Volga Gas plc Annual Report and Accounts 2012

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Volga Gas plc is an independent oil and gas exploration and production company focused on the Volga Region of Russia. It has 100% interests in five oil and gas exploration and production licences in the Saratov and Volgograd regions

Business Overview

Review of 2012

- Completed first two phases of Dobrinskoye gas processing plant upgrade
- Commenced full time production from the Vostochny Makarovskoye gas/condensate field
- Recommenced production from Dobrinskoye field after well sidetracks
- Steady production from the Uzenskoye oil field
- Independent assessment of reserves completed giving combined 2P reserves of 44 million barrels of oil equivalent and NPV of US$301.2 million

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Business Overview

Volga at a Glance

Our assets are located in an established oil and gas province. The area benefits from the existing rail, road and pipeline infrastructure and proximity to Russia's main energy markets.

Dobrinskoye gas processing plant

2012 Progress
Completed the first two phases of the gas plant upgrade – upgrade of the sulphur extraction capability and to the condensate separation capacity to enable processing of gas from the Vostochny Makarovskoye field.

2013 Objectives
Complete third phase of the gas plant upgrade and to achieve certification of plant processing capacity of up to 1 million cubic metres per day (35.3 million cubic feet per day).

Dobrinskoye gas/ condensate field

2012 Progress
Drilled and completed sidetracks to wells #22 and #26 on the Dobrinskoye field and achieved significant increases in production.

2013 Objectives
Manage production from the two existing wells to maximise long-term extraction of gas and condensate.

Vostochny Makarovskoye gas/ condensate field

2012 Progress
Workover of well #30 to provide an additional production well on the field. Completed hook up of production wells to the gas processing facility and commenced full time production of gas and condensate in October 2012.

2013 Objectives
Drilling of sidetrack to well VM#4 and of a new well, VM#3 to increase production capacity and utilise the planned increase in gas plant capacity.

Uzenskoye oil field

2012 Progress
Production maintained for a fourth year, averaging 1,050 barrels of oil per day ("bopd") (2011: 1,178 bopd).

2013 Objectives
Maintain/enhance production profile and maximise extraction of oil from existing wells.

Exploration activity

2012 Progress
Completed exploration wells in each of the Urozhainoye-2 and Pre-Caspian licence areas in line with licence commitments but without commercial success.

2013 Objectives
Complete evaluation of production potential of the Sobolevskoye oil discovery in Urozhainoye-2 licence area.

Business Overview

Chairman's Statement

Dear Shareholder,

2012 has been a pivotal year for Volga Gas, with the main focus of the Company on completion of a project to upgrade the Dobrinskoye gas plant to enable the start of commercial production from the Group's largest field, Vostochny Makarovskoye. While this work was under way, there was extended disruption to production from the other gas field, Dobrinskoye, as a result of which overall production realised in 2012 of 1,995 barrels of oil equivalent per day ("boepd") was slightly less than in 2011. Nevertheless, as we exit 2012 and start 2013, Volga Gas has three fields in commercial production and, following the anticipated increase in gas processing capacity, is poised to increase production significantly during 2013.

Improved realisations from our oil production, which has remained steady through 2012, partly offset lower gas production and helped the Group maintain its relatively strong cash flow.

The cash generating capability of the fields was also an important factor in the Group's ability to secure its first commercial debt facility which was drawn down during the first half of 2012. This facility was utilised to support the Group's short- and medium-term investment strategy and provided extra financial flexibility as we drive production growth in 2012 and 2013.

The Group has significant proven reserves in its three principal fields, which were subject to an independent evaluation during 2012. These fields form the basis of short-term growth in production. Our fields are advantageously located and our costs are sufficiently low for us to achieve good returns at oil and gas prices significantly lower than those we currently experience. Most importantly, these assets provide a strong platform for the Group to grow in the future, both through successful exploration and by selective value accretive acquisitions.

Volga Gas has identified material exploration prospects within existing acreage that can be tested at low cost.

During 2013, the strategic priority of the Group will be to enable full production from the existing wells in the Vostochny Makarovskoye field and to continue the development drilling on that field. The Board is also evaluating opportunities to extend the Group's activities into new areas, where we have identified the potential to add significant value and incremental production volumes.

The Board believes that Volga Gas has a strong asset base and the financial and operational capability to develop and extend these assets to provide long-term value growth for our shareholders.

Aleksey Kalinin
Chairman

US$7m

Cash balance at the end of 2012

Business Overview

Chief Executive's Report

Volga Gas reached a key milestone in 2012 with first commercial production of gas and condensate with its largest field, Vostochny Makarovskoye ("VM"). This followed from the successful completion of the first two phases of the upgrade to the gas processing plant located at the Dobrinskoye field site, 5 km from the VM field. The Dobrinskoye field and gas plant were both acquired in 2011 through the purchase of Gazneftedobycha. Another significant event of 2012 was the completion of an independent evaluation of our oil, gas and condensate reserves under SPE standards. The study , by Miller and Lents Ltd, with an effective date of 1 August 2012, confirmed the total Proven and Probable Reserves of the Group at 44.0 million barrels of oil equivalent ("mmboe") and gave a net present value ("NPV") of US$301.2 million (with a 10% per annum discount rate) to those reserves. Of these reserves, the overwhelming majority are classified as Proven.

As detailed in the Operational Review below, the majority of the work done on our producing assets base was focused on the two gas fields. On VM, the Group added to the wells drilled in earlier years by recompleting an old exploration well, #30, into a third production well. On the Dobrinskoye field, both of the production wells have been sidetracked with the aim of restoring production to earlier levels on this field. The third producing field, Yuzhny Uzenskoye, in the Karpenskiy licence area, produced steadily for its fourth full year of production.

For much of 2012, our gas and condensate production was limited to the output from a single well on Dobrinskoye and was, indeed, shut in while the construction on the gas plant upgrade project was completed. Thus, although with volumes from VM the final quarter saw a rise in production to over 2,500 boepd, aggregate production in 2012, of 1,995 boepd, was slightly lower than 2011. Consequently the revenue and EBITDA performance of the Group in 2012 reflected this lower production. See the Financial Report on pages 8 and 9 for details.

In 2012, exploration activity was limited to the fulfilment of exploration licence commitments in the Urozhainoye-2 and Pre-Caspian licence areas. Drilling operations on two wells, one in each licence area, concluded in 2012 without discovering potentially commercial hydrocarbons and both wells have been plugged and abandoned.

Our key strategic objective is to complete the last phases of the Dobrinskoye gas plant upgrade, with the intention of increasing permitted processing capacity fourfold to 1 million cubic metres per day (35 million cubic feet per day) and to bring the VM field into full scale production. The latter will require further development drilling of two wells, which is planned to take place in 2013 and 2014.

While the immediate strategic objective is to bring our existing assets into peak production, we remain active in our search for complementary assets to expand our business.

Finance

Historically, the Group's investments in exploration and capital expenditure have been funded from equity and cash generated from operational activities. Now that the Group's assets have established a track record of reliable cash generation, the Board decided that it is an appropriate time to bring bank debt into the capital structure of the Group. On 26 March 2012 the Group arranged its first debt facility, with ZAO Raiffeisen Bank, for a sum of US$10 million.

Current trading

In January and February 2013, production from the Dobrinskoye, VM and Uzenskoye fields averaged 2,679 boepd. Having produced water-free oil for four years, we are beginning to see some water cut in Uzenskoye as a result of which we plan to install water separation facilities at the field shortly, a modest investment of less than US$1.0 million. With oil and condensate prices remaining firm and an 11.6% increase in our gas sales price since the start of the year to an equivalent of US$2.62 per mcf, Volga Gas continues to experience positive net operating cash flow.

Outlook

Key activities for 2013 will be the ongoing management and development of existing production across the portfolio. The Group's priority is to achieve the targeted fourfold increase in the Dobrinskoye gas plant capacity and to extend the well production to utilise this capacity to the maximum extent. It is our current expectation that works on the final stage of the upgrade will be completed during Q3 2013 from when, subject to obtaining the necessary permits, it would be possible to operate the plant at the higher capacity.

With three wells on the VM field and two recently worked over wells on the Dobrinskoye field, the wellhead capacity is higher than the currently permitted plant throughput. Nevertheless, during 2013 and 2014 we intend to bring further wells into production on VM by sidetracking the previously drilled well VM#4 and by drilling new wells, VM#3 and VM#5.

We are managing the oil production on the Yuzhny Uzenskoye field pending installation of water separation equipment but expect overall output from the field to remain steady at approximately 1,000 bopd. Meanwhile in the Urozhainoye-2 licence area, a successful workover recently carried out on the Sobolevskaya #11 well, which was originally drilled by a former licensee, will provide a new stream of oil production after we install production facilities at the well site.

We look forward to delivering a successful new stream of production while also pursuing the other growth opportunities that we see for the business.

Mikhail Ivanov
Chief Executive Officer

Business Overview

Operational Review

Operations overview

The key event for the Group in 2012 was the completion of the first two stages of the upgrade to the Dobrinskoye gas processing plant which enabled the start-up of commercial production from the Vostochny Makarovskoye gas field. This represents a turning point for the Group's production activities with all three of the fields now in production.

The overall level of production in 2012, at 1,995 boepd was below the 2,114 boepd achieved in 2011. The cause for the lower output was the Dobrinskoye gas/condensate field being subject to extended periods of shut down pending drilling of sidetracks to the two production wells – both completed during 2012 – and for the installation of the process plant upgrades at the Dobrinskoye gas plant. Consequently revenues and EBITDA levels in 2012 were both lower than those of 2011. Full details are discussed in the Financial Review.

During 2012, two exploration wells were completed in fulfilment of outstanding licence obligations. Neither of these was commercially successful and the costs related to these wells were expensed.

Gas processing plant upgrade

The Group gained ownership of the producing Dobrinskoye gas/condensate field and the gas processing plant via the acquisition of Gazneftedobycha in April 2011. Ownership of the processing infrastructure and access to the Gazprom trunk line enabled the VM field to commence commercial production.

Following a successful test of the chemical process to be used for sulphur extraction, the plan for the gas plant upgrade was approved at the end of 2011. The first stage of the upgrade, aimed at increasing processing capacity and enhancing H2S extraction, was completed in September 2012 and gas from the VM field started flowing through the plant from the beginning of October 2012.

The build-up of production from VM has been gradual as a series of tests have been carried out to optimise the process flow. The plant normally operates at its current permitted capacity of 250,000 cubic metres per day (approximately 9 million cubic feet per day ("mmcf/d")).

The final stages of the plant upgrade, currently under way, are intended to raise the processing capacity of the plant to 1 million cubic metres per day (35 mmcf/d). The key construction elements are upgrades to the condensate processing and storage facilities and an upgrade to the safety flaring system in the plant. Following completion of these, the plant can be certified by the regulatory authorities to operate at full capacity. The equipment required for the processing and storage upgrade has been delivered to the plant site and construction and installation is close to completion. For the flaring system, the major long lead items have been delivered. The physical completion of the work is anticipated during the first half of 2013, after which regulatory approval of the increased throughput will be sought.

The Group has spent approximately US$6.0 million to date on the upgrade project.

Vostochny Makarovskoye gas/condensate field

The VM field is the Group's largest in terms of its reserves, representing some 74% of the Group total Proven and Probable reserves. Although the initial production wells were drilled in 2008 and 2009, full time production was held up pending the resolution of various legal and commercial matters relating to gas processing. These issues were finally resolved in April 2011 when the Group acquired the Dobrinskoye gas field and processing facility and as mentioned above, full time production commenced in October 2012 on completion of the first two phases of the gas plant upgrade.

In addition to the existing production wells, a previously suspended exploration well, #30, drilled and tested by a previous licensee in the Bobrikovskiy sandstone formation, was worked over and recompleted in April 2012. After the recompletion under a series of production tests the well flowed at a rate of 161,890 cubic metres per day (approximately 5.7 mmcf/d) through a 10 mm choke. Management estimates that when placed on permanent operation, the production rates for the well will exceed 100,000 cubic metres per day (3.5 mmcf/d) with condensate of approximately 20 cubic metres (125 barrels) per day.

During the early months of 2012, the Group continued with its extended pilot production programme on the VM#1 and VM#2 wells. The wells were individually flowed through a test separator installed at the field site. Condensate was gathered in storage tanks on location for sale while gas produced from the wells was flared. Although this activity was primarily a technical test programme, it provided a small profit contribution.

The data gathered from the test programme has enabled the Group to develop a production plan for the VM field. Initial production from the field will be managed to enable higher recovery of condensate from the reservoir in the early years while in the later years an increasing proportion of gas is planned to be produced from the wells. In 2013, the development plan for the VM field includes a sidetrack of the existing well VM #4, which was drilled early in 2009, and up to two new production wells, VM#3 and VM#5.

Dobrinskoye field

The Dobrinskoye gas/condensate field was acquired by the Group in April 2011 and produced steadily for some months after the purchase. During July and August 2011, the field was shut in while repairs were undertaken on the two wells in the Dobrinskoye field. It was decided during this operation that a sidetrack to well #22 would be necessary to enable optimum production from that well.

The sidetrack on well #22 was completed in August 2012. While the sidetrack well #22 tested at commercial rates, some water ingress was observed in the well, suggesting that the production that might be achieved would need to be managed carefully. The decision was taken at that time to drill a sidetrack to well #26 with the aim of improving field productivity.

By November 2012, the sidetrack to well #26 had been successfully drilled and tested. The well #26 sidetrack encountered the upper section of the producing Evlansko-Livenskiy carbonate reservoir as expected at a total vertical depth of 2,342 metres, 4 metres higher than at the original vertical hole. The well was completed with a 14 metre deviated open hole section (8 metres vertical) in the producing interval.

The well was tested with a 10 mm choke and produced at a stabilised rate of 136,500 cubic metres (4.8 million cubic feet) of gas per day and 62.8 cubic metres (395 barrels) per day of condensate (a total of approximately 1,195 boepd). The condensate ratio is 460 cm^3/m^3 (82.3 barrels per million cubic feet).

Volga Gas plans to operate well #26 with an 8 mm choke and expects production of approximately 3.5 mmcf/d of gas and 280 bpd of condensate (close to 900 boepd in total), with some additional production from well #22.

During H1 2012, the Dobrinskoye field, produced on average 3.5 mmcf/d of gas and 327 bpd of condensate (April to June 2011 8.0 mmcf/d of gas and 623 bpd of condensate) from a single well, #26, while the sidetrack on the other production well, #22, was being drilled. By August, with the upgrade nearing completion, the gas plant was not available for operation. On completion of the gas plant upgrade, management decided to utilise the capacity entirely for the VM field. Consequently the Dobrinskoye field remained shut in for that period.

Uzenskoye oil field

Having reached its fourth year of full time production, the Yuzhny Uzenskoye oil field is the Group's longest established field. During 2012, as in 2011, the focus was on managing and optimising the output from the five established production wells on the field. Average production for the full year 2012 was 1,106 bopd (2011: 1,178 bopd).

During 2011, the Group identified the potential to increase production from the field by drilling sidetracks on two non-producing wells, #4 and #9. These wells were drilled at the edge of the field and were seen as potential future water injection wells. However, with clear evidence of good natural water drive in the reservoir, it was decided that water injection would not be required in the medium-term and that the wells could be partially re-drilled into more advantageous locations and put on production. These drilling operations commenced towards the end of 2011. As announced on 13 March 2012, when the first of these sidetracked wells, #9, was put on stream, it produced only water. This indicates that the oil:water contact had migrated to a higher elevation than had been anticipated on the basis of cumulative production of oil from the field. On the basis of the new information, the Proven and Probable reserves of the field have been independently calculated at 5.6 million barrels. See the paragraph relating to reserves below.

A consequence of the rising oil:water contact is that some of the wells on the field have, since the start of 2013, exhibited some water cut. It is expected that water separation facilities will need to be installed in order to maintain the production levels. The investment required for this is likely to be modest – less than US$1.0 million – and may be implemented during 2013.

The Yuzhny Uzenskoye field, whilst of modest scale, remains very profitable to the Group. With the field being located close to market and producing high quality oil, the sales prices achieved are comparatively advantageous. Furthermore, as the oil is sold directly at the field facilities, the field bears no oil transportation costs. It was developed at a cost of US$1.91 per barrel of 2P reserves and benefits from very low production costs, averaging US$1.66 per barrel in 2012 (2011: US$2.00 per barrel).

Exploration activity

The Group drilled two exploration wells completed during 2012 in fulfilment of outstanding licence obligations.

Urozhainoye-2 licence area

Drilling operations on the YR#1 exploration were completed during H1 2012 with no commercial hydrocarbons found. The well was consequently plugged and abandoned and the costs of the well have been written off. During the period, the Group acquired for a nominal sum the rights to produce from the Sobolevskaya #11 well, an oil discovery drilled by a former licensee. The Sobolevskaya #11 well has recently been successfully worked over and, after installation of production facilities at the well site, will provide an additional, albeit modest, production stream.

Pre-Caspian licence area

During H2 2012 an exploration well on the Mirnaya prospect was drilled. No hydrocarbons were identified in the potential target Jurassic and Triassic layers. On conclusion of the operations the well was plugged and abandoned.

Oil, gas and condensate reserves as of 1 January 2012

During 2012, an independent evaluation of the Company's oil, gas and condensate reserves was conducted by Miller and Lents Ltd.

The independent assessment of the reserves and net present value of future net revenue ("NPV") attributable to the Company's three principal fields, Dobrinskoye, Vostochny Makarovskoye and Uzenskoye, as at 1 August 2012, was prepared in accordance with reserve definitions prepared by the Oil and Gas Reserves Committee of the Society of Petroleum Engineers ("SPE"). The NPV evaluation was conducted on a constant pricing basis, assuming no future escalations of oil prices, operating expenses, capital, or mineral extraction taxes above the respective 1 August, 2012 values.

The reserve report attributes Proved and Probable ("2P") reserves of 16.1 million barrels ("mmbbl") of oil and condensate and 167.5 billion cubic feet ("bcf") of gas, a total of 44.0 million barrels of oil equivalent ("mmboe"), to the Company's principal fields, and a NPV of US$301.2 million with a 10% per annum discount rate.

The following table shows the Proven and Probable reserves as evaluated by Miller & Lents as at 1 August 2012.

Mikhail Ivanov
Chief Executive Officer

Oil, gas and condensate reserves

As at 1 August 2012

Proved Reserves	Oil and condensate (mmbbl)	Gas (bcf)	Total (mmboe)	NPV 10% US$ million
Uzenskoye	4.925	0.0	4.925	49.4
Dobrinskoye	1.927	23.4	5.827	41.6
VM	7.948	133.2	30.148	201.4
Total Proved Reserves	**14.800**	**156.6**	**40.900**	**292.4**

Proved plus Probable Reserves	Oil and condensate (mmbbl)	Gas (bcf)	Total (mmboe)	NPV 10% US$ million
Uzenskoye	5.578	0.0	5.578	52.4
Dobrinskoye	1.927	23.4	5.827	41.6
VM	8.599	144.1	32.622	207.2
Total Proved plus Probable Reserves	**16.104**	**167.5**	**44.027**	**301.2**

Notes:
1. Future net revenues are defined as the total gross revenues less operating costs, Mineral Extraction Tax ("MET") and capital expenditures. The total gross revenues are the total revenues received at the wellhead. The future net revenues include deductions for other capital and property taxes but do not include deductions for profit taxes.
2. The constant price assumptions used in the calculation of future cash flows were as follows: Crude Oil – US$49.53 per barrel; Condensate – US$47.66 per barrel; Natural Gas – US$2.40 per mcf.

Business Overview

Financial Review

Financial and operational summary

Sales volumes	2012	2011	2010
Oil and condensate (barrels)	529,501	546,818	407,050
Gas (mcf)	1,193	1,348	–
Total (boe)	**728,334**	**771,479**	**407,050**

Operating results (US$ 000)	2012	2011	2010
Oil and condensate sales	25,526	25,425	13,052
Gas sales	2,769	3,146	–
Revenue	**28,295**	**28,571**	**13,052**
Production costs	(2,855)	(2,413)	(436)
Production based taxes	(8,951)	(9,537)	(5,254)
Depletion, depreciation and other	(2,280)	(2,641)	(1,037)
Other	(1,561)	(991)	(113)
Cost of sales	**(15,648)**	**(15,582)**	**(6,840)**
Gross profit	**12,647**	**12,989**	**6,212**
Exploration expense	(8,475)	(200)	(23,937)
Provision for VAT recovery	(2,945)	–	–
Other operating & administrative expenses	(6,945)	(6,704)	(4,733)
Write-off of development assets	(188)	(5,612)	–
Operating profit/(loss)	**(5,906)**	**473**	**(22,458)**

Net realisation	2012	2011	2010
Oil and condensate (US$/barrel)	48.21	46.50	32.06
Gas (US$/mcf)	2.32	2.33	n.a.

Operating data (US$/boe)	2012	2011	2010
Production costs	3.92	3.13	1.07
Production based taxes	12.29	12.36	12.91
Depletion, depreciation and other	3.13	3.42	2.55

EBITDA calculation (US$ 000)	2012	2011	2010
Operating profit/(loss)	(5,906)	473	(22,458)
Exploration expense	8,475	200	23,937
DD&A and other non-cash expense	5,413	8,253	1,150
EBITDA	**7,982**	**8,926**	**2,629**

Results for the year

In 2012, the Group generated US$28.3 million in turnover (2011: US$28.6 million) from the sale of 529,501 barrels of crude oil and condensate (2011: 546,818 barrels) and 1,193 million cubic feet of natural gas (2011: 1,348 million cubic feet). Oil and condensate sales were made into the domestic market during the period. In the early part of 2012 the gas sales proceeds were offset against payments of debt outstanding between Gazneftedobycha and Trans Nafta but from April 2012, all gas sales were made for cash payment. The average price realised for liquids was the equivalent of US$48.21 per barrel (2011: US$46.50 per barrel). The contract price for gas sales during 2012 averaged US$2.32 per thousand cubic feet (2011: US$2.33 per thousand cubic feet). With sales made exclusively into the regional market in the Volga region at the wellhead, our oil and condensate sales prices closely reflect international prices, adjusted for export taxes and transportation costs. Production activities generated a gross profit of US$12.6 million in 2012 (2011: gross profit of US$13.0 million).

In 2012, the total cost of production increased to US$2.9 million (2011: US$2.4 million), including a full year of operating costs of the Dobrinskoye gas plant and field. Production based taxes were lower at US$8.9 million (2011: US$9.5 million) reflecting lower rates of Mineral Extraction Tax ("MET") for condensate offset partly by higher MET rates for crude oil and natural gas, and lower production volumes. MET in 2012 represented 31.6% of revenues (2011: 33.3% of revenues). The gross profit margin in 2012 was 44.5% (2011: 45.5%).

Operating and administrative expenses in 2012 included a provision of US$2.9 million for disputed recovery of VAT (2011: nil) while other operating and administrative expenses were US$6.9 million (2011: US$6.7 million).

During the first half of 2012, the Group continued extended production testing on the Vostochny Makarovskoye gas-condensate field. The full costs incurred, including installation of test equipment and operating costs, were expensed during this period. These costs, offset by condensate sales from test production, were included in exploration and evaluation expenses. Following the start-up of commercial production from VM in October 2012, revenues and costs associated with this field were included in the Income Statement.

The Group experienced a decline in EBITDA (defined as operating profit before non-cash charges, including the VAT provision, exploration expense, depletion and depreciation) to US$8.0 million (2011: US$8.9 million) as a result of the higher operating costs and slightly lower revenues.

After recording an exploration and evaluation expense of US$8.5 million (2011: US$0.2 million), and other non-cash expenses of US$0.2 million (2011: US$5.6 million) the Group recorded an operating loss for 2012 of US$5.9 million (2011: operating profit of US$0.5 million). The exploration and evaluation expense arose primarily from the two unsuccessful exploration wells on which drilling was completed during 2012, reflecting impairment of capitalised costs and actual expenditure incurred in 2012.

After including net interest expense of US$0.2 million (2011: interest income of US$0.2 million) and foreign exchange and other losses of US$0.2 million (2011: US$1.8 million), the Group recognised a loss before tax of US$6.3 million (2011: US$1.1 million) and reported net loss after tax of US$7.4 million (2011: US$1.1 million) after taking a deferred tax charge of US$1.1 million (2011: US$18,000).

No dividends have been paid or proposed for the year (2011: nil).

Cash flow

Group cash flow from operating activities was US$5.4 million (2011: US$5.7 million). The net cash flow of the Group was reduced by US$1.1 million of gas sales being applied to repayment of Trans Nafta loans (2011: US$3.1 million) as well as settlement of disputed VAT for which a US$2.9 million (2011: nil) provision for recovery has been made. Net working capital movements contributed to a cash inflow of US$2.4 million in 2012 (2011: US$1.8 million outflow from working capital movements). With increased capital expenditures in 2012, the net outflow from investing activities was US$13.7 million (2011: US$5.6 million). Net cash inflow from financing activities was US$4.8 million (2011: outflow of US$15.7 million) with the drawing of the bank facility offset by final repayments of the Trans Nafta debt and the commencement of amortisation payments under the bank loan. During 2011, the majority of the net cash outflow from financing arose from the repayment of debts owed by GND to its former owner Trans Nafta, amounting to US$15.7 million.

Capital Expenditure

During 2012 a total of US$13.7 million was utilised in investing activities (2011: US$5.6 million) as detailed below:

	2012 (US$ million)	2011 (US$ million)
Oil and gas exploration assets	3.4	4.3
Development and producing assets	10.3	0.8
Acquisition net of cash acquired	–	0.5
Total	**13.7**	**5.6**

The most significant individual components of the capital expenditure were on development and producing assets and primarily relates to the Dobrinskoye gas plant upgrade and to drilling of sidetracks to the wells on the Dobrinskoye field. Expenditure on exploration was on two exploration wells completed during 2012, both of which were written off in the year.

Balance sheet and financing

As at 31 December 2012, the Group held cash and bank deposits of US$7.0 million (2011: US$10.1 million) and total bank debt outstanding of US$8.0 million (2011: nil), including a current portion of US$6.4 million (2011: nil). The bank loan was drawn during 2012 and is subject to monthly repayments which commenced in October 2012. As at 31 December 2011 there were loans payable by a Group company to Trans Nafta of US$4.2 million which were repaid during 2012. All of the Group's cash balances are held in bank accounts in the UK and Russia.

As at 31 December 2012, the Group's intangible assets decreased to US$9.6 million (2011: US$39.5 million), as licence costs relating to producing fields were reclassified as property, plant and equipment, which consequently increased to US$103.7 million (2011: US$60.8 million). Other increases in property, plant and equipment reflect investment in the gas plant upgrade and drilling of well sidetracks on the Dobrinskoye field.

The Group intends to fund its continuing development and exploration expenditures using a combination of cash flow from operations and cash-on-hand. The Group will consider additional debt facilities to fund the longer-term development of its existing licences as appropriate.

The Group's financial statements are presented on a going concern basis.

Tony Alves
Chief Financial Officer

Business Overview

Principal Risks and Uncertainties

The Group is subject to various risks relating to political, economic, legal, social, industry, business and financial conditions.

The following risk factors, which are not exhaustive, are particularly relevant to the Group's business activities:

Volatility of prices for oil and gas

The supply, demand and prices for oil and gas are volatile and are influenced by factors beyond the Group's control. These factors include global and regional demand and supply, exchange rates, interest and inflation rates and political events. A significant prolonged decline in oil and gas prices could impact the viability of some of the Group's exploration and development activities. Additionally, the Group's production is predominantly sold in the domestic Russian markets which are influenced by domestic supply and demand factors, the level of Russian export taxes and regional transportation costs.

Substantially all of the Group's revenues and cash flows come from the sale of oil, gas and condensate. If sales prices should fall below and remain below the Group's cost of production for any sustained period, the Group may experience losses and may be forced to curtail or suspend some or all of the Group's production, at the time such conditions exist. In addition, the Group would also have to assess the economic impact of low oil and gas prices on its ability to recover any losses the Group may incur during that period and on the Group's ability to maintain adequate reserves.

The Group does not currently hedge its crude oil production to reduce its exposure to oil price volatility.

Oil and gas production taxes

The Group's sales generated from oil and gas production are subject to Mineral Extraction Taxes, which form a material proportion of the total costs of sales. The rates of these taxes are subject to changes by the Russian government. Recently implemented changes to rates have reduced the effective rates on condensate and increased rates on crude oil and natural gas.

Exploration and reserve risks

Whilst the Group will seek to apply the latest technology to assess exploration licences, the exploration for, and development of, hydrocarbons is speculative and involves a high degree of risk. These risks include the uncertainty that the Group will discover sufficient commercially exploitable oil or gas resources. Unsuccessful exploration efforts may result in impairment to the balance sheet value of exploration assets.

During 2012, the Group commissioned a reserve evaluation based on reporting standards set by the Society of Petroleum Engineers. If the actual results of producing the Group's fields are significantly different to expectations, there may be changes in the future estimates of reserves. These may impact the balance sheet values of the Group's Intangible Assets and the Group's Property, Plant and Equipment.

Environmental risk

The oil and gas industry is subject to environmental hazards, such as oil spills, gas leaks, ruptures and discharges of petroleum products and hazardous substances. These environmental hazards could expose the Group to material liabilities for property damages, personal injuries, or other environmental harm, including costs of investigating and remediating contaminated properties.

The Group is subject to stringent environmental laws in Russia with regards to its oil and gas operations. Failure to comply with such laws and regulations could subject the Group to material administrative, civil, or criminal penalties or other liabilities. Additionally, compliance with these laws may, from time to time, result in increased costs to the Group's operations, impact production, or increase the costs of potential acquisitions.

The Group liaises closely with the Federal Service of Environmental, Technological and Nuclear Resources of the Saratov and Volgograd Oblasts on potential environmental impact of its operations and conducts environmental studies both as required by, and in addition to, its licence obligations to mitigate any specific risk. The Group's operations are regularly subject to independent environmental audit.

The Group did not incur any material costs relating to the compliance with environmental laws during the period.

Risk of operating oil and gas properties

The oil and gas business involves certain operating hazards, such as well blowouts, cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires, pollution and releases of toxic substances. Any of these operating hazards could cause serious injuries, fatalities, or property damage, which could expose the Group to liabilities. The settlement of these liabilities could materially impact the funds available for the exploration and development of the Group's oil and gas properties. The Group maintains insurance against many potential losses and liabilities arising from its operations in accordance with customary industry practices, but the Group's insurance coverage cannot protect it against all operational risks.

Foreign currency risk

The Group's capital expenditures and operating costs are predominantly in Russian rubles ("RUR") while a minority of costs are also in US dollars. Revenues are in RUR and funding has been raised in US dollars and to a minor extent in euros. Any changes in the relative exchange rates among US dollar, euros and RUR could positively or negatively affect the Group's results.

Business in Russia

Amongst the risks that face the Group in conducting business and operations in Russia are:

> Economic instability, including in other countries or the global economy that could lead to consequences such as hyperinflation, currency fluctuations and a decline in per capita income in the Russian economy.
> Governmental and political instability that could disrupt, delay or curtail economic and regulatory reform, increase centralised authority or result in nationalisations.
> Social instability from any ethnic, religious, historical or other divisions that could lead to a rise in nationalism, social and political disturbances or conflict.
> Uncertainties in the developing legal and regulatory environment, including, but not limited to, conflicting laws, decrees and regulations applicable to the oil and gas industry and foreign investment.
> Unlawful or arbitrary action against the Group and its interests by the regulatory authorities, including the suspension or revocation of their oil or gas contracts, licences or permits or preferential treatment of their competitors.
> Lack of independence and experience of the judiciary, difficulty in enforcing court or arbitration decisions and governmental discretion in enforcing claims.
> Expected changes to the federal and local tax systems.
> Laws restricting foreign investment in the oil and gas industry.

Legal systems

Russia, and other countries in which the Group may transact business in the future, have or may have legal systems that are less well developed than those in the United Kingdom. This could result in risks such as:

> Potential difficulties in obtaining effective legal redress in the court of such jurisdictions, whether in respect of a breach of contract, law or regulation, including an ownership dispute.
> A higher degree of discretion on the part of governmental authorities.
> The lack of judicial or administrative guidance on interpreting applicable rules and regulations.
> Inconsistencies or conflicts between and within various laws, regulations, decrees, orders and resolutions.
> Relative inexperience of the judiciary and courts in such matters.

In certain jurisdictions, the commitment of local business people, government officials and agencies and the judicial system to abide by legal requirements and negotiated agreements may be more uncertain, creating particular concerns with respect to licences and agreements for business. These may be susceptible to revision or cancellation and legal redress may be uncertain or delayed. There can be no assurance that joint ventures, licences, licence applications or other legal arrangements will not be adversely affected by the jurisdictions in which the Group operates.

Liquidity risk

At 31 December 2012 the Group had US$7.0 million of cash and cash equivalents available to fund its ongoing operations and associated exploration and development activities. At 31 December 2012 the Group has had approved capital expenditures of approximately US$14 million primarily for the continuing development of gas and condensate production. It also had as at 31 December 2012 a bank loan outstanding of US$8.0 million which is currently being amortised. All current and planned capital expenditures are discretionary.

Through its ordinary course activities, the Group is exposed to legal, operational and development risk that could delay growth in its cash generation from operations or may require additional capital investment that could place increased burden on the Group's available financial resources.

Tony Alves
Chief Financial Officer

Corporate Governance

Board of Directors




Aleksey Kalinin
Non-Executive Chairman

Appointed to the Board: 14 March 2007

Committee membership: Remuneration

Mr Kalinin is a Senior Partner of Baring Vostok Capital Partners. He joined Baring Vostok in 1999 from Alfa Capital, where he served for six years as the Director of the Department for Direct Investments. Aleksey represents the interests of Baring Vostok's funds on the Board of Directors of a wide range of portfolio companies. He has a doctorate from the Moscow Power Engineering Institute, where he conducted scientific research, lectured for 12 years and served as the Director of the Youth Center for Scientific and Technical Creativity. Mr Kalinin is 53 years old.

Mikhail Ivanov
Chief Executive Officer, Executive Director

Appointed to the Board: 14 March 2007

Committee membership: n/a

Mr Ivanov is a Partner and Director of Oil and Gas Projects at Baring Vostok Capital Partners. Mr Ivanov brings with him a long history of involvement in the oil sector. Mikhail worked for over ten years at Shlumberger, the international oil services company, where he served as head of its Iran operations and was responsible for business development in Russia. Prior to joining Shlumberger, he founded and headed two companies that focused on oil production and service. In 2009 he was appointed non-executive director of Zhaikmunai Group Limited. Mr Ivanov holds an M.S. degree in Geophysics from Novosibirsk State University and an M.B.A. from the Kellogg School of Management of Northwestern University. He is an elected member of SPE. Mr Ivanov is 43 years old.

Antonio Alves
Chief Financial Officer, Executive Director

Appointed to the Board: 12 January 2009

Committee membership: n/a

Mr Alves has had experience with the independent the oil and gas industry for over 20 years as one of the leading equity analysts covering the sector. Prior to joining Volga Gas, he was head of oil and gas research for KBC Peel Hunt and was closely involved with the Company's 2007 IPO. He previously held positions with Investec Securities, The Bell Group International and Schroders. He is a Member of the Securities Institute and of the Petroleum Exploration Society of Great Britain. He read mathematics at Cambridge University between 1977 and 1983 both as an undergraduate and a post-graduate research student. Mr Alves is 53 years old.

Ronald Freeman
Non-Executive Director

Appointed to the Board: 14 March 2007

Committee membership: Audit, Nomination, Remuneration

Mr Freeman is a non-executive board director of Severstal (Cherepovets, Russia). He is also Chairman of the Executive Committee of the Atlantic Council (Washington DC), a member of the International Advisory Committee of Columbia Law School (New York); and, co-chairman of the finance committee of the UK-US Fulbright Commission (London). From 1973 to 1991 and from 1997 until his retirement from Citigroup as co-head of European Investment Banking in 2000, he was an investment banker specialising in financing and mergers and acquisition for companies in the oil and gas industry with Salomon Brothers, now a unit of Citigroup. From 1991 to 1997, he was head of the Banking Department of the European Bank for Reconstruction and Development (London). Prior to that, he practiced law with Baker & McKenzie (Paris) and served as a management consultant in the Paris office of McKinsey & Company. Mr Freeman was born in New York and has dual US and UK citizenship. He has a B.A from Lehigh University and an LL.B. from Columbia Law School (1964). He was admitted to the Bar of the State of New York. He is 73 years old.

Stephen Ogden
Non-Executive Director

Appointed to the Board: 14 March 2007

Committee membership: Audit, Nomination, Remuneration

Mr Ogden is the Founder & Managing Partner of the First Montenegro Stone Property Fund, and the Co-Founder & Managing Partner of the Istanbul-based Pera Property Fund. Mr Ogden is the Chairman of the Board of MDM-Print (Russia). Mr Ogden is the former Chairman of the Board of Lenta, Russia's largest privately owned food retailer, and was previously a non-executive director of United Confectioneries (Russia), Heineken Russia and Metropolis Media (former Yugoslavia). He was Chief Financial Officer of the Bochkarev Brewery in St. Petersburg from 1997 to 2002. Prior to becoming Chief Financial Officer of Bochkarev, Mr Ogden was an auditor with KPMG and PricewaterhouseCoopers, and Financial Controller of CS First Boston (Moscow). Mr Ogden has a joint honours degree in economics & politics from Durham University, England, and is a qualified British chartered accountant ("FCA"). Mr Ogden is active in British politics. He is a former Conservative Councillor of Altrincham, Cheshire and his name is on the approved list of Conservative Parliamentary candidates. Mr Ogden is a co-founder and treasurer of the charitable Rwanda Cricket Stadium Foundation. Mr Ogden is 45 years old.

Michael Calvey
Non-Executive Director

Appointed to the Board: 14 March 2007

Committee membership: Audit, Nomination

Mr Calvey is a Senior Partner of Baring Vostok Capital Partners and a Director of Baring Private Equity International and is on the Boards of several of Baring Vostok's portfolio companies. He began working in Moscow in 1994 as one of the members of the consulting committee of the First NIS Regional Fund. He is a member of the investment committees of three Baring Vostok funds. He is also a member of the Investment Committees of the Baring Asia and Baring India funds. Before 1994, Mr Calvey lived in London and New York, where he worked at the European Bank for Reconstruction and Development ("EBRD") and Salomon Brothers. At EBRD he was responsible for investments in the energy sector of Central and Eastern Europe. At Salomon Brothers Mr Calvey worked on mergers and acquisitions and capital market projects in the oil and gas sector. He is a member of the Boards of the Atlantic Council and the Emerging Markets Private Equity Association, and is a member of the Advisory Board of the Centre for International Business and Management at Cambridge University. Mr Calvey is 45 years old.

Vladimir Koshcheev
Non-Executive Director

Appointed to the Board: 14 March 2007

Committee membership: n/a

Mr Koshcheev currently acts as President of Joint Stock Company "NPO POG". Until 2009 he was President of Pervaya Investizionno–Stroitelnaya Company LLC, Spinaker LLC. He has been Chairman of CJSC AKSM since 2002. Mr Koshcheev was President of Privolzhskaya Neftyanaya Company LLC between 2003 and 2005 and was previously a shareholder in and acted as President of Vesla. Mr Koshcheev received a specialist diploma from Moscow State Technical University in 1978 and he is a member of the Russian Academy of Natural Sciences. Mr Koshcheev is 56 years old.

Corporate Governance
Corporate Governance Statement

Introduction
The Board's overriding objective is to ensure that the Group delivers long-term capital appreciation for its shareholders.

Compliance
Volga Gas plc seeks to comply with the UK Corporate Governance Code (the "Code") albeit as an AIM-listed company it is not required to. The Board of Directors is committed to developing and applying high standards of corporate governance appropriate to the Company's size and its future prospects.

This statement sets out measures taken by the Board to apply the principles of the Code to the year ended 31 December 2012 and to the date of the Directors' Report.

Board of directors
Role of the Board
The Board's role is to provide entrepreneurial leadership to the Group within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the Group's strategic aims and ensures that the necessary financial and human resources are in place for the Group to meet its objectives, and reviews management's performance in meeting these objectives. The Board sets and monitors the Group's values and standards and ensures that the Group's obligations to shareholders and other stakeholders are understood and met.

The Board has a formal schedule of matters reserved for its approval, including:
> Strategic and policy considerations
> Annual budget, including capital expenditure
> Interim and final financial statements
> Management structure and appointments
> Mergers, acquisitions, disposals
> Capital raising
> Significant changes in accounting policies
> Appointment or removal of Directors or the Company Secretary

Board composition
The Board currently comprises two executive directors and five non-executive directors, of whom three are deemed to be independent and two non-independent:
> Aleksey Kalinin – Non-Executive Chairman
> Mikhail Ivanov – Executive Director and CEO
> Tony Alves – Executive Director, CFO and Company Secretary
> Ronald Freeman – Independent Non-Executive
> Stephen Ogden – Independent Non-Executive
> Vladimir Koshcheev – Independent Non-Executive
> Michael Calvey – Non-Executive

There is a clear division of responsibilities between the executive and non-executive directors.

Board balance and independence
The board recognises that Messrs Kalinin and Calvey are not independent by virtue of their direct management responsibilities for the limited partnerships comprising Baring Vostok Private Equity Funds III and IV, the Company's controlling shareholder ("Controlling Shareholder"). However, in light of the value, experience and contacts which they afford to the Company at this stage of its development and by virtue of the Relationship Agreement, which, inter alia, ensures that the Controlling Shareholder does not exercise undue influence over the Company or prevent it from acting independently of the Controlling Shareholder, the Board believes that the continued presence of Messrs Kalinin and Calvey on the Board is beneficial for the Company. Mr Kalinin also serves as Chairman of the Board and was not considered to be independent on his appointment.

Notwithstanding under the provisions of the UK Corporate Governance Code as a Smaller Company the Company meets the requirements to have at least two independent non-executives on the Board.

All directors are permitted access to independent professional advice in the course of execution of their duties, at the Company's expense.

The Board has established the following committees:

Audit Committee
The Audit Committee was appointed in March 2007 and comprises three directors:
Mr Ogden – Chairman
Mr Freeman
Mr Calvey

The Audit Committee is responsible for selecting the Group's independent auditors, pre-approving all audit and non-audit related services, reviewing with management and the independent auditors the Group's financial statements, significant accounting and financial policies and practices, audit scope and adequacy of internal audit and control systems.

The audit committee meets at least twice each year.

Remuneration Committee
The Remuneration Committee was also appointed in March 2007 and comprises three directors:
Mr Freeman – Chairman
Mr Ogden
Mr Kalinin

The Remuneration Committee is responsible for determining compensation of the Company's key employees, including the Chief Executive Officer, Chief Financial Officer, and other key personnel as may be determined from time to time by the Remuneration Committee.

The directors' remuneration report is set out on pages 19 to 20.

Nomination Committee
The Nomination Committee was appointed in March 2007 and comprises three directors:
Mr Freeman – Chairman
Mr Ogden
Mr Calvey

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board, making recommendations to the Board concerning plans for succession for both Executive and Non-Executive Directors including the Chief Executive and other senior management, preparing a description of the role and capabilities required for a particular appointment and identifying and nominating candidates to fill Board positions as and when they arise.

Board meetings

The Board met five times during the year ended 31 December 2012 (2011: six times) with the following attendance:

	2012	2011
Aleksey Kalinin	5	5
Mikhail Ivanov	5	6
Tony Alves	5	6
Ronald Freeman	5	6
Stephen Ogden	5	6
Vladimir Koshcheev	4	4
Michael Calvey	5	6

Indemnification of directors

In accordance with the Company's Articles of Association and to the extent permitted by the law of England and Wales, directors are granted an indemnity from the Company in respect of liabilities incurred as a result of their office. In respect of those matters for which the directors may not be indemnified, the Company maintained a directors' and officers' liability insurance policy throughout the financial year. This policy has been renewed for the next financial year.

Re-election of directors

The Company requires that all directors stand for re-election at intervals of no more than three years. Accordingly Messrs Ivanov, Kalinin and Koshcheev will retire at the forthcoming AGM and will seek re-election by shareholders.

Internal controls

The directors acknowledge their responsibility for the system of internal controls for the Group and for reviewing its effectiveness. Any system of internal control can only provide reasonable, and not absolute, assurance that material financial irregularities will be detected or that the risk of failure to achieve business objectives is eliminated.

The Group's risk and controls framework covers all material risks and controls including those of an operational, financial, and compliance nature. Internal control procedures consist, inter alia, of formal delegations of expenditure authority by the Board to executive management, and controls relating to key stages of transactions including supplier approval, contract signature, and payment release.

The directors consider that the frequency of Board meetings and level of detail presented to the Board for its consideration in relation to the operations of the Group provide an appropriate process to identify, evaluate and manage significant risks relevant to its operations on a continuous basis, and this process is considered to be in accordance with the revised guidance on internal control published in October 2005 ("Turnbull Guidance").

Investor relations

The Company places considerable importance on communication with shareholders and engages them on a wide range of issues. The Group has an ongoing programme of dialogue and meetings between the executive directors and institutional investors, fund managers and analysts. At these meetings a wide range of relevant issues including strategy, performance, management and governance are discussed within the constraints of the information already made public.

The Company is equally interested in the views and concerns of private shareholders and to this end ensures that the executive directors present the Company at forums where private investors are present.

Shareholders have the opportunity to meet and question the Board at the AGM which will be held on 7 June 2012, at which the Chairman, the Chairman of the Audit Committee and all executive directors will be available.

By order of the Board

Tony Alves
Company Secretary
28 March 2013

Corporate Governance
Report of the Directors

The directors present their report together with the Group's audited consolidated financial statements for the period from 1 January 2012 to 31 December 2012.

Results and dividend

The Group's results are set out on pages 22 to 26 and show net loss of US$6.9 million for the year to 31 December 2012 (2011: net loss of US$1.1 million). The directors do not propose to pay a dividend (2011: nil).

Principal activities, business review and future developments

Volga Gas is a public limited company registered in England and Wales with registered number 5886534, was incorporated in the United Kingdom on 25 July 2006 and listed on AIM on 25 April 2007. Volga Gas operates primarily through subsidiary companies as set out in note 2.2 to the accounts. The principal activity of the Group is the exploration, development and production of its gas, condensate and oil fields in the Volga Region of European Russia. The Group owns 100% of five licence areas in the Saratov and Volgograd regions: Karpenskiy, Vostochny-Makarovskoye, Dobrinskoye, Pre-Caspian and Urozhainoye-2.

The Group's business strategy is to continue the development of the Vostochny Makarovskoye field and to manage production on the Dobrinskoye and Uzenskoye fields whilst at the same time exploring the potentially prospective structures on the Group's licence areas. The Group also regularly evaluates acquisition opportunities as part of its overall growth strategy.

Highlights of the Group's activities for the period ended 31 December 2012 are:

> Completion of the first two stages of a programme to upgrade the gas processing facility at the site of the Dobrinskoye gas/condensate field which enabled the commencement of full time production from the Vostochny-Makarovskoye field.
> Continued and steady production from the Yuzhny Uzenskoye oil field on the KLA.
> Successful redevelopment of the two production wells on the Dobrinskoye field.
> Independent assessment of Group oil, gas and condensate reserves.

The Group's activities are described in greater detail in the Chief Executive's Report on page 5 and in the Operational Review on pages 6 and 7. The principal risks associated with the Group's activities are set out in the Financial Review on pages 8 and 9.

Key performance indicators

Given the nature of the business and that the Group has only two operating fields, the directors are of the opinion that further analysis using KPIs is not appropriate for an understanding of the development, performance or position of our business at this time. The directors are of the opinion that the Operational Review on pages 6 and 7 provides the relevant information.

Directors

The directors who served during the year were:
Aleksey Kalinin, Non-Executive Chairman
Mikhail Ivanov, Chief Executive Officer
Michael Calvey, Non-Executive
Tony Alves, Chief Financial Officer
Ronald Freeman, Non-Executive
Vladimir Koshcheev, Non-Executive
Stephen Ogden, Non-Executive

Messrs Kalinin, Koshcheev and Freeman will retire by rotation and offer themselves for re-election in accordance with the Company's Articles of Association.

Directors' interests

The directors serving during the year had the following beneficial interests in the shares of the Company:

	Ordinary Shares of 0.01p each	
	31 December 2012	31 December 2011
Aleksey Kalinin[1]	–	–
Mikhail Ivanov	1,000,000	1,000,000
Tony Alves	25,000	25,000
Ronald Freeman	55,000	55,000
Stephen Ogden	105,000	105,000
Vladimir Koshcheev[2]	600,000	650,000
Michael Calvey[1]	–	–

1 Mr Calvey and Mr Kalinin are Co-Managing Partners of Baring Vostok Capital Partners Limited, a related party to Baring Vostok Nominees Limited and Dehus Dolmen Nominees Limited. As such Mr Calvey and Mr Kalinin have an indirect beneficial interest in the Company.
2 On 11 January 2013, Mr. Koshcheev disposed of 80,790 shares and his beneficial interest in the Company consequently reduced to 519,210 shares.

Substantial shareholders

On 28 March 2013 the following parties had notifiable interests of 3% or greater in the nominal value of the Company's issued 0.01p ordinary shares:

	Number of shares	Percentage
Baring Vostok Nominees Ltd[1]	39,620,000	48.90
Dehus Dolmen Nominees Ltd[2]	7,906,889	9.76
JP Morgan Asset Management (UK) Limited	4,404,600	5.55
BlackRock Investment Management (UK) Limited	2,464,008	3.04
BNP Paribas Investment Partners S.A.	2,450,000	3.02

1 Baring Vostok Nominees Ltd is a nominee vehicle which holds the interests of the limited partnerships which comprise Baring Vostok Private Equity Fund III.
2 Dehus Dolmen Nominees Ltd is a nominee vehicle which holds the interests of the limited partnerships which comprise Baring Vostok Private Equity Fund IV.

Options granted
An Executive Share Option Plan was adopted by the Company in July 2008 following which options over a total of 1,706,196 shares were granted to Mikhail Ivanov and to Tony Alves. During 2012 options over 379,154 shares (2011: 432,474 shares) were eligible for vesting. The details of these option grants are disclosed in the Remuneration Report below.

Interests in contracts
There were no contracts or arrangements during the period in which a director of the Company was materially interested and which were significant in relation to the business of the Company.

Creditors payment policy and practice
The Group aims to pay all its creditors promptly. For trade creditors it is the Group's policy to:
(i) agree the terms of the payment at the start of the business with that supplier;
(ii) ensure that suppliers are aware of the terms of the payment; and
(iii) pay in accordance with contractual and other obligations.

Political and charitable contributions
No political or charitable contributions were made in the year (2011: nil).

Employment policies
The Group is committed to pursuing an equal opportunities employment policy, covering recruitment and selection, training, development, appraisal and promotion. The Group recognises the diversity of its employees, its customers, and the community at large and seeks to use employees' talents to the fullest. This approach extends to the fair treatment of people with disabilities, in relation to their recruitment, training and development. Full consideration is given to staff members who become disabled during employment.

Employee communication
The Group is committed to effective communications, which it maintains through regular information releases and staff briefings. Formal communications with employees take place through these channels. With respect to the Group's operations in Russia and the recruitment of Russian employees, announcements, contracts, interviews and advertisements are conducted in the English and Russian languages, as applicable.

Health, safety and the environment
The Group's policy and practice is to comply with health, safety and environmental regulations and requirements of the countries in which it operates, to protect its employees, contractors, assets and the environment.

The Company closely monitors its environmental obligations under the terms of its licence agreements. In particular, portions of the Karpenskiy Licence Area are located in the Saratovskiy Federal Nature Reserve and Tulipannaya Steppe Natural Sanctuary, which are protected by Russian environmental law. In accordance with Russian environmental law, all economic activity within the protected area is approved by the Russian government. The Company has ensured that all its activities minimise the impact on this sensitive environment.

UK Bribery Act
The Company has adopted Anti-Corruption and Anti-Bribery Policies and a framework of adequate procedures for managing the Volga Gas Group's responsibilities in relation to the UK Bribery Act 2010.

Share capital
The Company has authorised ordinary share capital of 330,720,100 shares of 1p each. Under a special resolution by the shareholders of the Company on 8 June 2012 the directors have authority to allot shares up to an aggregate nominal value of £1,000,000 of which £150,000 could be issued non-preemptively, in accordance with sections 570 and 573 of the Companies Act 2006. This authority will expire the earlier of (i) 15 months from the passing of the Resolution, or (ii) the conclusion of the Annual General Meeting of the Company to be held in 2013.

Capital risk management
The Group's objectives when managing the balance of equity and debt capital are (a) to safeguard the Group's ability to continue as a going concern, (b) provide returns for shareholders and benefits for other stakeholders and (c) to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. To date the Group has been funded entirely by equity capital.

Statement of disclosure of information to auditors
As at the date of this report the serving directors confirm that:
> so far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware; and
> they have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors
During 2012, following a review of audit arrangements, the Board decided to appoint KPMG Audit Plc as the Company's auditors. KPMG Audit Plc, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the next Annual General Meeting.

Statement of directors' responsibilities
Company law requires the directors to prepare financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange, they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and applicable law and have elected to prepare the parent Company financial statements on the same basis. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view both of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

Corporate Governance
Report of the Directors continued

In preparing the Group and parent Company financial statements, the directors are required to:

> select suitable accounting policies and then apply them consistently;
> make judgements and estimates that are reasonable and prudent;
> prepare the financial statements on the going concern basis unless it is inappropriate to presume the Group and parent Company will continue in business; and
> state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Electronic communications

The maintenance and integrity of the Volga Gas plc website (www.volgagas.com) is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

The Company's website is maintained in compliance with AIM Rule 26.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board

Aleksey Kalinin
Chairman of the Board
28 March 2013

Corporate Governance
Directors' Remuneration Report

In common with the Board's commitment to compliance with the Combined Code, the Company has adopted the Principles of Good Governance relating to directors' remuneration. The Company discloses certain information relating to directors' remuneration in this report, which is not audited.

Remuneration Committee
The Company established a Remuneration Committee in April 2007, as set out in Corporate Governance on pages 14 to 15.

The Remuneration Committee advises the Board on Group compensation policy as it relates to executive directors and other key members of management, and may obtain advice from independent remuneration consultants appointed by the Company. The Remuneration Committee comprises Ronald Freeman (Chairman), Stephen Ogden and Aleksey Kalinin, who are all deemed to be non-executive directors. Executive directors may be invited to attend meetings of the Remuneration Committee but do not vote on their own remuneration or incentives. The Remuneration Committee meets as required.

Remuneration policy
The Company's policy is to maintain levels of compensation for the Group that are comparable and competitive with peer group companies, so as to attract and retain individuals of the highest calibre, by rewarding them as appropriate for their contribution to the Group's performance.

Executive Directors' employment agreement and terms of appointment
The terms of each executive director's appointment are set out in their service agreements. Each executive director agreement is based on similar terms, with no fixed duration. Each service agreement sets out details of basic salary and share options as applicable.

All executive director employment agreements can be terminated either by the director concerned or by the Company on giving 6 months' notice during the first 24 months of service and thereafter by giving 3 months' notice.

The executive directors do not participate in any Group pension scheme and their remuneration is not pensionable. However, one of the executive directors has elected to receive part of his remuneration by way of contributions to a personal pension plan. The executive directors are eligible for payment of cash bonuses and participation in any share-based incentive plan the Board implements.

Basic salaries
The basic salary of each executive director is established by reference to their responsibilities and individual performance.

Non-executive Directors' terms, conditions and fees
The non-executive directors have been engaged under the terms of their letters of appointment. These engagements are for two years and can be terminated upon one month's notice by either party. Re-appointment is subject to the Company's Articles of Association which provide that one third of the directors shall be required to retire each year.

Fees
The fees paid to non-executive directors are determined by the Board and reviewed periodically to reflect current rates and practice commensurate with the size of the Company and their roles.

The remuneration of the non-executive directors is a matter for the Chairman of the Board and the Chief Executive Officer. In the event of the appointment of an independent non-executive Chairman his remuneration would be a matter for the Chairman of the Remuneration Committee and the Chief Executive Officer.

Audited Information – Directors detailed emoluments

	Salary US$'000	Pension Contribution US$'000	Share-based Compensation US$'000	Fees US$'000	Aggregate Remuneration for the Year 31 December 2012 US$'000	Aggregate Remuneration for the Year 31 December 2011 US$'000
Executive Directors						
M. Ivanov	400	–	–	–	**400**	338
A. Alves	236	81	–	–	**317**	328
Non-Executive						
A. Kalinin	–	–	–	–	**–**	–
R. Freeman	–	–	–	50	**50**	50
S. Ogden	–	–	–	50	**50**	50
V. Koshcheev	–	–	–	–	**–**	–
M. Calvey	–	–	–	–	**–**	–

Corporate Governance
Directors' Remuneration Report continued

Directors' interests in the share capital of the Company
The Directors' interests in the share capital of the Company are disclosed in the Report of the Directors on page 16. There has been no change in the interest of any director between 1 January 2012 and the date of this report.

Directors' share options
The Company adopted an Executive Share Option Plan ("ESOP") on 14 July 2008, which was subsequently amended on 17 December 2008. Under the terms of this Plan, a maximum of 2,843,661 shares (equivalent to approximately 5% of the then issued share capital) may be allocated and subject to performance criteria and vesting periods as specified by the Remuneration Committee.

During 2008, the Company granted options to acquire 1,137,464 ordinary shares to Mikhail Ivanov under the terms ESOP. The options may be exercised at a price of 405p per share and vest in equal portions on May 2010, 2011 and 2012 and will remain outstanding until May 2017. On 17 December 2008, Tony Alves was granted options to acquire up to 568,732 ordinary shares in the Company at an exercise price of 100p per share. The options vest over a period of up to four years subject to the satisfaction of performance conditions related to the market price of the Company's shares. The vested options become exercisable on a straight line, cumulative basis at a rate of 12.5% of the total option grant every six months (starting from the date of grant) and will remain exercisable until eight years from the date of grant. During 2012, options over 379,154 shares became eligible for vesting (2011: 432,474 shares).

By order of the Board

Tony Alves
Company Secretary
28 March 2013

Financial Statements
Independent Auditors' Report to the Members of Volga Gas plc

We have audited the financial statements of Volga Gas plc for the year ended 31 December 2012 set out on pages 22 to 43.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 17, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

> the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2012 and of the Group's loss for the year then ended;
> the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
> the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
> the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

> adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
> the parent Company financial statements are not in agreement with the accounting records and returns; or
> certain disclosures of directors' remuneration specified by law are not made; or
> we have not received all the information and explanations we require for our audit.

Adrian Wilcox (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
8 Salisbury Square
London
EC4Y 8BB
1 April 2013

Financial Statements

Group Income Statement

(presented in US$ 000)

Year ended 31 December	Notes	2012	2011
Continuing Operations			
Revenue		28,295	28,571
Cost of sales	5	(15,648)	(15,582)
Gross profit		**12,647**	**12,989**
Exploration and evaluation expense	5	(8,475)	(200)
Operating and administrative expenses	5	(9,890)	(6,704)
Write off of development assets	5	(188)	(5,612)
Operating (loss)/profit		**(5,906)**	**473**
Interest income	6	185	219
Interest expense		(415)	–
Other losses – net	7	(172)	(1,810)
Loss for the year before tax		**(6,308)**	**(1,118)**
Current income tax	8	–	–
Deferred income tax	8	(1,113)	(18)
Loss for the year		**(7,421)**	**(1,136)**
Attributable to:			
The owners of the parent Company		**(7,421)**	**(1,136)**
Basic and diluted loss per share (in US dollars)	9	(0.09)	(0.01)
Weighted average number of shares outstanding		*81,017,800*	*81,017,800*

The Company has elected to take the exemption under section 408 of the Companies Act 2006 to not present the parent Company income statement. The loss for the parent Company for the year was US$1,338,000 (2011: US$1,432,000).

Group Statement of Comprehensive Income

(presented in US$ 000)

Year ended 31 December	2012	2011
Loss for the year attributable to equity shareholders of the Company	**(7,421)**	**(1,136)**
Other comprehensive income:		
Currency translation differences	6,677	(6,458)
Total comprehensive income (expense) for the year	**(744)**	**(7,594)**
Attributable to:		
The owners of the parent Company	**(744)**	**(7,594)**

The accompanying notes on pages 27 to 43 are an integral part of these financial statements.

Financial Statements
Group Balance Sheet

(presented in US$ 000)

At 31 December	Notes	Group 2012	Group 2011
Assets			
Non-current assets			
Intangible assets	10	9,646	39,522
Property, plant and equipment	11	103,703	60,794
Other non-current assets	12	798	1,855
Deferred tax assets	8	2,062	5,560
Total non-current assets		**116,209**	**107,731**
Current assets			
Cash and cash equivalents	13	7,049	10,099
Inventories	14	1,235	1,851
Other receivables	15	2,330	2,409
Total current assets		**10,614**	**14,359**
Total assets		**126,823**	**122,090**
Equity and Liabilities			
Equity			
Share capital	16	1,485	1,485
Share premium (net of issue costs)	16	165,873	165,873
Other reserves	17	(13,619)	(20,296)
Accumulated loss	21	(39,338)	(31,916)
Equity attributable to the shareholders of the parent		**114,401**	**115,146**
Non-controlling interests		–	–
Total equity		**114,401**	**115,146**
Non-current liabilities			
Asset retirement obligation		330	350
Long-term debt	18	1,586	–
Total non-current liabilities		**1,936**	**330**
Current liabilities			
Trade and other payables	19	4,083	6,614
Short-term debt	18	6,403	–
Total current liabilities		**10,486**	**6,614**
Total equity and liabilities		**126,823**	**122,090**

Approved by the Board of Directors on 28 March 2013 and signed on its behalf by

Mikhail Ivanov
Chief Executive Officer

Tony Alves
Chief Financial Officer

The accompanying notes on pages 27 to 43 are an integral part of these financial statements.

Financial Statements
Group Cash Flow Statement

(presented in US$ 000)

Year ended 31 December	Notes	Group 2012	Group 2011
Loss for the year before tax		**(6,308)**	**(1,118)**
Adjustments to loss before tax:			
Share grant expense		–	37
Depreciation		2,280	2,714
Exploration and evaluation expense		8,359	490
Write off of development assets		–	5,322
Loan repayment by offset of gas sales		(1,132)	(3,146)
Other non-cash expenses		57	147
Foreign exchange differences		(262)	1,320
Decrease/(increase) in long-term assets		–	1,678
Operating cash flow prior to working capital		**2,994**	**7,444**
Working capital changes			
Decrease/(increase) in trade and other receivables		3,156	(1,847)
Decrease in payables		(177)	(20)
(Increase)/decrease in inventory		(528)	78
Cash flow from operations		**5,445**	**5,655**
Income tax paid		(3)	–
Net cash flow generated from operating activities		**5,442**	**5,655**
Cash flows from investing activities			
Expenditure on exploration and evaluation	10	(3,408)	(4,307)
Purchase of property, plant and equipment	11	(10,319)	(784)
Acquisition of subsidiary net of cash acquired		–	(481)
Net cash used in investing activities		**(13,727)**	**(5,572)**
Cash flows from financing activities			
Loans received		10,124	–
Loans repaid		(5,294)	(15,737)
Net cash provided by financing activities		**4,830**	**(15,737)**
Effect of exchange rate changes on cash and cash equivalents		405	(846)
Net decrease in cash and cash equivalents		**(3,050)**	**(16,500)**
Cash and cash equivalents at beginning of the year	13	10,099	26,599
Cash and cash equivalents at end of the year	**13**	**7,049**	**10,099**

The accompanying notes on pages 27 to 43 are an integral part of these financial statements.

Financial Statements
Company Balance Sheet

(presented in US$ 000)
Company registration number: 05886534

At 31 December	Notes	Company 2012	Company 2011
Assets			
Non-current assets			
Investments	20	152,234	152,134
Intercompany receivables		16,040	15,949
Total non-current assets		**168,274**	**168,083**
Current assets			
Cash and cash equivalents	13	1,017	2,614
Other receivables		62	60
Total current assets		**1,079**	**2,674**
Total assets		**169,353**	**170,757**
Equity and Liabilities			
Equity			
Share capital	16	1,485	1,485
Share premium (net of issue costs)	16	165,873	165,873
Other reserves	17	5,233	5,233
Accumulated loss	21	(4,610)	(3,272)
Total equity		**167,981**	**169,319**
Current liabilities			
Intercompany payables		1,357	1,357
Trade and other payables	19	15	81
Total current liabilities		**1,372**	**1,438**
Total equity and liabilities		**169,353**	**170,757**

Approved by the Board of Directors on 28 March 2013 and signed on its behalf by

Mikhail Ivanov
Chief Executive Officer

Tony Alves
Chief Financial Officer

The accompanying notes on pages 27 to 43 are an integral part of these financial statements.

Financial Statements

Group Statement of Changes in Shareholders' Equity

(presented in US$ 000)

	Attributable to the equity shareholders of the Company					
	Share Capital	Share Premium	Other Reserves	Accumulated Loss	Non-controlling Interests	Total Equity
Opening equity at 1 January 2011	**1,485**	**165,873**	**(13,874)**	**(30,781)**	**(114)**	**122,590**
Loss for the year	–	–	–	(1,136)	–	(1,136)
Transactions with owners						
Share capital issued	–	–	–	–	–	–
Share issue costs	–	–	–	–	–	–
Share based payments	–	–	37	–	–	37
Total transactions with owners	–	–	37	–	–	37
Non-controlling interests	–	–	–	–	114	114
Currency translation differences	–	–	(6,459)	–	–	(6,459)
Total comprehensive income	–	–	(6,459)	–	114	(6,459)
Closing equity at 31 December 2011	**1,485**	**165,873**	**(20,296)**	**(31,917)**	**–**	**115,145**
Opening equity at 1 January 2012	**1,485**	**165,873**	**(20,296)**	**(31,917)**	**–**	**115,145**
Loss for the year	–	–	–	(7,421)	–	(7,421)
Transactions with owners						
Share capital issued	–	–	–	–	–	–
Share issue costs	–	–	–	–	–	–
Share based payments	–	–	–	–	–	–
Total transactions with owners	–	–	–	–	–	–
Currency translation differences	–	–	6,677	–	–	6,677
Total comprehensive income	–	–	6,677	–		6,742
Closing equity at 31 December 2012	**1,485**	**165,873**	**(13,619)**	**(39,337)**	**–**	**114,402**

Company Statement of Changes in Shareholders' Equity

(presented in US$ 000)

	Note	Share Capital	Share Premium	Other Reserves	Accumulated Loss	Total Equity
Opening equity as at 1 January 2011		**1,485**	**165,873**	**5,196**	**(1,840)**	**170,714**
Loss for the year		–	–	–	(1,432)	(1,432)
Share capital issued		–	–	–	–	–
Share Issue costs		–	–	–	–	–
Share based payments	16	–	–	37	–	37
Closing equity at 31 December 2011		**1,485**	**165,873**	**5,233**	**(3,272)**	**169,319**
Opening equity as at 1 January 2012		**1,485**	**165,873**	**5,233**	**(3,272)**	**169,319**
Loss for the year		–	–	–	(1,338)	(1,338)
Share capital issued		–	–	–	–	–
Share Issue costs		–	–	–	–	–
Share based payments		–	–	–	–	–
Closing equity at 31 December 2012		**1,485**	**165,873**	**5,233**	**(4,610)**	**167,981**

The accompanying notes on pages 27 to 43 are an integral part of these financial statements.

Financial Statements
Notes to the IFRS Consolidated Financial Statements
For the year ended 31 December 2012
(presented in US$ 000)

1. General information
Volga Gas plc (the "Company" or "Volga") is a public limited company registered in England and Wales with registered number 5886534. The Company was incorporated on 25 July 2006. The principal activities of the Company and its subsidiaries (the "Group") are the acquisition, exploration and development of hydrocarbon assets and production of hydrocarbons in the Volga Region of the Russian Federation. Its registered office is at Ground floor, 17-19 Rochester Row, London, SW1P 1QT. The Company's shares are listed on the Alternative Investment Market of the London Stock Exchange.

These Group consolidated financial statements were authorised for issue by the Board of Directors on 28 March 2013.

2. Summary of significant accounting policies
The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation
The consolidated financial statements of Volga have been prepared in accordance with International Financial Reporting Standards (IFRSs), as adopted by the European Union (EU), International Financial Reporting Interpretations Committee (IFRIC) interpretations, and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

No income statement is presented for Volga Gas plc as permitted by Section 408 of the Companies Act 2006.

The consolidated financial statements have been prepared on the going concern basis as the directors, having reviewed the future cash flow forecasts of the Group, have concluded that the Group will continue to have access to sufficient funds in order to meet its obligations as they fall due for at least the foreseeable future.

Disclosure of impact of new and future accounting standards
(a) New and amended standards and interpretations adopted by the Group:

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on 1 January 2012 that have a material impact on the Group.

(b) Amended standards and interpretations not relevant to the Group:

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2012, but are not currently relevant for the Group:
> Amendment to IAS 12, "Income taxes" on deferred tax
> Amendment to IAS 1, "Presentation of financial statements" on OCI

(c) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group. The following new standards, amendments to standards and interpretations have been issued, but are not effective for the financial year beginning 1 January 2012 and have not been early adopted:
> IAS 19 (revised 2011) "Employee benefits" (effective 1 January 2013)
> IFRS 9 "Financial instruments" (effective 1 January 2015)
> IFRS 10 "Consolidated financial statements" (effective 1 January 2013)
> IFRS 12 "Disclosures of interests in other entities" (effective 1 January 2013)
> IFRS 13 "Fair value measurement" (effective 1 January 2013)
> IFRS 11, "Joint arrangements" (effective 1 January 2013)
> IAS 27 (revised 2011) "Separate financial statements" (effective 1 January 2013)
> IAS 28 (revised 2011) "Associates and joint ventures" (effective 1 January 2013)
> IFRIC 20 "Stripping costs in the production phase of a surface mine" (effective 1 January 2013)

The Group is yet to assess the full impact of these new standards and amendments but does not expect them to have a material impact on the financial statements.

2.2 Consolidation
(a) Subsidiaries
The consolidated financial statements include the financial statements of the Company and its subsidiaries. Subsidiaries are all entities in which the Group directly or indirectly owns more than 50 per cent of the voting stock or otherwise has the power to govern the financial and/or operating policies. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

Investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments.

Cost also includes direct attributable costs of investment.

Financial Statements
Notes to the IFRS Consolidated Financial Statements
continued

2. Summary of significant accounting policies continued
The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of comprehensive income.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered.

The Company and its subsidiaries outside the Russian Federation maintain their financial statements in accordance with IFRSs as adopted by the EU. The Russian subsidiaries of the Group maintain their statutory accounting records in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The consolidated financial statements are based on these statutory accounting records, appropriately adjusted and reclassified for fair presentation in accordance with International Financial Reporting Standards as adopted by the EU.

A list of the Company's subsidiaries is provided in note 19.

2.3 Segment reporting
Segmental reporting follows the Group's internal reporting structure.

Operating segments are defined as components of the Group where separate financial information is available and reported regularly to the chief operating decision maker ("CODM"), which is determined to be the Board of Directors of the Company. The Board of Directors which decide how to allocate resources and assesses operational and financial performance using the information provided.

The CODM receives monthly IFRS based financial information for the Group and its development and production entities. There were three development and production entities during both 2011 and 2012. Management has determined that the operations of these production and development entities are sufficiently homogenous (all are concerned with upstream oil and gas development and production activities) for these to be aggregated for the purpose of IFRS 8, "Operating Segments". The Group has other entities that engage as either head office or in a corporate capacity or as holding companies. Management has concluded that due to application of the aggregation criteria that separate financial information for segments is not required.

No geographic segmental information is presented as all of the companies operating activities are based in the Russian Federation.

Management has determined therefore that the operations of the Group comprise one class of business, being oil and gas exploration, development and production and the Group operates in only one geographic area – the Russian Federation.

There is no concentration of sales with any major customer that is required to be separately disclosed.

2.4 Foreign currency translation
(a) Functional and presentation currency
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in US dollars, which is the Company's functional and the Group's presentation currency.

The functional currency of the Group's subsidiaries that are incorporated in the Russian Federation is the Russian rouble ("RUR"). It is the Management's view that the RUR best reflects the financial results of its Cyprus subsidiaries because they are dependent on entities based in Russia that operate in an RUR environment in order to recover their investments. As a result, the functional currency of the subsidiaries continues to be the RUR.

(b) Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss.

Foreign exchange gains and losses that relate to cash and cash equivalents, borrowings and other foreign exchange gains and losses are presented in the income statement within "Other gains and losses".

(c) Group companies
The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
(iii) all resulting exchange differences are recognised in other comprehensive income.

The major exchange rates used for the revaluation of the closing balance sheet at 31 December 2012 were
> GBP 1.6242: US$ (2011: GBP 1: US$1.5453)
> EUR 1.3215: US$ (2011: not applicable)
> US$1:30.558 RUR. (2011: US$1: RUR. 32.196)

2. Summary of significant accounting policies continued

2.5 Oil and gas exploration assets

The Company and its subsidiaries apply the successful efforts method of accounting for Exploration and Evaluation ("E&E") costs, in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources". Costs are accumulated on a field-by-field basis. Costs directly associated with an exploration well, including certain geological and geophysical costs, and exploration and property leasehold acquisition costs, are capitalised until the determination of reserves is evaluated. If it is determined that a commercial discovery has not been achieved, these costs are charged to expense after the conclusion of appraisal activities. Exploration costs such as geological and geophysical that are not directly related to an exploration well are expensed as incurred.

Capital expenditure is recognised as property, plant and equipment or intangible assets in the financial statements according to the nature of the expenditure and the stage of development of the associated field, i.e. exploration, development, production.

Once commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development tangible and intangible assets. No depreciation or amortisation is charged during the exploration and evaluation phase.

(a) Development tangible and intangible assets

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells into commercially proven reserves, is capitalised within property, plant and equipment and intangible assets depending on the nature of the expenditure. When development is completed on a specific field, it is transferred to producing assets as part of property, plant and equipment or intangible assets. No depreciation or amortisation is charged during the development phase.

(b) Oil and gas production assets

Development and production assets are accumulated generally on a field by field basis and represent the cost of developing the commercial reserves discovered and bringing them into production together with E&E expenditures incurred in finding commercial reserves and transferred from the intangible E&E assets as described above.

The cost of development and production assets also includes the cost of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised and the cost of recognising provisions for future restoration and decommissioning.

Where major and identifiable parts of the production assets have different useful lives, they are accounted for as separate items of property, plant and equipment. Costs of minor repairs and maintenance are expensed as incurred.

(c) Depreciation/amortisation

Oil and gas properties are depreciated or amortised using the unit-of-production method. Unit-of-production rates are based on proved and probable reserves, which are oil, gas and other mineral reserves estimated to be recovered from existing facilities using current operating methods. Oil and gas volumes are considered produced once they have been measured through meters at custody transfer or sales transaction points at the outlet valve on the field storage tank.

(d) Impairment – exploration and evaluation assets

Exploration and evaluation assets are tested for impairment prior to reclassification to development tangible or intangible assets, or whenever facts and circumstances indicate that an impairment condition may exist. An impairment loss is recognised for the amount by which the exploration and evaluation assets' carrying amount exceeds their recoverable amount. The recoverable amount is the higher of the exploration and evaluation assets' fair value less costs to sell and their value in use. For the purposes of assessing impairment, the exploration and evaluation assets subject to testing are grouped with existing cash-generating units of production fields that are located in the same geographical region.

(e) Impairment – proved oil and gas production properties and intangible assets

Proven oil and gas properties and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The cash generating unit applied for impairment test purposes is generally the field, except that a number of field interests may be grouped together where the cash flows of each field are interdependent, for instance where surface infrastructure is used by one or more field in order to process production for sale.

(f) Decommissioning

Provision is made for the cost of decommissioning assets at the time when the obligation to decommission arises. Such provision represents the estimated discounted liability (the discount rate used currently being at 10% per annum) for costs which are expected to be incurred in removing production facilities and site restoration at the end of the producing life of each field. A corresponding item of property, plant and equipment is also created at an amount equal to the provision. This is subsequently depreciated as part of the capital costs of the production facilities. Any change in the present value of the estimated expenditure attributable to changes in the estimates of the cash flow or the current estimate of the discount rate used are reflected as an adjustment to the provision and the property, plant and equipment. The unwinding of the discount is recognised as a finance cost.

2.6 Other business and corporate assets

Property, plant and equipment not associated with exploration and production activities are carried at cost less accumulated depreciation. These assets are also evaluated for impairment when circumstances dictate.

Land is not depreciated. Depreciation of other assets is calculated on a straight line basis as follows:

Machinery and equipment	6–10 years
Office equipment in excess of US$5,000	3–4 years
Vehicles and other	2–7 years

Financial Statements
Notes to the IFRS Consolidated Financial Statements
continued

2. Summary of significant accounting policies continued

2.7 Financial assets

The Group classifies its financial assets in the following categories:

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. This category comprises derivatives unless they are effective hedging instruments. The Group had no financial assets in this class as at 31 December 2012 or 31 December 2011.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category comprises trade and other receivables, term bank deposits and cash and cash equivalents in balance sheet.

2.8 Derivative financial instruments

Derivative financial assets and financial liabilities are financial instruments whose value changes in response to an underlying variable, require little or no initial investment and are settled in the future. The Company has used derivatives such as foreign exchange forward contracts to manage risks of changes in foreign exchange rates. The Group has not applied hedge accounting in respect of forward foreign exchange contracts. Consequently, movements in the fair value of derivative instruments are immediately recognised in profit or loss.

2.9 Acquisitions, asset purchases and disposals

Acquisitions of oil and gas properties are accounted for under the purchase method where the target meets the definition of a business combination.

Transactions involving the purchases of an individual field interest, or a group of field interests, that do not qualify as a business combination are treated as asset purchases, irrespective of whether the specific transactions involved the transfer of the field interests directly or the transfer of an incorporated entity. Accordingly, no goodwill or deferred tax gross up arises. The purchase consideration is allocated to the assets and liabilities purchased on an appropriate basis.

Proceeds on disposal are applied to the carrying amount of the specific intangible asset or development and production assets disposed of and any surplus is recorded as a gain on disposal in the income statement.

2.10 Inventories

Crude oil inventories are stated at the lower of cost of production and net realisable value. Materials and supplies inventories are recorded at average cost and are carried at amounts which do not exceed the expected recoverable amount from use in the normal course of business. Cost comprises direct materials and, where applicable, direct labour plus attributable overheads based on a normal level of activity and other costs associated in bringing inventories to their present location and condition.

2.11 Trade and other receivables

Trade and other receivables are recorded initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, and deposits held at call with banks.

2.13 Share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2.14 Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.15 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at end of the reporting period in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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

2. Summary of significant accounting policies continued

2.16 Employee benefits

(a) Share-based compensation

The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The option plan currently in place for certain of the directors is an equity settled share option plan.

The Company measures the equity instruments granted to employees at the fair value at grant date. The fair value of fully-vested shares is expensed immediately. The fair value of shares with vesting requirements is estimated using Black-Scholes option pricing model. This value is recognised as an expense over the vesting period on a straight-line basis. The estimate is revised, as necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.

(b) Social obligations

Wages, salaries, contributions to the Russian Federation state pension and social insurance funds, paid annual leave, sick leave and bonuses are accrued in the year in which the associated services are rendered by the employees of the Group.

2.17 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of oil and gas in the ordinary course of the Group's activities. Revenue is shown net of value added tax, returns, rebates and discounts and after eliminating sales within the Group.

(a) Sales of oil and gas

Revenue from the sale of oil or gas is recognised when the oil/gas is delivered to customers and title has transferred. Revenue is stated net of value-added tax. In 2011 and 2012 , the Group's revenue related to sales of crude oil and condensate collected directly by customers and gas sales made at the entry to the gas distribution system.

(b) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method.

2.18 Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

2.19 Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.20 Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of completion of the acquisition. Acquisition costs incurred are expensed and included in administrative expenses. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If there is excess of the cost of acquisition over the fair value of the acquired entity's share of the identifiable net assets acquired, then the excess is recorded as goodwill. If the cost of the acquisition is less than acquired entity's share of the net assets required, the difference is recognised directly in the statement of income.

3. Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, price risk, and cash flow interest rate risk), credit risk, and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

(a) Market Risk

(i) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from currency exposures, primarily with respect to the Russian Ruble. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities.

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3. Financial risk management continued

At 31 December 2012, if the US dollar had weakened/strengthened by 5% against the RUR with all other variables held constant, post-tax profit for the year would have been US$40,000 (2011: US$24,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of RUR denominated trade payables and financial assets. At 31 December 2012, if the US dollar had weakened/strengthened by 5% against the Euro ("EUR") with all other variables held constant, post-tax profit for the year would have been US$197,000 (2011: not applicable) higher/lower, mainly as a result of foreign exchange gains/losses on translation of EUR denominated interest charges and financial liabilities. At 31 December 2012, if the US dollar had weakened/strengthened by 5% against the Pound Sterling ("GBP") with all other variables held constant, post-tax profit for the year would have been US$5,000 (2011: US$41,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of GBP denominated trade payables and financial assets.

The following table shows the currency structure of financial assets and liabilities:

At 31 December 2012	Rubles US$ 000	US Dollars US$ 000	Euros US$ 000	Sterling US$ 000	Total US$ 000
Financial assets					
Cash and cash equivalents	2,790	4,166	25	69	7,049
Total financial assets	**2,790**	**4,166**	**25**	**69**	**7,049**
Financial liabilities (before provision for UK taxes)	4,068	3,987	4,002	11	12,068

At 31 December 2011	Rubles US$ 000	US Dollars US$ 000	Euros US$ 000	Sterling US$ 000	Total US$ 000
Financial assets					
Cash and cash equivalents	6,987	2,644	–	468	10,099
Total financial assets	**6,987**	**2,644**	**–**	**468**	**10,099**
Financial liabilities (before provision for UK taxes)	6,521	83	–	10	6,614

No foreign exchange forward contracts were used in 2012 or 2011.

(ii) Price risk

The Group is not exposed to price risk as it does not hold financial instruments of which the fair values or future cash flows will be affected by changes in market prices.

(iii) Cash flow and fair value interest rate risk

As the Group has no significant interest-bearing assets and liabilities, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

(b) Credit risk

The Group's maximum credit risk exposure is the fair value of each class of assets, presented in note 3.1(a)(i) of US$7,049,000 and US$10,099,000 at 31 December 2012 and 2011 respectively.

The Group's principal financial asset is cash and credit risk arises from cash and cash equivalents and deposits with banks and financial institutions. It is the Group's policy to monitor the financial standing of these assets on an ongoing basis. Bank balances are held with reputable and established financial institutions.

The Group's oil sales are undertaken on a prepaid basis and accordingly the Group has no trade receivables and consequently no credit risk associated with trade receivables.

Rating of financial institution (S&P)	31 December 2012	31 December 2011
A+	1,147	2,795
BBB+	5,296	563
BBB–	517	6,387
Other	89	354
Total bank balance	**7,049**	**10,099**

3. Financial risk management continued

(c) Liquidity risk

Cash flow forecasting is performed by Group finance. Group finance monitors rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operational needs. The Group believes it has at least sufficient liquidity headroom to fund its currently planned exploration and development activities.

The Group expects to fund its exploration and development programme, as well as its administrative and operating expenses, through 2012 using a combination of existing working capital, medium term bank borrowings and expected proceeds from the sale of oil and gas production. If the Group is unsuccessful in generating enough liquidity to fund its expenditures, the Group's ability to execute its long-term growth strategy could be significantly affected. The Group may need to raise additional equity or debt finance as appropriate to fund investments beyond its current commitments.

3.2 Fair value estimation

Effective 1 January 2009, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the balance sheet at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The Group has no financial assets and liabilities that are required to be measured at fair value.

4. Critical accounting estimates and judgements

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Carrying value of fixed assets, intangible assets and impairment

Fixed assets are assessed for impairment when events and circumstances indicate that an impairment condition may exist. The carrying value of fixed assets is evaluated by reference to their value in use and primarily looks to the present value of management's best estimate of the cash flows expected to be generated from the asset. In identifying cash flows management firstly determine the cash generating unit or group of assets that give rise to the cash flows. The cash generating unit is the lowest level of asset at which independent cash flows can be generated.

The estimation of forecast cash flows involves the application of a number of significant judgements and estimates to a number of variables including production volumes, commodity prices, operating costs, capital investment, hydrocarbon reserves estimates, inflation and discount rates. For the purposes of impairment testing, the discount rate used is 15% per annum. In addition, judgement is applied in determining the cash generating unit to be assessed for impairment.

(b) Estimation of oil and gas reserves

Estimates of oil and gas reserves are inherently subjective and subject to periodic revision. In addition, the results of drilling and other exploration or development activity will often provide additional information regarding the Group's reserve base that may result in increases or decreases to reserve volumes. Such revisions to reserves can be significant and are not predictable with any degree of certainty. Management considers the estimation of reserves to represent a significant judgement in the context of the financial statements as reserve volumes are used as the basis for assessing the useful life of oil and gas assets, applying depreciation to oil and gas assets and in assessing the carrying value of oil and gas assets. Decreases in reserve estimates can lead to significant impairment of oil and gas assets where revisions (positive or negative) can have a significant effect on depreciation rates from period to period. Management have considered the sensitivity of this key assumption and in order for an impairment issue to present itself to the Group, reserve estimates would need to reduce by more than 25%.

(c) Income taxes

Significant judgement is frequently required in estimating provisions for deferred taxes. This process involves an assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the balance sheet.

(d) Business combination – acquisition of LLC Gazneftedobycha

In April 2011, the Group purchased 100% of the share capital of LLC Gazneftedobycha ("GND"). IFRS 3 requires that, at the date of acquisition, all assets and liabilities, including intangible assets, of an acquired entity be recorded at their respective fair values. The estimation of fair values requires significant management judgement. To assess fair values of monetary assets and liabilities, management used all information available to determine whether an asset is recoverable or whether it is probable that an event will result in outflows of resources from the Group, including assessment of such factors as the current overall economic conditions, specific customer, counterparty or industry conditions and the current overall legal environment. Changes in any of these conditions may result in adjustments to fair values of monetary assets and liabilities recorded by the Group. Management engaged independent experts to advise as to the fair values of acquired property, plant and equipment. Acquisition accounting has been finalised in 2012 with no material revisions other than for the recognition of US$2.7 million of deferred tax which has been added to licence acquisition costs. However, future changes in any of the estimates may result in losses in future periods.

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4. Critical accounting estimates and judgements continued
The recognised amounts determined for the fair values of the assets acquired and liabilities assumed were as follows:

As at 1 April 2011	US$ 000
Property, plant and equipment	31,078
Intangible assets – licence acquisition costs	17,010
Other non-current assets	288
Cash and cash equivalents	554
Inventory	631
Trade and other receivables	520
Deferred tax liabilities	(1,869)
Other current assets	17
Trade payables	(946)
Other current liabilities	(112)
Total identifiable net assets acquired	**47,171**

There was no goodwill arising from the business combination based on the provisional accounting. As a part of the accounting for the business combination the excess amount of the consideration paid over the provisional net fair value of the other assets and liabilities acquired has been attributed to the fair value of the Dobrinskoye production licence, which is owned by GND.

The fair value of the consideration paid plus liabilities assumed in the acquisition of GND was:

	US$ 000
Cash purchase of GND equity	1,082
Debt outstanding to Trans Nafta	24,440
GNS receivable (Note 12(b))	21,649
Total	**47,171**

The fair value of trade and other receivables is US$520,000 and includes trade receivables with a fair value of less than US$100.

The revenue included in the consolidated income statement from 1 April 2011 to 31 December 2011 contributed by GND was $9,262,000. GND also contributed profit of US$1,083,000 over the same period.

Had GND been consolidated from 1 January 2011, the consolidated income statement for the year ended 31 December 2011 would show revenue of US$13,035,000 and profit of US$4,319,000.

Subsequent to the acquisition and between 28 April 2011 and 31 December 2011, GND made repayments to Trans Nafta totalling US$18,883,000. The remainder of the loans outstanding to Trans Nafta were repaid in full during the year ended 31 December 2012.

5. Cost of sales and administrative expenses – Group
Cost of sales and administrative expenses are as follows:

Year ended 31 December	2012 US$ 000	2011 US$ 000
Cost of sales	15,648	15,582
Exploration and evaluation expenses	8,475	200
Operating and administrative expenses	9,890	6,704
Write off of development assets	188	5,612
Total operating and administrative expenses	**34,201**	**28,098**

5. Cost of sales and administrative expenses – Group continued

Total operating and administrative expenses are analysed as follows:

Year ended 31 December	2012 US$ 000	2011 US$ 000
Mineral extraction tax	8,951	9,537
Exploration and evaluation	8,475	200
Salaries and staff benefits	3,025	2,485
Depreciation and amortisation	2,280	2,641
Directors' emoluments and other benefits	817	827
Field operating expenses	2,855	2,413
Audit fees	257	301
Taxes other than payroll and mineral extraction	1,000	896
Legal and consulting	994	1,050
Write off of development assets	188	5,612
Provision against VAT recovery	2,945	–
Fines and penalties	977	–
Other	1,437	2,136
Total	**34,201**	**28,098**

(a) Exploration and evaluation

The principal component of the 2012 exploration and evaluation expense is the impairment charge on the carrying value of intangible assets relating to the two unsuccessful exploration wells completed during 2012 . This includes licence acquisition costs as wells as the cost of seismic studies and costs of drilling and testing operations.

(b) Staff and salaries

The average monthly number of employees (including executive directors) employed by the Group was:

Year ended 31 December	2012	2011
Exploration and production	121	121
Administration and support	24	26
Total	**145**	**147**

Their aggregate remuneration (excluding executive directors) comprised:

Year ended 31 December	2012 US$ 000	2011 US$ 000
Wages and salaries	2,453	1857
Payroll taxes and social contribution	533	542
Staff benefits	39	86
Total	**3,025**	**2,485**

The average monthly number of employees employed by the Company was:

Year ended 31 December	2012	2011
Administration and support	2	2

Only directors are employed by the Company.

(c) Directors' emoluments and other benefits

Details of directors' emoluments and other benefits for the years ended 31 December 2012 and 31 December 2011 are provided in the Directors' Remuneration Report. Included in directors' emoluments were share grant expenses of US$nil (2011: US$37,000).

(d) Audit Fees – Group and Company

Disclosure of the fees paid to the Company's auditors and its associates is given in note 21.

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5. Cost of sales and administrative expenses – Group continued

(e) Depreciation

Substantially all depreciation relates to oil and gas assets and is included within cost of sales.

(f) Provision for disputed VAT

During 2012, the Group paid a sum of US$2.9 million in settlement of a disputed VAT claim. Recovery of this is subject to a continuing court process in Russia. Management considers recovery of the sum to be likely and intends to pursue the recovery vigorously. However, it was considered prudent to make a provision against an unsuccessful outcome.

6. Finance income – Group

Finance income comprises interest earned during the period on cash balances with different financial institutions (note 13). Interest expense relates to a two year amortising debt facility (note 18).

7. Other gains and losses – Group

Year ended 31 December	2012 US$ 000	2011 US$ 000
Foreign exchange loss	(234)	(1,341)
Other gains/(losses)	62	(469)
Total other gains and losses	**(172)**	**(1,810)**

8. Current and deferred income tax – Group

Year ended 31 December	2012	2011
Current tax:		
Current income tax	–	–
Adjustments to tax charge in respect of prior periods	–	–
Total current tax	–	–
Deferred tax:		
Adjustments to tax charge in respect of prior periods	(500)	–
Origination and reversal of timing differences	(613)	(18)
Total deferred tax	**(1,113)**	**(18)**
Total tax credit/(charge)	**(1,113)**	**(18)**

The tax charge in the Group income statement differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

Year ended 31 December	2012 US$ 000	2011 US$ 000
Profit/(loss) before income tax and minority interest	(6,308)	(1,118)
Tax calculated at domestic tax rates applicable to (profits)/losses in the respective countries	(1,322)	153
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	982	(238)
Tax losses for which no deferred tax asset was recognised	–	(512)
Other tax adjustments	(773)	579
Income tax charge	**(1,113)**	**(18)**

The weighted average applicable tax rate was 19.6% (2011: 19.6%).

8. Current and deferred income tax – Group continued

Deferred taxation is attributable to the temporary differences that exist between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The tax effects of temporary differences that give rise to deferred taxation are presented below:

	31 December 2012	Differences recognition and reversal	31 December 2011	Business combination	Differences recognition and reversal	31 December 2010
Tax effects of taxable temporary differences:						
Exploration and production assets	(6,488)	(5,829)	(659)	–	39	(698)
Property, plant and equipment	(2,466)	(2,466)	–	–	–	–
Inventories	(7)	5	(12)	–	1	(13)
Total	**(8,961)**	**(8,290)**	**(671)**	**–**	**40**	**(711)**
Tax effect of deductible temporary differences:						
Tax losses carry forward	10,590	4,874	5,716	831	(386)	5,271
Trade and other receivables	275	(48)	323	–	(19)	342
Property, plant and equipment	158	(27)	185	–	(11)	196
Share grant expenses	–	(7)	7	–	–	7
Total	**11,023**	**4,792**	**6,231**	**831**	**(416)**	**5,816**
Net tax effect of temporary differences	**2,062**	**(3,498)**	**5,560**	**831**	**(376)**	**5,105**

Deferred income tax assets are recognised for tax loss carry forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable. Tax losses in respect of Cyprus and the UK do not expire. The Group has not recognised a deferred tax asset of $1,224k in respect of tax losses and other short-term timing differences in the UK (2011: $1,009k).

9. Basic and diluted loss per share – Group

Profit per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary and diluted shares in issue during the year excluding ordinary shares purchased by the Company and held as treasury shares.

Year ended 31 December	2012	2011
Net loss attributable to equity shareholders (per share)	(0.08)	(0.01)
Net loss attributable to equity shareholders	(7,421)	(1,136)
Basic weighted number of shares	81,017,800	81,017,800

10. Intangible assets – Group

Intangible assets represent exploration and evaluation assets such as licences, studies and exploratory drilling, which are stated at historical cost.

	Work in progress: exploration and evaluation	Exploration and evaluation	Development and producing assets	Total
At 1 January 2011	3,444	6,073	19,603	29,120
Additions	398	–	15,780	16,178
Impairments	(99)	–	(2,193)	(2,292)
Transfers	(51)	–	51	–
At 31 December 2011	3,692	6,073	33,241	43,006
Accumulated amortisation				
At 1 January 2011	–	–	(155)	(155)
Depreciation	–	–	(631)	(631)
At 31 December 2011	–	–	(786)	(786)
Exchange adjustments	(205)	(324)	(2,169)	(2,698)
At 31 December 2011	**3,487**	**5,749**	**30,286**	**39,522**

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10. Intangible assets – Group continued

	Work in progress: exploration and evaluation	Exploration and evaluation	Development and producing assets	Total
At 1 January 2012	3,487	5,749	31,072	40,308
Additions	–	28	427	455
Impairments	(33)	(136)	–	(169)
Transfers	(3,238)	3,238	–	–
Transfers to PP&E			(31,499)	(31,499)
At 31 December 2012	216	8,879	–	9,095
Exchange adjustments	134	417	–	551
At 31 December 2012	**350**	**9,296**	**–**	**9,646**

During 2012 the licence acquisition costs and other intangible assets associated with producing oil and gas fields were transferred to Property, plant and equipment (note 11) following management review of the performance of the Group's fields in Cash Generating Units. As a result of this transfer all producing assets are allocated to the same financial statement caption and are therefore consistent with how the results are monitored.

11. Property, plant and equipment – Group

Movements in property, plant and equipment, for the years ended 31 December 2012 and 2011 are as follows:

Cost	Development assets	Work in progress	Land and buildings	Producing assets	Other	Total
At 1 January 2011	25,563	440	1,070	12,277	146	39,496
Additions	2,591	5,202	126	30,259	674	38,852
Write offs	(5,789)	(456)	–	(275)	(78)	(6,598)
Transfers	(660)	–	–	577	83	–
At 31 December 2011	21,705	5,186	1,196	42,838	825	71,750
Accumulated depreciation						
At 1 January 2011	–	–	–	(1,942)	(61)	(2,003)
Depreciation	–	–	–	(4,225)	(382)	(4,607)
Disposals	–	–	–	20	52	72
At 31 December 2011	–	–	–	(6,147)	(391)	(6,538)
Exchange adjustments	(1,030)	(436)	(68)	(2,849)	(35)	(4,418)
At 31 December 2011	**20,675**	**4,750**	**1,128**	**33,842**	**399**	**60,794**

Cost	Development assets	Work in progress	Land and buildings	Producing assets	Other	Total
At 1 January 2012	20,675	4,750	1,128	39,989	790	67,332
Additions	10,236	3,643	65	3,574	–	17,518
Impairments	–	(7,314)	–	–	–	(7,314)
Disposals	(144)	(984)	–	(238)	(18)	(1,384)
Transfers	(18,051)	(367)	–	18,404	14	–
Transferred from Intangible assets	–	–	–	31,499	–	31,499
At 31 December 2012	12,716	(272)	1,193	93,228	786	107,651
Accumulated depreciation						
At 1 January 2012	–	–	–	(6,147)	(391)	(6,538)
Transferred from Intangible assets	–	–	–	(786)	–	(786)
Depreciation	–	–	–	(2,188)	(113)	(2,301)
Disposals	–	–	–	107	16	123
At 31 December 2012	–	–	–	(9,014)	(488)	(9,502)
Exchange adjustments	1,057	169	69	4,237	22	5,554
At 31 December 2012	**13,773**	**(103)**	**1,262**	**88,451**	**320**	**103,703**

12. Non-current assets – Group

As at 31 December	2012 US$ 000	2011 US$ 000
VAT recoverable	714	1,779
Other non-current assets	82	76
Total other non-current assets	**796**	**1,855**

Management believes that it may not be able to recover all VAT specific to licence and exploration and evaluation contractors' payments within the 12 months of the balance sheet date. Therefore this VAT is classified as a non-current asset.

13. Term deposits, cash and cash equivalents – Group and Company

	Group		Company	
At 31 December	2012 US$ 000	2011 US$ 000	2012 US$ 000	2011 US$ 000
Cash at bank and on hand	4,484	4,509	1,017	2,614
Short-term bank deposits	2,565	5,590	–	–
Total cash and cash equivalents	**7,049**	**10,099**	**1,017**	**2,614**

An analysis of Group deposits, cash and cash equivalents by bank and currency is presented in the table below:

		Group		Company	
At 31 December Bank	Currency	2012 US$ 000	2011 US$ 000	2012 US$ 000	2011 US$ 000
United Kingdom					
Barclays Bank PLC	USD	1,078	2,327	949	2,146
Barclays Bank PLC	GBP	69	468	69	468
Russian Federation					
Transcredit Bank	RUR	71	6,387	–	–
Unicreditbank	RUR	234	246	–	–
Unicreditbank	USD	283	317	–	–
ZAO Raiffeisenbank	RUR	2,466	–	–	–
ZAO Raiffeisenbank	USD	2,805	–	–	–
ZAO Raiffeisenbank	EUR	25	–	–	–
Other banks and cash on hand	RUR	19	354	–	–
Total cash and cash equivalents		**7,049**	**10,099**	**1,017**	**2,614**

14. Inventories – Group

At 31 December	2012 US$ 000	2011 US$ 000
Production and other spares	1,124	1,643
Crude oil inventory	111	208
Total inventories	**1,235**	**1,851**

15. Other receivables – Group

At 31 December	2012 US$ 000	2011 US$ 000
VAT receivable	697	95
Prepayments	1,520	2,108
Other accounts receivable	113	206
Total other receivables	**2,330**	**2,409**

Prepayments are to contractors relate to initial advances made in respect of drilling, construction and other projects.

Financial Statements
Notes to the IFRS Consolidated Financial Statements
continued

16. Share capital and share premium – Group
The following summarises the movement in the share capital and share premium of the Company for the years ended 2010 and 2011.

	Number of shares	Share capital US$ 000	Share premium US$ 000
At 1 January 2011	81,017,800	1,485	165,873
Issues of shares	–	–	–
At 31 December 2011	**81,017,800**	**1,485**	**165,873**
At 1 January 2012	81,017,800	1,485	165,873
Issues of shares	–	–	–
At 31 December 2012	**81,017,800**	**1,485**	**165,873**

The total number of authorised ordinary shares is 330,720,100 (2010: 330,720,100) with a par value of £0.01 per share (2010: £0.01 per share).

Share based compensation
Share options and other share based awards have been granted to certain directors. There were no shares issued to directors under such schemes during 2012 (2011: nil).

2008 Executive Share Option Plan
On 15 July 2008 the Group announced a new Executive Share Option Plan ("ESOP"). During 2008, the Company granted options to acquire 1,137,464 ordinary shares to Mikhail Ivanov under the terms of the ESOP. The options may be exercised at a price of 405p per share and vest in equal portions on May 2010, 2011 and 2012 and will remain outstanding until May 2017. In January 2009, the Company granted 568,732 share options to Tony Alves under the ESOP. The options vest in 8 semi-annual tranches over a period of 4 years providing certain performance conditions related to the Company's share price are met. The options have an exercise price of £1.00. Under the terms of the plan, during 2012 options over 379,154 shares (2011: 432,474 shares) were eligible for vesting. There were no share grant expenses in 2012 (2011: US$37,000).

The fair value of share options granted and of restricted shares issued is measured by use of the Black-Scholes pricing model with the following assumptions:

Year ended 31 December 2012	2009 Executive Share Option Plan
Share price	97.0p
Exercise price	100.0p–405.0p
Expected volatility	35.3%
Expected life	0–3 years
Risk free rate	2.5%
Expected dividends	None

17. Other reserves – Group

At 31 December	2012 US$ 000	2011 US$ 000
Currency translation adjustment	(18,852)	(25,529)
Share grant expense	5,233	5,233
Total other reserves	**(13,619)**	**(20,296)**

Currency translation adjustments represent adjustments on translation of the share capital of non-US$ subsidiaries into US$. All related exchange gains and losses are charged directly to equity.

18. Debt – Group
On 26 March 2012, the Group entered into a loan agreement to provide up to US$10 million by way of a two year amortising credit facility. Under the facility, the amounts outstanding are amortised over 19 monthly instalments commencing October 2012. The maturity period of the financial liabilities under this facility is disclosed in note 19 below.

19. Trade and other payables – Group

At 31 December	2012 US$ 000	2011 US$ 000
Trade payables	771	416
Taxes other than profit tax	1,864	1,553
Customer advances	1,448	466
Loans due to Trans Nafta	–	4,179
Total	**4,083**	**6,614**

In April 2011, the Group purchased 100% of the share capital of LLC Gazneftedobycha ("GND"). At the date of the acquisition, GND had loans outstanding due to its former parent, Trans Nafta. The final balances were repaid in April 2012.

The maturity period of the Group's financial liabilities, comprising only trade and other payables at 31 December 2012 and 2011 is as follows:

Maturity period at 31 December 2012	0 to 3 months	3 to 12 months	Over 1 year	Total
Trade and other payables	4,058	25	–	4,083
Bank debt	1,600	4,803	1,586	7,989

Maturity period at 31 December 2011	0 to 3 months	3 to 12 months	Over 1 year	Total
Trade and other payables	2,435	4,179	–	6,614
Bank debt	–	–	–	–

20. Investments – Company

Investments in subsidiaries, comprising solely ordinary share capital, are accounted for at cost. The Company's subsidiaries are as follows:

Name	Jurisdiction	Nature of Operations	% Owned	From
Woodhurst Holdings Ltd.	Cyprus	Intermediate Holding Company	100%	October 2005
Pre-Caspian Gas Company	Russia	Oil and gas exploration and production	100%	May 2006
Gazneftеservice	Russia	Oil and gas exploration and production	100%	September 2006
Shropak Investments Ltd	Cyprus	Dormant	100%	June 2007
Volga Gas (Cyprus) Ltd.	Cyprus	Intermediate Holding Company	100%	August 2007
Gazservice	Russia	Special purpose entity	99%	October 2008
ZAO Gamma	Russia	Joint operating company	75%	January 2009
Volga Gas Finance Ltd.	UK	Intermediate Holding Company	100%	March 2010

To avoid certain legal restrictions on land ownership in October 2008 Pre-Caspian Gas Company acquired a 99% shareholding in ZAO Gazservice. Subsequently, Pre-Caspian Gas Company sold an unimproved plot of land to ZAO Gazservice at cost basis.

Company	31 December 2011 US$ 000	Additions US$ 000	Disposals US$ 000	31 December 2012 US$ 000
Investments in Woodhurst Holdings	150,683	0	–	150,683
Investments in Volga Gas (Cyprus)	1,451	100	–	1,551
Total investments	**152,134**	**100**	**0**	**152,234**

The Company funds its activities in the Russian Federation via Woodhurst Holdings, the Company's Cyprus registered subsidiary.

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21. Accumulated loss – Group and Company

At 31 December	Group 2012 US$ 000	Group 2011 US$ 000	Company 2012 US$ 000	Company 2011 US$ 000
Retained losses	(31,916)	(30,780)	(3,272)	(1,840)
Loss for the year	(7,421)	(1,136)	(1,338)	(1,432)
Accumulated loss 31 December	**(39,337)**	**(31,916)**	**(4,610)**	**(3,272)**

22. Audit fees – Group and Company
During the year the Group (including its overseas subsidiaries) obtained the following services from the Company's auditors and associates:

Year ended 31 December	2012 US$ 000	2011 US$ 000
Fees payable to Company's auditor for the audit of parent Company and consolidated financial statements	215	225
Fees payable to the Company's auditor and its associated firms for other services:		
– The audit of Company's subsidiaries pursuant to legislation	27	76
– Other services pursuant to legislation	153	99
– Tax services	–	–
Total	**396**	**400**

23. Related Party Transactions – Group and Company
The Group is controlled by Baring Vostok Private Equity Funds III and IV, which respectively own 48.9% and 9.76% (in aggregate 58.66%) of the Company's shares. The Baring Vostok Private Equity Funds exercise their control through a number of nominee holding companies. The remaining 41.34% of the shares are widely held.

The following transactions concerning purchases of goods and services were carried out with related parties:

Related party	Relationship	Nature of transactions	Year ended 31 December 2012	Year ended 31 December 2011
Baring Vostok Cyprus Limited	Affiliated with controlling shareholder	Rent, services	137	145
Baring Vostok Holding Limited	Affiliated with controlling shareholder	Travel expenses	6	3
Granitie Consulting Limited	Affiliated with controlling shareholder	Consultancy services	46	–

Year-end balances arising from transactions with related parties

	31 December 2012 US$ 000	31 December 2011 US$ 000
Due to related parties		
Baring Vostok (Cyprus) Limited	12	13

All transactions with related parties were made on commercial basis.

Key management
Key management is considered to be the Company's executive directors. Information on key management compensation is presented in the Directors' Remuneration Report.

24. Contingencies and Commitments
24.1 Capital commitments
Pre-Caspian Licence Area
In accordance with the licence agreement for the Pre-Caspian licence area, PGK was required to commence drilling one additional well before 31 December 2013. There are currently no plans for drilling in the block.

As of the balance sheet date all other licence commitments have been met.

24. Contingencies and Commitments continued

24.2 Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review, but under certain circumstances, reviews may cover longer periods.

At 31 December 2012, management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained.

24.3 Restoration, rehabilitation and environmental costs

The Group operates in the upstream oil industry in the Russian Federation and its activities may have an impact on the environment. The enforcement of environmental regulations in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligation related thereto. The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter interpretation and enforcement of existing legislation, cannot reasonably be estimated at present, but could be material.

Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group.

24.4 Oilfield licences

The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licences. Management of the Group correspond with governmental authorities to agree on remedial actions, if necessary, to resolve any findings resulting from these reviews. Failure to comply with the terms of a licence could result in fines, penalties, licence limitation, suspension or revocation. The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Group.

In January 2008 the Group was issued with an amendment to its Karpenskiy Licence Agreement. The amendments to the KLA remove the historical licence breaches.

The principal licences of the Group and their expiry dates are:

Field	Licence Holder	Licence expiry date
Karpenskiy	OOO Pre-Caspian Gas Company	2021
Pre-Caspian	OOO Pre-Caspian Gas Company	2031
Urozhainoye-2	OOO Pre-Caspian Gas Company	2032
Vostochny-Makarovskoye	OOO Gazneftеservice	2026
Dobrinskoye	OOO Gazneftedobycha	2026

Management believes that in practice the relevant authorities rarely suspend or restrict the licences, especially at the exploration stage, and tend to terminate licences only in the event of continuous non-compliance and the failure of the licence holder to remedy breaches. The Group has not received any official warnings or notifications about continuous non-compliance or any risk of suspension, restriction or termination.

Notice of Meeting

Notice is hereby given that the annual general meeting (the "AGM") of Volga Gas plc (the "Company") will be held at the London office of Akin Gump Strauss Hauer & Feld at Ten Bishops Square, London E1 6EG on 7 June 2013 at 10.00 a.m. for the following purposes:

Ordinary Resolutions

1. To receive and adopt the Company's accounts for the year ended 31 December 2012 and the directors' report.
2. To reappoint Mikhail Ivanov, who retires by rotation, as a director.
3. To reappoint Aleksey Kalinin, who retires by rotation, as a director.
4. To reappoint Vladimir Koshcheev, who retires by rotation, as a director.
5. To appoint KPMG Audit Plc as auditors of the Company until the conclusion of the next general meeting at which accounts are laid before the Company.
6. To authorise the directors to determine the remuneration of the auditors of the Company.

7. That the directors be and they are hereby generally and unconditionally empowered to exercise all the powers of the Company to allot shares in the Company and/or to grant rights to subscribe for or to convert any security for shares in the Company (together "Relevant Securities") up to a maximum aggregate nominal amount of £1,000,000 to such persons and at such times and on such terms as they think proper, provided that this authority shall expire the earlier of (i) fifteen months from the passing of this resolution, or (ii) the conclusion of the AGM of the Company to be held in 2014 (unless renewed, varied or revoked by the Company prior to or on such date), save that this authority shall allow the Company to make offers or agreements before the expiry of such authority which would or might require Relevant Securities to be allotted after such expiry and the directors shall be entitled to allot Relevant Securities pursuant to any such offer or agreement as if this authority had not expired; and all unexercised authorities previously granted to the directors to allot Relevant Securities be and are hereby revoked.

Special Resolutions

8. That the directors be and they are hereby empowered pursuant to Sections 570 and 573 of the Companies Act 2006 (the "Act") to allot equity securities (as defined in Section 560 of the Act) for cash; pursuant to the authority conferred by resolution 7 set out in this Notice convening the AGM (the "Notice") as if Section 561 of that Act did not apply to any such allotment, provided that this power shall be limited to:

   (a) the allotment of equity securities in connection with a rights issue, open offer or other offer of securities in favour of the holders of ordinary shares on the register of members at such record date(s) as the directors may determine where the equity securities respectively attributable to the interests of the ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them on any such record date(s), subject to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements or legal or practical problems arising under the laws of any overseas territory or the requirements of any regulatory body or stock exchange or by virtue of shares being represented by depositary receipts or any other matter; and

   (b) the allotment (otherwise than pursuant to sub-paragraph (a) above) to any person or persons of equity securities up to an aggregate nominal amount of £150,000.

   And the power conferred hereby shall expire upon the expiry of the general authority conferred by resolution 7 set out in this Notice (unless renewed, varied or revoked by the Company prior to or on such date), save that the Company shall be entitled to make offers or agreements before the expiry of such power which would or might require equity securities to be allotted after such expiry and the directors shall be entitled to allot equity securities pursuant to any such offer or agreement as if the power conferred hereby had not expired.

9. That, the articles of association, produced to the meeting and initialled by the Chairman for the purposes of identification, shall be approved and adopted by the Company in substitution for, and to the exclusion of, the existing articles of association.

Registered Office:
Ground Floor
17-19 Rochester Row
London
SW1P 1QT

BY ORDER OF THE BOARD
Antonio Maria Alves
Company Secretary
19 April 2013

Notes:

1. Resolutions 1-7 are ordinary resolutions. For these resolutions to be passed, a simple majority of the votes cast at the Company's AGM must be in favour of the resolutions. Resolutions 8 and 9 are special resolutions. For these resolutions to be passed, at least three-quarters of the votes cast at the AGM must be in favour of the resolution.
2. Amendment of Company's articles of association (Resolution 9).

   The purpose of this resolution 9 is to enable the use by the Company's registrar, Capita Registrars Limited, of an electronic seal or electronic signatures on share certificates as opposed to an embossed seal, which would be more cost effective. The Company's current articles of association do not provide for the use of an electronic seal or electronic signatures. Resolution 9 will therefore propose the adoption of new articles of association in substitution of the existing articles of association to explicitly allow for the use of an electronic seal or electronic signatures via amendments to Articles 6.1, 36.1 and 36.2 of the articles of association. The following documents will be available for inspection during business hours at the registered office until the date of the meeting and on the day of the meeting itself:
   - the current articles of association; and
   - the proposed new articles of association.
3. Only those members entered on the register of members of the Company at 6.00 p.m. on 5 June 2013 or, in the event that this meeting is adjourned, in the register of members as at 6.00 p.m. on the day two days before the date of any adjourned meeting, shall be entitled to attend and vote at the meeting in respect of the number of ordinary shares registered in their names at that time. Changes to the entries on the register of members after 6.00 p.m. on 5 June 2013 or, in the event that this meeting is adjourned, in the register of members after 6.00 p.m. on the day two days before the date of the adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the meeting.
4. A member entitled to attend, speak and vote at the meeting convened by the notice set out above is entitled to appoint a proxy to attend, speak and, on a poll, to vote in his place. To appoint more than one proxy you may photocopy this form. Please indicate the proxy holder's name and the number of shares in relation to which they are authorised to act as your proxy (which, in aggregate, should not exceed the number of shares held by you). Please also indicate if the proxy instruction is one of multiple instructions being given. All forms must be signed and should be returned together in the same envelope.
5. A form of proxy is enclosed. To be effective, it must be deposited at the office of the Company's registrars (Capita Registrars, The Proxy Department, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU) so as to be received not later than 48 hours before the time appointed for holding the AGM. Completion of the proxy does not preclude a member from subsequently attending and voting at the meeting in person if he or she so wishes.
6. To change your proxy instructions simply submit a new proxy appointment using the methods set out in Notes 2 and 3 above. Note that the cut-off time (in Note 3 above) for receipt of proxy appointments also apply in relation to amended instructions; any amended proxy appointment received after the relevant cut-off time will be disregarded.

   Where you have appointed a proxy using the hard-copy proxy form and would like to change the instructions using another hard-copy proxy form, please contact the Company's registrars. If you submit more than one valid proxy appointment, the appointment received last before the latest time for the receipt of proxies will take precedence.
7. In order to revoke a proxy instruction you will need to inform the Company using one of the following methods:
   (a) by sending a signed hard copy notice clearly stating your intention to revoke your proxy appointment to the Company's registered office address. In the case of a member which is a company, the revocation notice must be executed under its common seal or signed on its behalf by an officer of the company or an attorney for the company. Any power of attorney or any other authority under which the revocation notice is signed (or duly a certificated copy of such power of authority) must be included with the revocation notice; or
   (b) by sending an email to info@volgagas.com.

   In either case, the revocation notice must be received by the Company's registrars no later than the cut-off time set out in Note 3 above.
8. The register of interests of the directors and their families in the share capital of the Company and copies of contracts of service of directors with the Company or with any of its subsidiary undertakings will be available for inspection at the registered office of the Company during normal business hours (Saturdays and public holidays excepted) from the date of this notice until the conclusion of the AGM.
9. To appoint a proxy or to give or amend an instruction to a previously appointed proxy via the CREST system, the CREST message must be received by the issuer's agent RA10 no later than forty eight hours before the meeting date. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message. After this time any change of instructions to a proxy appointed through CREST should be communicated to the proxy by other means. CREST Personal Members or other CREST sponsored members, and those CREST Members who have appointed voting service provider(s) should contact their CREST sponsor or voting service provider(s) for assistance with appointing proxies via CREST. For further information on CREST procedures, limitations and system timings please refer to the CREST Manual. We may treat as invalid a proxy appointment sent by CREST in the circumstances set out in Regulation 35(5) (a) of the Uncertificated Securities Regulations 2001. In any case your proxy form must be received by the Company's registrars no later than forty eight hours before the meeting date.
10. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided they do not do so in relation to the same shares.
11. Under section 319A of the 2006 Act, the Company must cause to be answered any question relating to the business being dealt with at the Annual General Meeting put by a member attending the meeting unless answering the question would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, or the answer has already been given on a website in the form of an answer to a question, or it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.

    Members who have any queries about the Annual General Meeting should contact the Company Secretary by email on info@volgagas.com. Members may not use any electronic address or fax number provided in this notice or in any related documents (including the Form of Proxy) to communicate with the Company for any purpose other than those expressly stated.
12. Information regarding the Annual General Meeting, including information required by section 311A of the 2006 Act, and a copy of this notice of Annual General Meeting is available from www. volgagas.com.

Glossary of Technical Terms

2-D seismic	geophysical data that depicts the subsurface strata in two dimensions
3-D seismic	geophysical data that depict the subsurface strata in three dimensions. 3-D seismic typically provides a more detailed and accurate interpretation of the subsurface strata than 2-D seismic
abandonment	application of a cement plug to close a well and welding of a steel plate to the top of the well; the well is then plugged and abandoned
bbl	the standard barrel of crude oil or other petroleum product is 42 US gallons (approximately 159 litres)
bcf	billion cubic feet
bcm	billion cubic metres
Best estimate	the term "best estimate" is used here as a generic expression for the estimate considered to be the closest to the quantity that will actually be recovered from the accumulation between the date of the estimate and the time of abandonment
boe	barrels of oil equivalent, being for natural gas the energy equivalent on one barrel of oil. The usual ratio is to equate 6,000 cubic feet to one barrel of oil equivalent
condensate	liquid hydrocarbons associated with the production from a primarily natural gas reservoir
field	means an area consisting of either a single reservoir or multiple reservoirs, all grouped on or related to the same individual geological structural feature and/or stratigraphic condition
gas	natural gas
gas processing facilities	together with the laboratory, gathering pipelines and storage facilities (if any), a plant comprising one or more units such that after conditioning the gas will be of pipeline quality as, specified by Gazprom, such units may include dehydration, sweetening and separation of natural gas liquids
gas-water contact	bounding surface in a reservoir above which predominantly gas occurs and below which predominantly water occurs
hydrocarbons	compounds formed from the elements hydrogen (H) and carbon (C) and existing in solid, liquid or gaseous forms
Kungurian Salt	a layer of salt laid down during the lower Permian age which occurs in the Northern Caspian Petroleum Province
licence area	the particular subsoil plot specified in the subsoil licence issued by the applicable Russian federal authority, which the licence holder has the right to use for the purpose and on the terms specified in the subsoil licence. A licence area may contain one or more fields or may encompass only a portion of a field
liquidation	abandonment
mmbbls	million barrels
mcm	thousand cubic metres
mmBOE	million barrels of oil equivalent
natural gas	hydrocarbons that are gaseous at one atmosphere of pressure at 20°C. It can be divided into lean gas, primarily methane but often containing some ethane and smaller quantities of heavier hydrocarbons (also called sales gas) and wet gas, primarily ethane, propane and butane as well as smaller amounts of heavier hydrocarbons; partially liquid under atmospheric pressure
petroleum	naturally occurring liquids and gasses which are predominantly comprised of hydrocarbon compounds
possible reserves	are those unproven reserves that, on the available evidence and taking into account technical and economic factors, have a 10 per cent chance of being produced
probable reserves	are those reserves in which hydrocarbons have been located within the geological structure with a lesser degree of certainty because fewer wells have been drilled and/or certain operational tests have not been conducted. Probable reserves are those reserves that, on the available evidence and taking into account technical and economic factors, have a better than 50 per cent chance of being produced
prospective resources	are those quantities of hydrocarbons which are estimated, on a given date, to be potentially recoverable from undiscovered accumulations

proved reserves	include reserves that are confirmed with a high degree of certainty through an analysis of development history and/or volume method analysis of the relevant geological and engineering data. Proved reserves are those that, based on the available evidence and taking into account technical and economic factors, have a better than 90 per cent chance of being produced
proved plus probable reserves	sum of the proved reserves and the probable reserves calculated in accordance with SPE standards
reserves	quantities of petroleum which are anticipated to be commercially recoverable from known accumulations from a given date forward
reservoir	a porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs
risk factor	for contingent resources means the estimated chance, or probability, that the volumes will be commercially extracted; for prospective resources means the chance or probability of discovering hydrocarbons in sufficient quantity for them to be tested to the surface, this, then, is the chance or probability of the prospective resource maturing into a contingent resource
SPE standards	reserves definitions consistent with those approved in March 1997 by the Society of Petroleum Engineers and the World Petroleum Congresses
sub-salt	below the Kungurian salt layer
supra-salt	above the Kungurian salt layer

Notes

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United Kingdom

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Tony Alves
of the registered office

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United Kingdom

Auditors
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United Kingdom

Lawyers and Solicitors to the Company as to English and Russian Law
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United Kingdom

As to Russian law:
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Moscow 107031
Russian Federation

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