights, foreign exchange restrictions, currency fluctuations, royalty and tax increases, and other risks arising out of foreign governmental sovereignty over the areas in which Iona's operations are conducted, as well as risks of loss due to civil strife, acts of war, guerilla activities and insurrections. Changes in legislation may affect Iona's oil and natural gas exploration and production activities. Iona's international operations may also be adversely affected by laws and policies of Canada as they pertain to foreign trade, taxation and investment.

Iona's subsidiary, Iona UK, was incorporated under the laws of Scotland. In addition, substantially all of Iona's oil and gas assets are located in the U.K. North Sea. The government of Scotland has proposed terms upon which Scotland could secede from the United Kingdom. If all required governmental approvals are obtained and such proposal for secession is implemented, Iona may be subject to substantial changes in legislation, including taxation and environmental legislation. The effect upon Iona of any such proposed changes being implemented is uncertain at this time.

In the event of a dispute arising in connection with its foreign operations, Iona may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdiction of courts in Canada or enforcing Canadian judgments in foreign jurisdictions. In addition, Iona's existing joint ventures and its subsidiaries were formed pursuant to, and their operations are governed by, a number of complex legal and contractual relationships. The effectiveness of and enforcement of such contracts and relationships with parties in these jurisdictions cannot be assured. Consequently, Iona's foreign exploration, development and production activities could be substantially affected by factors beyond Iona's control, any of which could have a material adverse effect on Iona.

### *Production Concentration*

The Company's anticipated revenue for 2013 and 2014 is dependent upon production rates from the Company's Huntington and the Trent & Tyne fields as well as prevailing oil and natural gas prices in the UK marketplace. The Company is dependent upon revenue from these fields to service future obligations, including future obligations relating to the Bonds. The Company's current production is concentrated to a limited number of wells which are tied back to two production platforms (one for Huntington production and one for Trent & Tyne production). A decrease in production from the Huntington field or the Trent & Tyne field for any reason, including if the actual reserves associated with such fields are lower than the Company's estimated reserves for such fields, could have an adverse impact on the Company's operating results, financial position or ability to service its obligations. Additionally, issues at either of the two production platforms which constrain, delay or limit production, including without limitation, unanticipated delays, shutdowns, mechanical problems, extreme weather conditions or production curtailments by the facility operators, could also have an adverse impact on the Company's operating results, financial position or ability to service its obligations.

### *Financing Requirements and Liquidity*

It may take many years and substantial cash expenditures to pursue exploration activities on Iona's existing undeveloped properties. Accordingly, Iona is likely to need to raise additional funds from outside sources in order to explore and develop its properties in a timely manner. Additionally, unexpected delays may result in significant increases in the capital expenditures required to develop projects.

Iona's financing risk relates to the availability and cost of equity or debt financing and is affected by many factors, including world and regional economic conditions, the state of international relations, the stability and the legal, regulatory, fiscal and tax policies of various governments in areas of operation, fluctuations in the world and regional price of oil and gas and in interest rates, the outlook for the oil and gas industry in general and in areas in which Iona has or intends to have operations, and competition for funds from possible alternative investment projects. Although there have been improvements in the global economy and financial markets in recent months, there continues to be restrictions on the availability of credit which may limit Iona's ability to access debt or equity financing for its development projects.

Potential investors and lenders will be influenced by their evaluations of Iona and its projects, including their technical difficulty, and comparison with available alternative investment opportunities.

Iona continuously monitors its cash position, capital commitments and future capital requirements in order to ensure sufficient liquidity and capital resources are available. In the event that adequate funds from credit/loan facilities, suitable aligned partners or cashflows are not attained; Iona may be required to scale back certain projects or to raise additional funds.

Iona is also dependent upon continued access to the proceeds of the Bond offering to fund its development projects. An inability to access the proceeds of the Bond offering for any reason, including non-compliance with the operating covenants contained in the Bond Agreement may have a material adverse effect on Iona and its operations.

#### *Loss from Operations*

Iona had a deficit as at June 30, 2014 of \$15,632,000 and retained earnings of \$12,733,000 as at December 31, 2013. No assurance can be given that Iona will not experience operating losses or write-downs of its oil and gas properties in the future.

#### *Volatility of Crude Oil and Natural Gas Prices*

Crude oil and natural gas are commodities that are sensitive to numerous worldwide factors, which are beyond Iona's control, and are generally sold at contract or posted prices. Changes in world crude oil and natural gas prices may significantly affect Iona's results of operations and cash generated from operating activities. Consequently, such prices may also affect the value of Iona's oil and gas properties and the level of spending for oil and natural gas exploration and development.

Iona's crude oil prices are based on various reference prices, primarily the WTI crude oil reference price and other reference prices such as UK Brent Light. Occasionally a differential in price exists between WTI and UK Brent Light. Adjustments are made to the reference price to reflect quality differentials and transportation. WTI and other reference prices are affected by numerous and complex worldwide factors such as supply and demand fundamentals, economic outlooks, production quotas set by the Organization of Petroleum Exporting Countries ("OPEC") and political events. Occasionally quality differentials are affected by local supply and demand factors.

Any material declines in prices could result in a reduction of Iona's net production revenue. The economies of producing from some wells may change as a result of lower prices, which could result in a reduction in the volumes of Iona's reserves and Iona limiting or abandoning an exploration program on its undeveloped properties. Iona might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Iona's net production revenue. All of Iona's expenditures are subject to the effects of inflation and prices received for the product sold are not readily adjustable to cover any increase in expenses from inflation.

#### *Hedging*

From time to time the Company may enter into agreements such as the Payment Swap and the hedging agreements entered into with the lenders in the Loan Facility to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, the Company will not benefit from such increases and the Company may nevertheless be obligated to pay royalties on such higher prices, even though such higher prices are not received by it, after giving effect to such agreements.

#### *Offshore Exploration*

Iona faces additional risks when conducting offshore activities. In particular, drilling conditions, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity, or other geological and mechanical conditions. Sub-sea tiebacks in the UK North Sea, while common, are also affected by weather conditions. Potential pipeline tie-backs can only be conducted from April to late September. Offshore oil and gas activities can also be affected by extreme weather and ocean phenomena arising from occurrences such as hurricanes and tsunamis. Due to general industry response to the BP Macondo Gulf of Mexico, it may be that extra delays in permitting and increased costs with respect to insured operations, oil spill mitigation and clean up will be incurred.

#### *Availability of Drilling Equipment and Access Restrictions*

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to Iona and may delay exploration and development activities. Iona is subject to the relatively limited availability of offshore drilling rigs to proceed with its UK North Sea drilling program.

#### *Access to Production Facilities and Pipelines*

Access to facilities and pipelines to process field production is an important consideration when developing fields in the North Sea. Such access is not guaranteed and directly affects the economics of a project. The United Kingdom government with the assistance of DECC has introduced a policy which has been adopted by the major operators of facilities in the North Sea that should allow access to facilities at a reasonable rate.

These types of initiatives are intended to ensure that reserves that cannot support facilities on a stand-alone basis can be developed.

#### *Conflicting Interests with Partners*

Joint venture, acquisition, financing and other agreements and arrangements must be negotiated with independent third parties and, in some cases, must be approved by governmental agencies. These third parties generally have objectives and interests that may not coincide with Iona's interests and may conflict with Iona's interests. Unless the parties are able to compromise these conflicting objectives and interests in a mutually acceptable manner, agreements and arrangements with these third parties will not be consummated.

In certain circumstances, the concurrence of co-venturers may be required for various actions. Other parties influencing the timing of events may have priorities that differ from Iona's, even if they generally share Iona's objectives. Demands by or expectations of governments, co-venturers, customers, and others may affect Iona's strategy regarding the various projects. Failure to meet such demands or expectations could adversely affect Iona's participation in such projects or its ability to obtain or maintain necessary licences and other approvals.

#### *Changes to Development Plans*

Development plans for the Company's properties are based on management's estimates as of the date of this MD&A. Development plans may change as a result of new information, events or as a result of business decisions. Any such changes could have a material effect on the Company's proposed capital expenditures and the timelines associated with the development of the Company's properties.

#### *Foreign Currency Rate Risk*

A significant portion of Iona's activities is transacted in or referenced to United States dollars, Canadian dollars or British Pounds Sterling. Iona's operating costs and certain of Iona's payments, in order to maintain property interests, is incurred in the local currency of the jurisdiction where the applicable property is located. As a result, fluctuations in the Canadian dollar and British pounds sterling against the United States dollar, and each of those currencies against any other local currencies in jurisdictions where properties of Iona are located, could result in unanticipated fluctuations in Iona's financial results which are denominated in US dollars. Iona has not entered into any risk management contracts to hedge its exposure to foreign exchange rates.

#### *Commodity Price Risk*

From time to time Iona may enter into agreements to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, Iona would not benefit from such increases.

#### *Governmental Regulation*

The petroleum industry is subject to regulation and intervention by governments in such matters as the awarding of exploration and production interests, the imposition of specific drilling obligations, environmental protection controls, control over the development and abandonment of fields (including restrictions on production) and possibly expropriation or cancellation of contract rights. As well, governments may regulate or intervene with respect to price, taxes, royalties and the exportation of oil and natural gas. Such regulations may be changed from time to time in response to economic or political conditions. The implementation of new regulations or the modification of existing regulations affecting the oil and gas industry could reduce demand for natural gas and crude oil, increase costs and may have a material adverse impact on Iona. Export sales are subject to the authorization of provincial and federal government agencies and the corresponding governmental policies of foreign countries. Development of reserves and rates of return are also susceptible to changes in national fiscal policy.

The UK government does not assess a crown royalty against production. The current tax regime in the UK is favorable to companies of the Iona's size in that it allows full deductions of appraisal and development expense before any tax is payable. As of January 1, 2006, the supplementary tax rate applicable to North Sea oil and gas companies rose from 10% to 20%. This change resulted in an effective rate of corporation tax of 30% of profits after all capital and operating costs have been recovered, and an effective supplementary rate of 20% on profits after all capital and operating costs (excluding finance costs) have been recovered, resulting in an effective combined base and supplementary tax rate of no less than 50%. In 2009, a number of reforms were introduced to the North Sea fiscal regime aimed at fostering

developments in smaller fields as well as more complex high pressure/high temperature and heavy oil fields. The smaller field relief is granted in respect of fields less than 20 MMbbls and is a potential benefit to Iona. Further favorable tax reforms were announced in January 2010 in which the additional tax allowances were extended to gas fields in frontier areas.

On March 24, 2011, the supplementary tax rate applicable to North Sea oil and gas companies increased unexpectedly from 20% to 32%. As a result, the effective combined base and supplementary tax rate rose from 50% to 62%.

On March 21, 2012, the UK Government increased the Small Field Allowance (“SFA”) tax shelter availability from the 32% Supplemental tax charge for small developments. The size of fields that qualify for full SFA was increased to include all fields with reserves of under 45 MMboe and the tax allowance available to each field has been doubled from approximately \$120 million to \$240 million. The expectation is that this change will materially reduce the future effective tax rate of the Company.

During September 2012, the UK Government announced the Brown Field Allowance (“BFA”), which is a new tax relief to encourage investment in older oil and gas fields. The BFA will shield up to £250m of income in qualifying brown field projects, or £500m for projects in fields paying Petroleum Revenue Tax, from the 32% Supplementary Charge rate (providing tax relief of up to £80m or £160m respectively). The level of relief available to an individual project will depend on its size and unit costs. A qualifying project will be an incremental project increasing expected production from an offshore oil or gas field as described in a revised consent for development which is authorized by DECC on or after September 7, 2012, and has verified expected capital costs per tonne of incremental reserves in excess of £60. The maximum level of allowance will be £50/tonne and will be available to projects with verified expected capital costs of £80/tonne or above. The Company welcomes this announcement and hopes to utilize it on its qualifying projects in the future.

Based on Iona's present stage of development, Iona is able to avail itself of tax efficiencies with respect to tax pools and small field allowances and therefore expects the supplementary tax rate changes to have a small but negative effect on the present net worth of Iona's reserves. Any further changes to these laws would impact the net present worth of Iona's reserves. No assurances can be given that such an event would not re-occur.

#### *Strategic Partnerships*

As part of its development plan in the North Sea, Iona may consider the formation of strategic partnerships, potentially sharing development costs and, where appropriate, the acquisition or exchange of working interests. There is no assurance that any such strategic transaction will be entered into. If such strategic transaction is entered into, there is no assurance that such transaction will be successful.

#### *Write-Off of Unsuccessful Properties and Projects*

In order to realize the carrying value of its oil and gas properties and ventures, Iona must produce oil and gas in sufficient quantities and then sell such oil and gas at sufficient prices to produce a profit. Iona has a number of non-producing oil and gas properties. The risks associated with successfully developing such oil and gas properties are even greater than those associated with successfully continuing development of producing oil and gas properties, since the existence and extent of commercial quantities of oil and gas in unevaluated properties have not been fully established. Iona could be required to write-off some or all of its non-producing oil and gas properties if such projects prove to be unsuccessful.

#### *Insurance*

Iona's operations are subject to the risks normally associated with the operation and development of oil and natural gas properties and the drilling of oil and natural gas wells, including encountering unexpected formations or pressures, blowouts, cratering and fires, all of which could result in personal injuries, loss of life and damage to the property of Iona and others. In accordance with customary industry practice, Iona is not fully insured against all of these risks, nor are all such risks insurable. Damages and losses occurring as a result of such risks may give rise to claims against Iona.

Although Iona believes that it, or where applicable the operator, will carry adequate insurance with respect to its operations in accordance with industry practice, in certain circumstances Iona's, or where applicable the operator's, insurance may not cover or be adequate to cover the consequences of such events. The payment of such uninsured liabilities would reduce the funds available to Iona. The occurrence of a significant event that is not covered or not fully covered by insurance, or the insolvency of the insurer of such event, could have a materially adverse effect on the business, financial condition and results of operations of Iona. Moreover, there can be no assurance that Iona will be able to maintain adequate insurance in the future at rates that it considers reasonable.



### *Regulatory Approvals*

The further development of Iona's properties requires the approval of applicable regulatory authorities to the plans of Iona with respect to the drilling and development of such properties. A failure to obtain such approval on a timely basis or material conditions imposed by such authority in connection with the approval would materially affect the prospects of Iona.

### *Dilution from Further Equity Issuances*

If Iona issues additional equity securities to raise additional funding or as consideration for the acquisition of a company or assets, as the case may be, such transactions may substantially dilute the interests of Iona Shareholders, and reduce the value of their respective investment.

### *Dividends*

The Company has neither declared nor paid any dividends on its Ordinary Shares since the date of its incorporation. Any payments of dividends on the Ordinary Shares of the Company will be dependent upon the financial requirements of the Company to finance future growth, the financial condition of the Company and other factors, which the Company's board of directors may consider appropriate in the circumstance. It is unlikely that the Company will pay dividends in the immediate or foreseeable future.

For additional information regarding the Company's risks and uncertainties, please refer to the Company's annual information form for the year ended December 31, 2013, which is available on SEDAR under the Company's profile at [www.sedar.com](http://www.sedar.com).

## **Notes Regarding Oil and Gas Disclosure**

As used in this MD&A, "boe" means barrel of oil equivalent on the basis of 6 mcf of natural gas to 1 bbl of oil. Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

It should not be assumed that the present worth of estimated future net revenue represents the fair market value of the reserves disclosed in this MD&A. The reserve and related revenue estimates set forth in this MD&A are estimates only and the actual reserves and realized revenue may be greater or less than those calculated. The estimates of reserves and future net revenue for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties, due to the effects of aggregation.

As used in this MD&A, "possible reserves" are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

All contingent resources and prospective resources estimates herein relating to Ronan and Oran have been prepared by a non-independent qualified reserves evaluator of the Company, effective as of April 25, 2014.

"contingent resources" is defined in the Canadian Oil and Gas Evaluation Handbook as 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. Contingencies may include factors such as economic, legal, environmental, political, and regulatory matters, or a lack of markets. It is also appropriate to classify as contingent resources the estimated discovered recoverable quantities associated with a project in the early evaluation stage. Contingent Resources are further classified in accordance with the level of certainty associated with the estimates and may be sub-classified based on project maturity and/or characterized by their economic status.

1C, 2C and 3C refer to the low estimate, best estimate, and high estimate, respectively, of contingent resources. The Ronan and Oran fields are currently at an early stage of evaluation and require further analysis to confirm their economic viability. Additionally, the resources in each of these fields are currently classified as Contingent Resources rather than reserves due to the current lack of access to infrastructure in the region for each field. Additional drilling and testing are required to confirm volumetric estimates and reservoir productivity for the Contingent Resources to be classified as reserves.

The Contingent Resources estimates are estimates only and the actual results may be greater than or less than the estimates provided herein. There is no certainty that it will be commercially viable or technically feasible to produce any portion of the 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 and a chance of development. Prospective resources are further subdivided in accordance with the level of certainty associated with recoverable estimates assuming their discovery and development and may be sub classified based on project maturity. There is no certainty that any portion of the undiscovered resources will be discovered. If a discovery is made, there is no certainty that it will be commercially viable to produce any portion of the resources nor can there be any certainty regarding the timing of any such development.

Additionally, this MD&A uses certain abbreviations as follows:

<b>Oil and Natural Gas Liquids</b>		<b>Natural Gas</b>	
bbls	barrels	mcf	thousand cubic feet
Mbbls	thousand barrels	mcf/d	thousand cubic feet per day
MMbbls	million barrels	MMcf	millions of cubic feet
MMboe	million barrels of oil equivalent	MMcf/d	millions of cubic feet per day
boepd	barrels of oil equivalent per day	Bscf	billion standard cubic feet
bopd	barrels of oil per day		
NGLs	natural gas liquids		

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