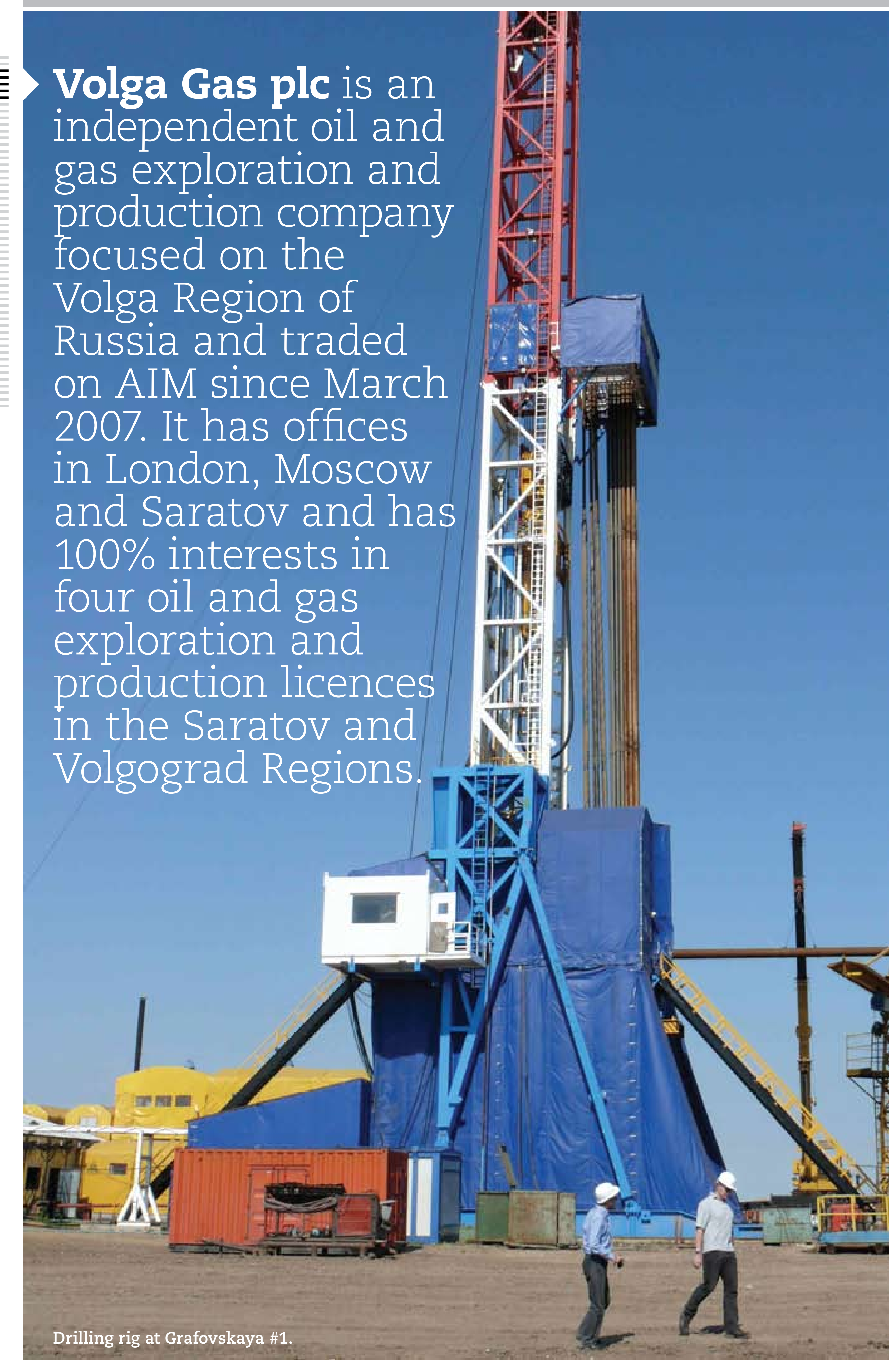
Volga Gas plc

Annual Report and Accounts

For the year ended 31 December 2009

Volga Gas plc Annual Report and Accounts 2009



Volga Gas plc is an independent oil and gas exploration and production company focused on the Volga Region of Russia and traded on AIM since March 2007. It has offices in London, Moscow and Saratov and has 100% interests in four oil and gas exploration and production licences in the Saratov and Volgograd Regions.

Drilling rig at Grafovskaya #1.

2009 a Milestone Year

- Development of supra-salt Uzenskoye oil field in the Karpenskiy Licence Area completed
- Five new oil wells successfully tested and production of 1,267 barrels of oil per day achieved in 2009
- Sub-salt exploration drilling at Grafovskaya #1 continuing as at 30 March 2010
- First phase development drilling on the Vostochny Makarovskoye gas/condensate field completed. Two wells tested and ready for production
- Combined Russian classification C1/C2 recoverable reserves of 68 million barrels of oil equivalent on Uzenskoye and Vostochny Makarovskoye
- Revenues of US$11.6 million in 2009, positive EBITDA and positive operating cash flow established
- Year end cash and deposits of US$33.6 million

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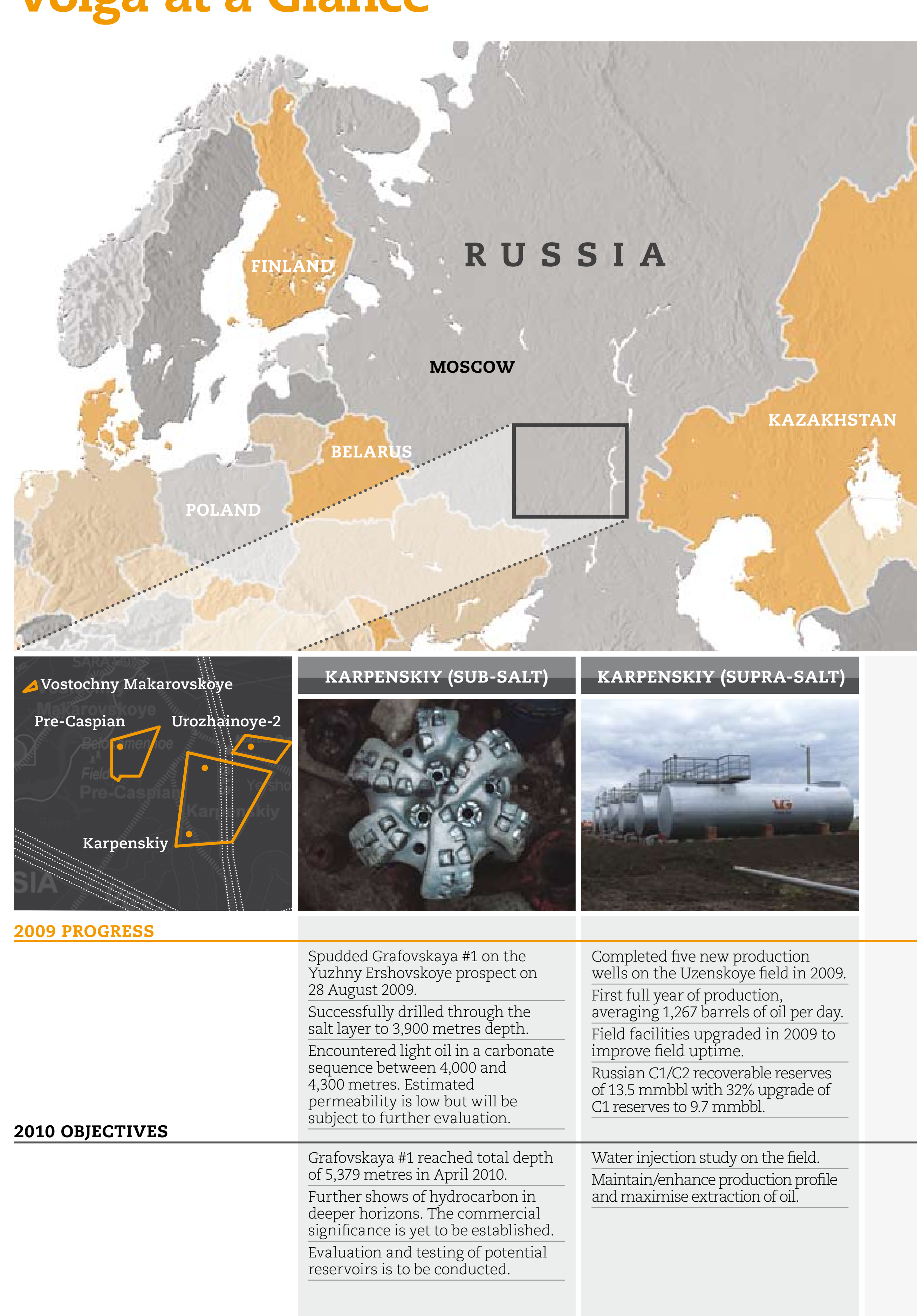
"2009 was an important year for Volga Gas. We have achieved sustainable production that gives us positive operating cash flow and we started drilling our sub-salt exploration well at Grafovskaya #1."

Mikhail Ivanov, Chief Executive Officer

"We believe that Volga Gas has performed well in 2009. The Company has managed successful drilling operations, most importantly in the challenging sub-salt exploration project, where we look forward to the evaluation of the results."

Alexey Kalinin, Chairman

Volga at a Glance



	KARPENSKIY (SUB-SALT)	KARPENSKIY (SUPRA-SALT)
2009 PROGRESS	Spudded Grafovskaya #1 on the Yuzhny Ershovskoye prospect on 28 August 2009. Successfully drilled through the salt layer to 3,900 metres depth. Encountered light oil in a carbonate sequence between 4,000 and 4,300 metres. Estimated permeability is low but will be subject to further evaluation.	Completed five new production wells on the Uzenskoye field in 2009. First full year of production, averaging 1,267 barrels of oil per day. Field facilities upgraded in 2009 to improve field uptime. Russian C1/C2 recoverable reserves of 13.5 mmbbl with 32% upgrade of C1 reserves to 9.7 mmbbl.
2010 OBJECTIVES	Grafovskaya #1 reached total depth of 5,379 metres in April 2010. Further shows of hydrocarbon in deeper horizons. The commercial significance is yet to be established. Evaluation and testing of potential reservoirs is to be conducted.	Water injection study on the field. Maintain/enhance production profile and maximise extraction of oil.

Our assets are located in a proven area of large oil and gas finds. The area benefits from the existing rail, road and pipeline infrastructure and proximity to Russia's main energy markets.

Successful development drilling on the Uzenskoye field enabled the Company to achieve positive operating cash flow and EBITDA in 2009. With eventual completion of the Vostochny Makarovskoye project and further potential developments, the Company aspires to further growth in production in the medium term.

Meanwhile as we evaluate the resources encountered and identified in the sub-salt structures in the Karpenskiy Licence Area and the Pre-Caspian Licence Area, the Company has the potential to deliver material growth in reserves.

VOSTOCHNY MAKAROVSKOYE

- First two development wells completed and wellhead facilities constructed ready for production.
- Intra-field flow lines installed.
- Negotiations with Trans Nafta on gas processing unit.
- Russian C1/C2 reserves approved.

- Aim to commence test production from the initial two wells.

PRE-CASPIAN LICENCE AREA

- Completed seismic commitment on the licence.
- Acquired, processed and interpreted new 3-D seismic data.
- Large sub-salt exploration structure confirmed.

- Preparation to meet target for exploration drilling by 2011.

UROZHAINOYE-2 LICENCE AREA

- Completed acquisition, processing and interpretation of 340km of 2-D seismic.
- Planning for a commitment well in 2010.

- Drill a step-out appraisal/exploration well close to the existing oil discovery well.

Chairman's Statement

"We believe that Volga Gas has performed well in 2009. The Company has managed successful drilling operations, most importantly in the challenging sub-salt exploration project, where we look forward to the evaluation of the results."

Having been through a challenging period late in 2008 and early 2009, the economic environment in Russia stabilised during 2009. There has been a strong recovery in global oil prices, which was reflected in the prices achieved by Volga Gas in 2009.

The Russian Ruble reversed some of its steep declines but remains at a level far lower than seen up to mid 2008. The developments in the Russian gas market in terms of demand and pricing were significantly better than the consensus expectations early in the year.

We believe that Volga Gas has performed well in face of the challenges. Our fields are advantageously located and our costs are sufficiently low for us to achieve good returns even at low oil prices. Most importantly, we have fulfilled our licence commitments on the Karpenskiy and Vostochny Makarovskoye licences and have sufficient funds to meet the commitments due in other licence areas during 2010.

Volga Gas currently operates entirely in European Russia, close to domestic markets and with pipeline and logistical infrastructure nearby. Our four licence blocks encompass proven oil, gas and condensate in shallow and medium depth horizons and major exploration targets in deep sub-salt horizons that were previously believed to be principally gas and condensate. The actual results from our first well suggest that there may also be significant oil potential.

The Group was created to explore the sub-salt structures on the Karpenskiy Licence Area ("KLA"). The highlight of the 2009 operations was the commencement of drilling operations on the Group's first sub-salt exploration well.

As of the date of writing, the well has reached a depth of 5,270 metres and drilling continues. The commercial significance of any hydrocarbon bearing zones encountered has yet to be evaluated. If they prove capable of commercial production, there would be a significant contingent resource for the Group.

We have identified further high impact sub-salt exploration targets within our acreage at Yuzhny Mokrousovskoye in the KLA and in the nearby Pre-Caspian Licence where the 3-D seismic acquired in 2009 has already been processed and interpreted. This provides the opportunity to apply the understanding of the sub-salt play acquired from the first well in other high impact prospects within our existing licence areas.

Volga also achieved an important milestone in the Company's development: a first year of substantial revenues and positive cash flow. While the financial impact is currently modest, as the other assets are brought into production,

Horses grazing freely within the Karpenskiy Licence Area.

the vision of Volga Gas as a sustainable and high growth oil and gas exploration and production business comes a step closer to being realised.

While the Group made progress on most fronts, it is frustrating that the Vostochny Makarovskoye field is yet to commence production. As outlined in the 2008 Annual Report, we reached an agreement to acquire a 75% interest in a gas processing facility being constructed by Trans Nafta and had in late 2008 made a RUR 600 million advance payment for this acquisition. In March 2010 the Company moved ahead to complete the purchase of the 75% interest in the gas processing facility.

Since the beginning of 2010, oil production from the Uzenskoye supra-salt field has been steady although recently transportation by customers has been disrupted by unusually heavy snow falls. This field continues to provide the Group with positive operating cash flow. The key activities for 2010 will include ongoing management and enhancement of the existing production, completion of the Vostochny Makarovskoye development and evaluation of the results from the sub-salt exploration drilling on the Grafovskaya #1 well. During 2010, the Group will also evaluate its forward strategy in relation to exploration of the sub-salt exploration potential in existing licence areas as well as opportunities to extend the Group's activities into new areas.

We ended 2009 with cash and bank deposits of US$33.6 million and with positive operating cash flow. Volga Gas is consequently sufficiently funded to complete planned developments and to fulfil the committed 2010 exploration work programme.

Alexey Kalinin
Chairman

Chief Executive's Report

"2009 was an important year for Volga Gas. We fulfilled the licence commitments on our key Karpenskiy block, we have achieved sustainable production that gives us positive operating cash flow and we started drilling our sub-salt exploration well at Grafovskaya #1."

During 2009, the majority of the activity and investment was concentrated on developing our production assets. Drilling on Uzenskoye delivered better than anticipated results, confirming a high quality light oil resource.

There is still much to accomplish, namely completion of the Vostochny Makarovskoye field development, evaluation of the results from our sub-salt Grafovskaya #1 exploration well and enhancement of our understanding of the sub-salt hydrocarbon resources in our licence areas. We remain committed to delivering growing value to our shareholders.

The focus for Volga Gas in 2009 was on advancing our key sub-salt exploration project and completing the first phase development of our oil reserves in the Uzenskoye field. This coincided with fulfilment of the key remaining licence commitments on the Karpenskiy Licence Area ("KLA"). These we achieved.

During 2009, we completed eight shallow supra-salt wells in the KLA and commenced drilling the Grafovskaya #1 sub-salt exploration well.

The resulting growth in oil production has enabled Volga Gas to reach a significant milestone for a young company: positive EBITDA and operating cash flow. This allows us to deploy our equity entirely in the most value-productive part of our activities – growing the asset base.

This is exemplified by the commencement of drilling of Grafovskaya #1, on the Yuzhny Ershovskoye prospect which itself was one of the original catalysts for the establishment of Volga Gas. In parallel, we have progressed with the geological and geophysical studies on opportunities to follow on from a successful outcome. Two further high impact sub-salt exploration targets have been advanced sufficiently to be ready for drilling.

Prior to undertaking this technically challenging well, we considered it vital for the Company to have sufficient financial headroom to deal with possible cost overruns. For this reason, we launched a placing of 27 million shares to raise net proceeds of US$26.6 million. Management is appreciative of the continuing support of shareholders in the placing.

We had at the beginning of the year also expected to bring the Vostochny Makarovskoye gas field into production. We did complete two production wells and installed intra-field pipelines, but the planned acquisition of a 75% interest in a gas processing unit was still under negotiation by the end of the year. As announced on 4 March 2010, this acquisition is now moving towards legal completion. We will now proceed as quickly as possible to enable the gas processing unit to commence operation and to start the first phase of production from the Vostochny Makarovskoye field.

Flow lines within the Vostochny Makarovskoye Licence.

Executing our strategy

1. Developing our production assets
With successful completion of the first phase development drilling on the Uzenskoye field, the focus turns towards managing production with a view to maximising ultimate extraction from the field. With eventual start up of production from Vostochny Makarovskoye and with appraisal of other identified resources, Volga Gas looks forward to developing a growing and sustainable production business from its existing licence areas.

2. Sub-salt exploration
We are completing drilling our first sub-salt well Grafovskoye #1, in the KLA and are carefully evaluating the potential of the hydrocarbons found there. We have two additional major sub-salt exploration projects both within the Karpenskiy Licence and in the Pre-Caspian Licence Area.

3. Financing
With funds raised in 2009, our existing funds are sufficient to meet our current commitments and planned developments. Timely execution of our further sub-salt exploration strategy may require additional funds or the creation of joint ventures with other parties.

4. Acquisitions
Our acquisition strategy has enabled the company to secure an asset base of four licences with low entry cost. We regularly evaluate further similar opportunities where we can rapidly add value and, where possible, incremental production volumes.

During the first quarter of 2010, we have continued to enjoy net positive operating cash flow and have fulfilled all of our obligations on the licences where we have recognised reserves and prospective resources. Our planned capital expenditure for 2010 totals US$14.0 million, including the portion of the Grafovskaya #1 well cost falling in 2010. The Group is thus well positioned to move quickly to bring Vostochny Makarovskoye into production as and when the commercial and legal arrangements over the gas processing facilities have been resolved.

We now have Russian C1 recoverable reserves of 45.4 million barrels of oil equivalent and a further 22.3 million barrels equivalent of C2 recoverable reserves contained in just two fields. This solid base of reserves and resources gives us confidence that we can continue to build Volga Gas into a successful and profitable independent exploration and production company and to create sustainable value for our shareholders.

Mikhail Ivanov
Chief Executive Officer

Operational Review

The Group's operational activities in 2009 were focused on drilling of Grafovskaya #1, the first major sub-salt exploration well and development of the Uzenskoye supra-salt oil field.

Operations overview

The Group's two principal activities in 2009 were: preparation for and commencement of drilling of Grafovskaya #1, the Group's first major sub-salt exploration well in the KLA, and development of the Uzenskoye supra-salt oil field, also in the KLA. We also completed processing of the 3-D seismic over the second sub-salt prospect area in the KLA and acquired and processed 3-D seismic on the Pre-Caspian Licence Area.

At Uzenskoye we have already achieved a steady level of production that provides the Group with a valuable source of cash generation while we seek to bring our other field, Vostochny Makarovskoye, into production and while we undertake the beginning of what we hope will become an extended campaign of sub-salt exploration in our licences.

Karpenskiy Licence Area

Early in 2008 we amended the terms of the Karpenskiy Licence Agreement, thereby resolving certain licence breaches the Group inherited when it acquired the licence from a LUKOIL subsidiary. The amended licence agreement requires the Group to finalise the acquisition of 400 km^2 of 3-D seismic and drill a further ten exploration or production wells over the next two years. By the start of 2009 we had already fulfilled our seismic obligations and the drilling programme of 2009, which we report below, completed the remaining licence commitments.

Sub-salt exploration

There are two main sub-salt prospect areas in the KLA: the Yuzhny Ershovskoye and Yuzhny Mokrousovskoye structures. Pre-drilling evaluation of these structures was concluded during the first half of 2009. A brand new western deep drilling rig operated by Evrasia was mobilised late in 2008 and was assembled early in 2009 on location ready to commence drilling Grafovskaya #1, our first sub-salt exploration well on the Yuzhny Ershovskoye structure.

Drilling operations on Grafovskaya #1 commenced on 28 August 2009 and the drilling of the first 3,900 metres, including a 3,000 metre salt section was accomplished far more rapidly than planned. Having set casing at 3,900 metres, the well was drilled on through the first of two target zones that were, on seismic sections, identified as potential carbonate reservoirs.

Within the first section, a total column of over 300 metres was found to exhibit shows of light oil and condensate within a dolomitised carbonate formation that also exhibited some zones with both fracture and matrix porosity. Initial open hole logging was unable to determine conclusively the productive capability of this reservoir and we decided to conduct further tests after completing the drilling operations including various methods that may improve productivity.

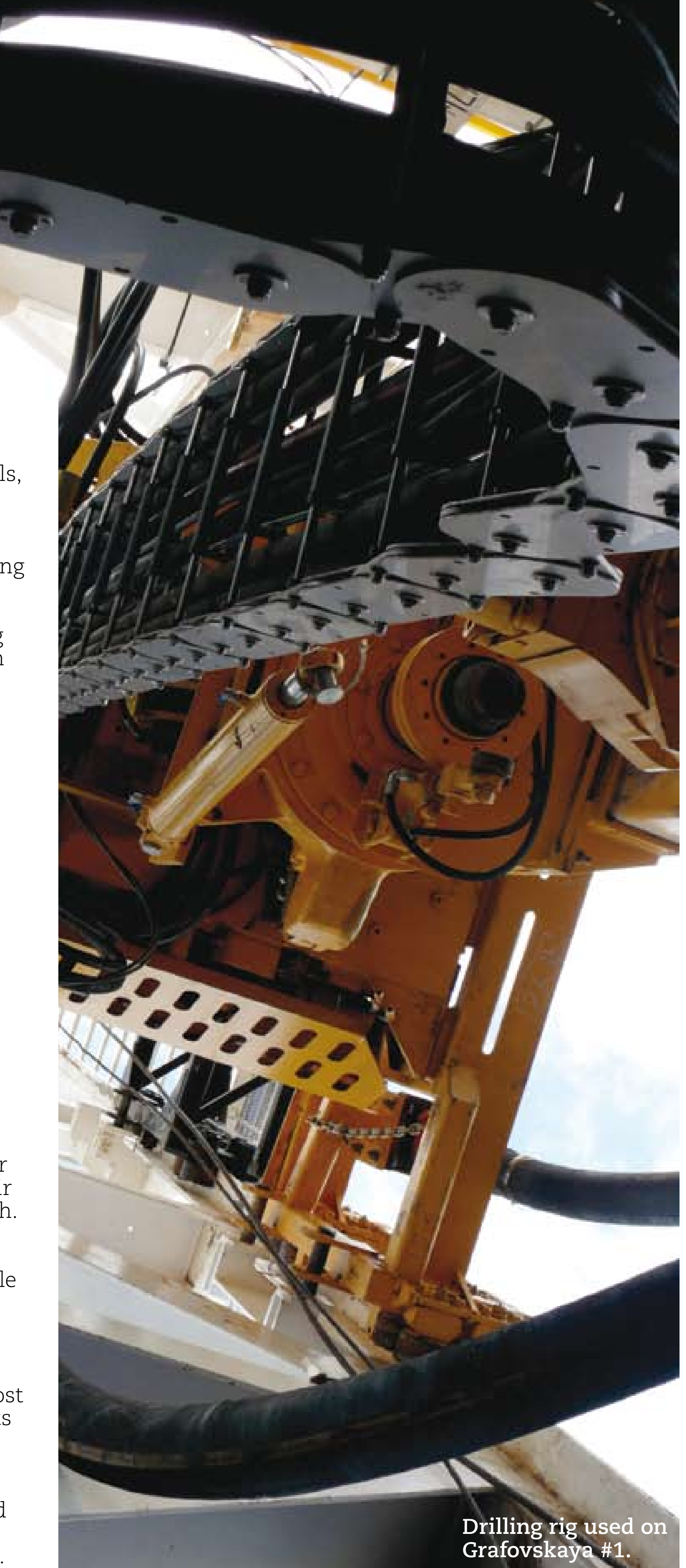
After the first carbonate section, drilling continued through a 600 metre shale sequence before entering a second carbonate sequence at 5,000-5,070 metre depth where gas shows were recorded. We plan to collect some further data from this layer after completing the drilling.

Drilling has continued through into a Devonian carbonate layer starting at a depth of approximately 5,200 metres. The commercial potential of this layer is yet to be evaluated. We expect to continue to drill a further 100–200 metres.

Supra-salt development

During 2009, activity was concentrated on completing initial development drilling on the Yuzhny Uzenskoye oil field and to evaluate further supra-salt prospects close to the Uzenskoye field production facilities. A total of eight supra-salt wells were drilled in this area during 2009 which, together with the commencement of drilling on Grafovskaya #1, completed the drilling commitments within the Karpenskiy licence terms.

The drilling programme included five development wells (including Uz. #6-bis, drilled as a sidetrack of Uz. #6 which did not at first


Drilling rig used on Grafovskaya #1.

encounter the productive reservoir). These wells, were progressively put on production in the course of 2009, enabling the Group to achieve its first year of sustained, albeit modest scale, production. Starting with a single well producing at approximately 300 barrels of oil per day in January 2009, there are now five wells on permanent production. With output increasing through the earlier part of the year, production averaged just over 1,050 barrels per day in the first half of 2009, while second half production was sustained at 1,484 barrels per day.

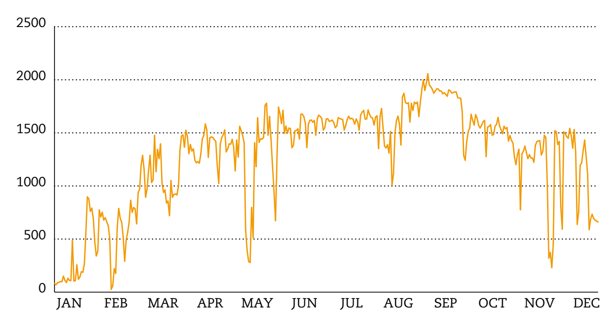
Exploration drilling in the area included additional 3-D seismic and two exploration wells, V.Uz #7 and V.Uz. #10. Although these wells found oil in a cretaceous sandstone formation, the pay encountered was considered sub-economic and the wells have been abandoned.

During 2009 we also upgraded the surface infrastructure, including the installation of a second separator unit, and additional storage tanks. This allows routine maintenance and testing operations on individual wells to be undertaken without disrupting the flow from other wells.

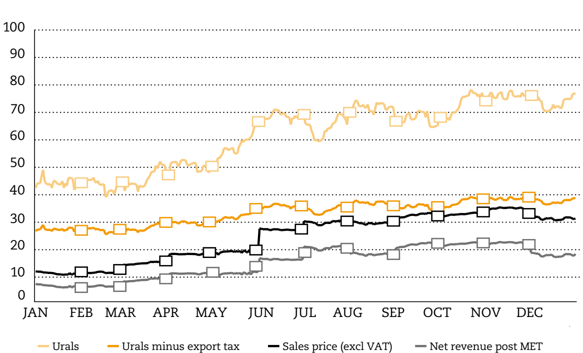
In the latter part of 2009, it was decided to choke back production from some of the higher productivity wells in order to preserve reservoir pressure and prevent early water break-through. During 2010 we plan to convert two of the existing wells, which are on the edge of the field, into water injectors which will then enable higher levels of production to be sustained for the longer term.

The Yuzhny Uzenskoye field, while of modest scale, is very profitable. It was developed at a cost of US$1.91 per barrel of C1 reserves and benefits from very low production costs, which in 2009 averaged US$0.71 per barrel. The oil is sold directly at the field facilities. During 2009 the average sales price was US$25.23 per barrel and after paying Mineral Extraction Tax (“MET”), gross profitability averaged US$14.52 per barrel. Prices in the second half of 2009 were higher

Uzenskoye field: daily oil production
(barrels per day)



Uzenskoye field: sales price comparison
(US$/bbl)



than in the first half, during the second half of 2009 average sales price was US$30.20 per barrel and gross profitability after MET averaged US$18.03 per barrel. The Group achieved an even better cash benefit as both the VAT receipts on sales and the MET liabilities were available to offset against unrecovered VAT paid on historic capital expenditure.

Vostochny Makarovskoye Licence Area

The Group completed its first phase three well drilling programme on the Vostochny Makarovskoye field early in 2009. As we reported in the 2008 Annual Report, there are two completed and tested wells on the field ready to commence production.

During early 2009, intra-field pipelines were laid between the well locations to the boundary of the Dobrinskoye gas facility in preparation for initial production. Actual commencement of production has been delayed pending completion of the acquisition by the Group of a 75% interest in the gas processing unit ("GPU") that is being constructed approximately 7 km from the Vostochny Makarovskoye Licence Area. Before the GPU can become fully operational, it would be necessary to transfer a sulphur treatment unit from the Vostochuy Makarovskoye Licence Area to the GPU. This process, with the required regulatory approvals, is expected to take up to nine months. Meanwhile, it may be possible to commence long-term test production from the VM field during 2010.

The current plan for the field is to commence production from the first two wells which will enable a dynamic modelling of the field's productive capacity and ultimate potential recovery.

Pre-Caspian Licence Area

Following interpretation of an initial 1,000 km of 2-D seismic data acquired in 2008, we agreed with the licensing authorities to exchange our remaining 2-D seismic commitment for 78 km^2 of 3-D seismic data over a potential sub-salt prospect identified by our initial work.

The new 3-D seismic data was acquired during 2009 and processing and interpretation largely completed by the end of the year. There is a commitment under the licence terms, for a well to commence drilling before the end of 2011. The Pre-Caspian Licence Area has no reserves associated with it.

Urozhainoye-2

On 7 September 2007 the Group acquired Urozhainoye-2 at government mandated auction for approximately US US$1.7 million. The licence area covers 354 km^2. It is located approximately 15 km to the north of the Group's Karpenskiy Licence Area and is in close proximity with up to 30 oil, gas and condensate fields.

The licence area is principally an exploration asset. Notwithstanding this, the licence area has had one well drilled on it in 1990 which discovered the Sobolevskoye field, which has Russian C1 recoverable reserves of 800,000 barrels of oil. The well produced at 1,200 barrels per day of oil and 1.9 mmcf/d of gas with an 8 mm choke on test production.

During 2009 we completed processing and interpretation of 350 km of 2-D seismic we acquired during 2008. The licence terms include a committed well during 2010. The current plan is to drill an offset well to the Sobolevskoye discovery well to attempt to prove up additional reserves and to enable a development plan for this field to be drawn up. The Group currently has no reserves or resources allocated to this licence.

Oil, gas and condensate reserves

The Group's Russian category C1 and C2 recoverable oil, gas and condensate reserves are presented in the table below. The reserves on the Yuzhny Uzenskoye field have recently been approved by the State Committee for Reserves as follows and represent the remaining recoverable reserves as at 1 January 2010. The reserves attributed to the Vostochny Makarovskoye field are unchanged from the numbers approved by the State Committee for Reserves in November 2008.

Mikhail Ivanov
Chief Executive Officer

"Drilling operations on the Grafovskaya #1 well have been accomplished more efficiently than anticipated and are expected to be within budgeted cost."

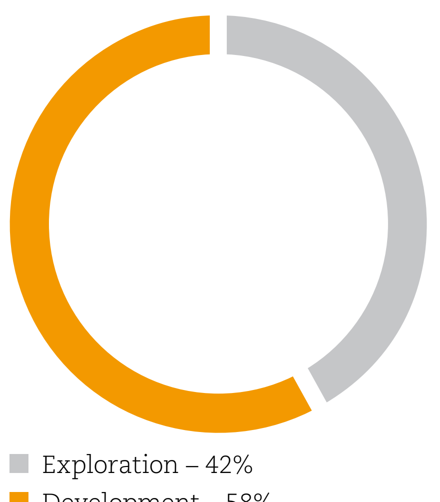
Mikhail Ivanov
Chief Executive Officer

In the rig control room.

Oil, gas and condensate reserves

	Recoverable reserves category		
	C1	C2	C1+C2
Vostochny Makarovskoye			
Natural gas (bcf)	164.5	87.5	252.1
Condensate (mmbbl)	8.3	3.9	12.2
Total (mmboe)	**35.8**	**18.5**	**54.2**
Yuzhny Uzenskoye (Karpenskiy Licence supra salt)			
Crude oil (mmbbl)	9.7	3.8	13.5
Group total	C1	C2	C1+C2
Gas (bcf)	164.5	87.5	252.1
Condensate (mmbbl)	8.3	3.9	12.2
Crude oil (mmbbl)	9.7	3.8	13.5
Total (mmboe)	**45.4**	**22.3**	**67.7**

Capital expenditure



Exploration – 42%
Development – 58%

C1/C2 reserves

Gas – 62%
Condensate – 18%
Oil – 21%

Financial Review

During 2009 our operations were primarily in an exploration and development phase although we also benefited from a period of sustained and growing production from the shallow oil reserves in the KLA.

The Group recorded net income after minority interests of US$0.2 million for the year ended 31 December 2009 (2008: net loss of US$10.3 million). No dividends have been paid or proposed for the year (2008: none).

In 2009, the Group generated US$11.6 million in turnover (2008: US$0.6 million) from the sale of 458,900 barrels of crude oil (2008: 24,545 barrels). Crude oil sales were made into the domestic market during the period. The average price realised was the equivalent of US$25.23 per barrel, with sales prices increasing steadily through the year as international oil prices recovered and the differential discounts for our crude reduced. The oil production activities generated a gross profit of US$5.8 million in 2009 (2008: profit of US$0.01 million), approximately US$12.64 per barrel of oil sold.

The Group experienced positive EBITDA (defined as operating profit before non-cash charges, exploration expense, depletion and depreciation) of US$3.0 million (2008: EBITDA loss of US$5.9 million). The operating profit for the year was US$0.6 million (2008: US$12.8 million loss) which includes exploration expenses of US$1.5 million (2008: US$5.6 million) and administrative expenses of US$3.7 million (2008: US$7.2 million).

The Group recognised a profit before tax of US$0.9 million (2008: loss US$10.1 million) and reported net income after minorities interests of US$0.2 million (2008: loss of US$10.3 million). These numbers include expenses of US$0.4 million (2008: nil) associated with the Vostochny Makarovskoye project, net gains on foreign exchange of US$0.2 million (2007: US$1.3 million) and current and deferred income tax charges of US$0.7 million (2008: tax charge of US$0.3 million).

Cash flow

Group net cash flow from operating activities was US$4.0 million (2008: outflow of US$15.9 million), after US$1.5 million of expensed exploration costs. The working capital of the Group was enhanced by a net US$1.3 million (2008: US$0.8 million) positive cash flow from working capital movements, including recovery of VAT on capital expenditures. Having accrued net prepayments in earlier years, the cash outflow from investing in exploration and development assets in 2009 was US$20.2 million (2008: US$55.7 million), somewhat less than the capital expenditure for the year.

Capital expenditure

During 2009 a total of US$23.7 million was invested in capital expenditure on the Group's licence areas (2008: US$48.5 million) as detailed on page 13.

The most significant individual components of the capital expenditure were US$5.6 million on the Yuzhny Uzenskoye oil field, including drilling and facilities, US$5.2 million on drilling operations at Grafovskaya #1 (which continues into 2010).

Financial and operational summary

Production	2009	2H09	1H09	2008
Oil (barrels)	462,455	270,830	191,625	24,545
Oil (bopd)	1,267	1,484	1,050	67

Operating results (US$ 000)	2009	2H09	1H09	2008
Revenue	11,580	8,212	3,368	617
Production costs	(327)	(142)	(185)	–
Production based taxes	(4,465)	(3,001)	(1,464)	(280)
Depletion, depreciation and other	(983)	(636)	(347)	(327)
Cost of sales	(5,775)	(3,779)	(1,996)	(607)
Gross profit	5,805	4,433	1,372	10
Exploration expense	(1,466)	(987)	(479)	(5,598)
Operating and administrative expenses	(3,728)	(2,175)	(1,553)	(7,186)
Operating profit/(loss)	611	1,271	(660)	(12,774)

Operating data (US$/bbl)	2009	2H09	1H09	2008
Net realisation	25.76	31.10	18.15	25.14
Production costs	0.71	0.52	0.97	–
Production based taxes	9.65	11.08	7.64	11.41
Depletion, depreciation and other	2.13	2.35	1.81	13.32

EBITDA calculation (US$ 000)	2009	2H09	1H09	2008
Operating profit/(loss)	611	1,271	(660)	(12,774)
Exploration expense	1,466	987	479	5,598
Depletion, Depreciation and Amortisation	881	534	347	100
EBITDA	**2,958**	**2,792**	**166**	**(7,076)**

In addition, US$4.7 million was expended early in 2009 on development drilling and field facilities for the Vostochny Makarovskoye field and a total of US$1.4 million was incurred on other exploration activities.

The security deposit on acquisition of fixed assets recognised in 2008 comprises the US$20.4 million of prepayment to Trans Nafta relating to the gas processing joint venture.

Year ended 31 December	2009 (US$ million)	2008 (US$ million)
Oil & gas exploration assets	**9.8**	2.4
Development & producing assets	**13.7**	25.5
Real estate assets	**0.2**	0.2
Security deposit on acquisition of fixed assets	**0.0**	20.4
Total	**23.7**	48.5

Balance sheet and financing

As at 31 December 2009, the Group held cash and bank deposits of US$33.6 million (2008: US$23.1 million) and remains debt free. In July 2009, the Company completed a placing of Ordinary Shares to raise a total of US$27 million gross ($26.6 million net of expenses).

The Group intends to fund its development and exploration expenditures using a combination of cash flow from operations and cash-on-hand. The Group will consider raising additional financing to more fully explore and develop its asset base as appropriate.

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

Issue of share capital

During the year to 31 December 2009, the Company issued a total of 27,000,000 shares in a non-preemptive placement generating net proceeds of US$26.6 million.

Tony Alves
Chief Financial Officer

Risk Factors

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 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 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 and gas. If oil and gas 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 the Group's 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.

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.

The Group has disclosed Russian category C1 and C2 reserves for its oil and gas fields, as recorded by the Russian State Committee for Reserves. If the actual results of producing these 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 development 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.

In particular, the Group's exploration activities in the northern end of the Karpenskiy Licence Area are conducted close to a protected nature area and the natural habitat of the Otis Tarda (Great Bustard), a rare and endangered bird species protected by Russian environmental law. The Group liaises closely with the Federal Service of Environmental, Technological and Nuclear Resources of the Saratov Oblast and conducts environmental studies both as required by, and in addition to, its licence obligations to mitigate any specific risk.

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 are predominantly in Russian Rubles ("RUR") and its operating costs in both US$ and RUR. Turnover is in RUR and funding has been raised in US$. Any changes in the relative exchange rates among US$ 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 disturbances or conflict, including terrorist attacks such as the bombing on the Moscow Metro in March 2010.
- 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 that 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 2009 the Group had US$33.6 million of cash and cash equivalents available to fund its ongoing operations and associated exploration and development activities. At 31 December 2009 the Group has committed capital expenditure of US$12.0 million relating to licence obligations on the Karpenskiy, Pre-Caspian Licence Areas and completion of the Vostochny Makarovskoye field development.

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

The Group's discretionary exploration drilling activities on the sub-salt structures on the Karpenskiy and Pre-Caspian Licence Areas may require additional funding. Furthermore, should these activities lead to one or more discoveries, the Group will require significant further funds to appraise and develop these licence areas.

Tony Alves
Chief Financial Officer

Board of Directors

Alexey Kalinin
Non-Executive Chairman
Appointed to the Board: 14 March 2007
Committee membership: Remuneration

Mr Kalinin is a Co-Managing 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. Mr Kalinin 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 50 years old.

Mikhail Ivanov
Chief Executive Officer, Executive Director
Appointed to the Board: 14 March 2007
Committee membership: n/a

Mr Ivanov was Director of Oil and Gas Investments at Baring Vostok. Mr Ivanov has over 15 years' experience in the oil and gas industry which includes ten years working for the Schlumberger Group, beginning his career with Schlumberger Limited as a Field Engineer in Siberian Russia. During his time with Schlumberger he assumed various management and technical positions in Russia, the USA and the United Kingdom. He was responsible for Schlumberger's operations in Iran, Georgia and Azerbaijan. He is the co-founder of a number of successful venture companies. During 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 40 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 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 50 years old. He was appointed as Chief Financial Officer and Company Secretary and joined the Board on 12 January 2009.

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 Troika Dialog, (Moscow); Severstal (Cherepovets); Polish Telecom (Warsaw). He is also a member of the Executive Committee of the Atlantic Council (Washington DC), the International Advisory Committee of Columbia Law School (New York); 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 70 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 Prospera Property Fund. Mr Ogden was previously Chairman of the Board of Lenta, Russia's largest privately owned food retailer, and a non-executive director of MDM-Print (Russia), 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. Mr Ogden is 42 years old.

Michael Calvey

Non-Executive Director
Appointed to the Board: 14 March 2007
Committee membership: Audit, Nomination

Mr Calvey is a Founder and Co-Managing Partner of Baring Vostok Capital Partners in Moscow, and a Director of Baring Private Equity International, a global private equity firm headquartered in London. Since 1994 Mr Calvey has co-led the investment team managing and has acted as the Chairman of the Investment Committee for all of Baring Vostok’s funds. Mr Calvey is currently on the Boards of Gallery Media Group, Caspian Bank, Europlan, Etalon and Volga Gas. Prior to joining Baring Vostok, Mr Calvey worked at the European Bank for Reconstruction and Development where he was responsible for several of the bank’s investments in the oil and gas sector in Russia. Prior to his work with the bank, Mr Calvey was a member of the oil and gas team at Salomon Brothers Inc in New York on a variety of corporate finance and mergers and acquisitions assignments. Mr Calvey has a M.Sc. in accounting and finance from the London School of Economics. Mr Calvey is 42 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 52 years old.

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 Combined Code on Corporate Governance 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 2009 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:
- Alexey Kalinin – Non-Executive Chairman.
- Mikhail Ivanov – Executive Director and Chief Executive Officer.
- Tony Alves – Executive Director, Chief Financial Officer and Company Secretary (appointed 29 January 2009).
- 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 Combined 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 23 to 24.

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 nine times during the year ended 31 December 2009 with the following attendance:

	2009	2008
Alexey Kalinin	8	7
Mikhail Ivanov	8	7
Tony Alves	9	–
Ronald Freeman	6	7
Stephen Ogden	7	6
Vladimir Koshcheev	5	6
Michael Calvey	7	7

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 Calvey, Ivanov and Ogden 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 14 June 2010, 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
29 March 2010

Report of the Directors

The Directors present their report together with the Group's audited financial statements for the period from 1 January 2009 to 31 December 2009.

Results and dividend

The Group's results are set out on pages 26 to 31 and show net income of US$0.2 million for the year to 31 December 2009. The directors do not propose to pay a dividend.

Subsequent events

In March 2010 the Company announced that an agreement had been signed with Trans Nafta for the completion of an acquisition of a 75% direct interest in a Gas Processing Unit situated nearby the Group's Vostochny Makarovskoye licence. The Group made an additional payment of US$6.2 million in relation to this, having made a payment in November 2008 of US$20.2 million as a security deposit for the acquisition of fixed assets. This is further detailed in the Chief Executive's Report on page 6 and in the Operational Review on page 8.

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 four licence areas in the Saratov and Volgograd regions: Karpenskiy, Vostochny Makarovskoye, Pre-Caspian and Urozhainoye-2.

The Group's business strategy is to bring the proven-undeveloped Vostochny Makarovskoye field into production and to grow production on the supra-salt Uzenskoye field in the Karpenskiy Licence Area ("KLA") whilst at the same time exploring the potentially highly prospective sub-salt structures on the Karpenskiy and Pre-Caspian Licence Areas. The Group is also conducting an exploration programme on a number of identified supra-salt structures on the KLA and the Urozhainoye-2 Licence Area.

Highlights of the Group's activities for the period ended 31 December 2009 are:

- Concluded first phase development of the Yuzhny Uzenskoye oil field on the KLA.
- Commenced drilling of the Grafovskaya #1 sub-salt exploration well on the Yuzhny Ershovskoye structure on the KLA.
- Completed the acquisition and interpretation of 80 km^2 of 3-D seismic on the Pre-Caspian Licence Area.
- Negotiations over a gas processing facility to enable production from the Vostochny Makarovskoye Licence Area.

The Group's activities are described in greater detail in the Chief Executive's Report on pages 6 and 7 and in the Operational Review on Pages 8 to 11. The principal risks associated with the Group's activities are set out in the Risk Factors section on pages 14 to 15.

Key performance indicators

Given the nature of the business and that the Group is in a start-up phase of operations, the directors are of the opinion that further analysis using KPI's 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 and Financial Reviews on Pages 8 to 13 provides the relevant information.

Directors

The directors who served during the year were:

Alexey Kalinin, non-Executive Chairman
Mikhail Ivanov, Chief Executive Officer
Tony Alves, Chief Financial Officer
Ronald Freeman, non-executive
Stephen Ogden, non-executive
Vladimir Koshcheev, non-executive
Michael Calvey, non-executive

Messrs Calvey, Ivanov and Ogden 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 2009	31 December 2008
Alexey Kalinin[1]	**–**	–
Mikhail Ivanov	**1,000,000**	525,100
Tony Alves	**25,000**	–
Ronald Freeman	**55,000**	5,000
Stephen Ogden	**115,000**	15,000
Vladimir Koshcheev	**650,000**	866,550
Michael Calvey[1]	**–**	–

1 Mr Calvey and Mr Kalinin are Co-Managing Partners of Baring Vostok Capital Partners Limited, a related party to Cavendish Nominees Limited and Dehus Dolmen Nominees Limited. As such Mr Calvey and Mr Kalinin have an indirect beneficial interest in the Company.

Substantial shareholders

On 31 December 2009 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
Cavendish Nominees Ltd[1]	39,620,000	48.90
Dehus Dolmen Nominees Ltd[2]	7,906,889	9.76
Capital Group International, Inc.	4,552,516	5.62
HQ Fonder Sverige AB	4,499,633	5.55

1 Cavendish 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. Of these, 71,092 became eligible for vesting during 2009. 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:
- agree the terms of the payment at the start of the business with that supplier;
- ensure that suppliers are aware of the terms of the payment; and
- pay in accordance with contractual and other obligations.

Political and charitable contributions
No political or charitable contributions were made in the year.

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 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 Otis Tarda, a rare and endangered bird, occupies portions of the Karpenskiy Licence Area; the Company has ensured that all its activities minimise the impact on the birds' habitat.

Share capital
The Company has authorised Ordinary Share capital of 300,000,000 shares of 1p each. Under a special resolution by the shareholders of the Company on 17 June 2008 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 80(1) and 89 of the Companies Act 1985. 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 2009.

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
The Company's auditors, PricewaterhouseCoopers LLP, 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. Under that law the directors have elected to prepare the Group and parent company financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

In preparing those 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 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.

Report of the Directors continued

Statement of directors' responsibilities continued
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

Alexey Kalinin
Chairman of the Board
29 March 2010

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 18 to 19.

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 Alexey 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 six months notice during the first 24 months of service and thereafter by giving three 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 2009 US$ 000**	Aggregate remuneration for the year 31 December 2008 US$ 000
Executive Directors						
M. Ivanov	391	–	46	–	**437**	1,262
A. Alves	270	24	26	–	**320**	–
Non-Executive						
A. Kalinin	–	–	–	–	**–**	–
R. Freeman	–	–	–	50	**50**	50
S. Ogden	–	–	–	50	**50**	50
V. Koshcheev	–	–	–	–	**–**	–
M. Calvey	–	–	–	–	**–**	–

Directors' Remuneration Report continued

Directors' Interests in the share capital of the Company

	Ordinary Shares of 0.01p each	
	31 December 2009	31 December 2008
Alexey Kalinin[1]	**–**	–
Mikhail Ivanov	**1,000,000**	525,100
Tony Alves	**25,000**	–
Ronald Freeman	**55,000**	5,000
Stephen Ogden	**115,000**	15,000
Vladimir Koshcheev	**650,000**	866,550
Michael Calvey[1]	**–**	–

1 Mr Calvey and Mr Kalinin are Co-Managing Partners of Baring Vostok Capital Partners, a related party to Cavendish Nominees Limited and to Dehus Dolmen Nominees Limited.
As such Mr Calvey and Mr Kalinin have an indirect beneficial interest in the Company.

There has been no change in the interest of any director between 1 January 2010 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 568,732 Ordinary Shares in the Company at an exercise price of 100p per share.
The options will vest over a period of up to four years subject to the satisfaction of performance conditions which are 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. In December 2009, options over 71,092 shares became eligible for vesting.

By order of the Board

Tony Alves
Company Secretary
29 March 2010

Independent Auditors' Report to the Members of Volga Gas plc

We have audited the group and parent company financial statements (the "financial statements") of Volga Gas plc for the year ended 31 December 2009 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group Balance Sheet, the Group Cash Flow Statement, the Company Balance Sheet, the Company Cash Flow Statement, the Group Statement of Changes in Shareholders' Equity, the Company Statement of Changes in Shareholders' Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement 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 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.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Sections 495 and 496 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

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 2009 and of the group's profit and group's and parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union 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 part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- 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 and the part of the Directors' Remuneration Report to be audited 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.

Kevin Reynard
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Aberdeen
29 March 2010

Group Income Statement
(presented in US$ 000)

Year ended 31 December	Notes	2009	2008
Continuing operations			
Revenue		**11,580**	617
Cost of sales	5	**(5,775)**	(607)
Gross profit		**5,805**	10
Other operating income			
Exploration and evaluation expense	5(a)	**(1,466)**	(5,598)
Operating and administrative expenses	5	**(3,728)**	(7,186)
Operating profit/(loss)		**611**	(12,774)
Interest income	6	**87**	1,461
Other gains and losses – net	7	**183**	1,256
Profit/(loss) for the period before tax		**881**	(10,057)
Current income tax	8	**(21)**	(1,600)
Deferred income tax	8	**(716)**	1,358
Profit/(loss) for the period before non-controlling interests		**144**	(10,299)
Non-controlling interests		**88**	–
Profit/(loss) for the period attributable to equity holders		**232**	(10,299)
Basic and diluted profit/(loss) per share (in US dollars)	9	**0.004**	(0.191)
Weighted average number of shares outstanding		**66,915,354**	54,008,474

The Company has elected to take the exemption under section 408 of the Companies Act 2006 to not present the parent company profit and loss account. The loss for the parent company for the year was US$1,006,000 (2008: US$1,084,000).

Group Statement of Comprehensive Income
(presented in US$ 000)

Year ended 31 December	Notes	2009	2008
Profit/(loss) for the period		**144**	(10,299)
Other comprehensive expense:			
Currency translation differences		**(2,037)**	(20,087)
Total comprehensive expense for the period		**(1,893)**	(30,386)
Non-controlling interests		**88**	–
Attributable to equity shareholders of the Company		**(1,805)**	(30,386)

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Group Balance Sheet
(presented in US$ 000)

At 31 December	Notes	2009	2008
Assets			
Non-current assets			
Intangible assets	10	**40,093**	30,596
Property, plant and equipment	11	**37,628**	26,550
Other non-current assets	12	**6,229**	7,245
Security deposit on acquisition of fixed assets	12	**19,839**	20,422
Deferred tax assets		**1,211**	2,003
Total non-current assets		**105,000**	86,816
Current assets			
Cash and cash equivalents	13	**32,643**	23,093
Term bank deposit	13	**1,000**	–
Inventories	14	**3,614**	1,485
Other receivables	15	**2,952**	8,449
Total current assets		**40,209**	33,027
Total assets		**145,209**	119,843
Equity and liabilities			
Equity			
Share capital	16	**1,485**	1,045
Share premium (net of issue costs)	16	**165,873**	139,681
Other reserves	17	**(12,990)**	(11,025)
Accumulated loss		**(13,911)**	(14,143)
Minority interest		**(92)**	–
Total equity		**140,365**	115,558
Long-term liabilities			
Asset retirement obligation		**164**	–
Total long-term liabilities		**164**	–
Current liabilities			
Trade and other payables	18	**3,162**	2,416
Current income tax liability		**1,518**	1,869
Total current liabilities		**4,680**	4,285
Total equity and liabilities		**145,209**	119,843

Approved by the Board of Directors on 29 March 2010 and signed on its behalf by

Mikhail Ivanov
Chief Executive Officer

Tony Alves
Chief Financial Officer

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Group Cash Flow Statement
(presented in US$ 000)

Year ended 31 December	Notes	2009	2008
Profit/(loss) for the before tax		**881**	(10,057)
Adjustments to loss after tax:			
Share grant expense		**72**	1,138
Depreciation		**890**	100
Other non-cash operating gains		**–**	(238)
Charge for provision		**220**	234
Foreign exchange differences		**(220)**	(1,841)
Total effect of adjustments		**962**	(607)
Decrease/(increase) in long-term assets		**770**	(5,981)
Operating cash flow prior to working capital		**2,613**	(16,645)
Working capital changes			
Decrease/(increase) in trade and other receivables		**3,794**	(33)
Decrease in derivative financial instruments		**–**	2,756
Increase/(decrease) in payables		**6**	(327)
Increase in inventory		**(2,067)**	(1,611)
Cash flow from operations		**4,346**	(15,860)
Income tax paid		**(389)**	–
Net cash flow from operating activities		**3,957**	(15,860)
Cash flows from investing activities			
Purchase of intangible assets	10	**(7,347)**	(8,628)
Purchase of property, plant and equipment	11	**(12,847)**	(24,904)
Movement in term bank deposit	13	**(1,000)**	–
Security deposit on acquisition of fixed assets	12	**–**	(22,204)
Net cash used in investing activities		**(21,194)**	(55,736)
Cash flows from financing activities			
Proceeds from the issue of shares (net of issue costs)		**26,632**	–
Change in loans		**56**	–
Net cash provided by financing activities		**26,688**	–
Effect of exchange rate changes on cash and cash equivalents		**99**	(2,850)
Net increase/(decrease) in cash and cash equivalents		**9,550**	(74,446)
Cash and cash equivalents at beginning of the year	13	**23,093**	97,539
Cash and cash equivalents at end of the year	13	**32,643**	23,093

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Company Balance Sheet
(presented in US$ 000)

Company registration number: 05886534

At 31 December	Notes	2009	2008
Assets			
Non-current assets			
Investments	19	**144,734**	120,305
Intercompany receivables		**15,876**	15,862
Total non-current assets		**160,610**	136,167
Current assets			
Cash at bank and on hand		**11,999**	18,496
Term bank deposit	13	**1,000**	–
Other receivables		**20**	72
Total current assets		**13,019**	18,568
Total assets		**173,629**	154,735
Equity and liabilities			
Equity			
Share capital	16	**1,485**	1,045
Share premium (net of issue costs)	16	**165,873**	139,681
Other reserves	20	**5,073**	5,001
Accumulated (loss)/profit	21	**(682)**	324
Total equity		**171,749**	146,051
Current liabilities			
Trade creditors		**1,666**	1,611
Intercompany payables		**–**	6,067
Current income tax liability		**214**	1,006
Total current liabilities		**1,880**	8,684
Total equity and liabilities		**173,629**	154,735

Approved by the Board of Directors on 29 March 2010 and signed on its behalf by

Mikhail Ivanov
Chief Executive Officer

Tony Alves
Chief Financial Officer

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Company Cash Flow Statement
(presented in US$ 000)

Year ended 31 December	Notes	2009	2008
Loss for the period before tax		**(1,410)**	(619)
Adjustments to loss after tax:			
Interest accrued		**–**	(1,871)
Other non-cash operating gains		**–**	(238)
Charge for provision		**220**	234
Share grant expense		**72**	1,138
Total effect of adjustments		**292**	(737)
Operating cash flow prior to working capital		**(1,118)**	(1,356)
Working capital changes			
Decrease/(increase) in trade and other receivables		**38**	(933)
Decrease in derivative financial instruments		**–**	2,756
Increase/(decrease) in payables		**(6,231)**	7,191
Cash (used in)/from operating activities		**(7,311)**	7,658
Income tax paid		**(389)**	–
Net cash flow (used in)/from operating activities		**(7,700)**	7,658
Cash flows from investing activities			
Movement in term bank deposit	13	**(1,000)**	–
Investments in capital	19	**(24,429)**	(16,000)
Net cash used in investing activities		**(25,429)**	(16,000)
Cash flows from financing activities			
Proceeds from the issue of shares (net of issue costs)		**26,632**	–
Net cash provided by financing activities		**26,632**	–
Net decrease in cash and cash equivalents		**(6,497)**	(8,342)
Cash and cash equivalents at beginning of the year		**18,496**	26,838
Cash and cash equivalents at end of the year		**11,999**	18,496

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Group Statement of Changes in Shareholders' Equity (presented in US$ 000)

	Notes	Share Capital	Share Premium	Other Reserves	Accumulated Loss	Non-controlling Interest	Total Equity
Opening equity at 1 January 2008		**1,037**	**139,681**	**7,932**	**(3,844)**	**–**	**144,806**
Loss for the year		–	–	–	(10,299)	–	(10,299)
Share based payments	16	8	–	1,130	–	–	1,138
Currency translation differences		–	–	(20,087)	–	–	(20,087)
Closing equity at 31 December 2008		**1,045**	**139,681**	**(11,025)**	**(14,143)**	**–**	**115,558**
Opening equity at 1 January 2009		**1,045**	**139,681**	**(11,025)**	**(14,143)**	**–**	**115,558**
Profit for the year		–	–	–	232	–	232
Share capital issued	16	440	26,560	–	–	–	27,000
Share issue costs		–	(368)	–	–	–	(368)
Share based payments		–	–	72	–	–	72
Currency translation differences		–	–	(2,037)	–	–	(2,037)
Non-controlling interests		–	–	–	–	(92)	(92)
Closing equity at 31 December 2009		**1,485**	**165,873**	**(12,990)**	**(13,911)**	**(92)**	**140,365**

Company Statement of Changes in Shareholders' Equity (presented in US$ 000)

	Notes	Share Capital	Share Premium	Other Reserves	Accumulated Profit/(loss)	Total Equity
Opening equity as at 1 January 2008		**1,037**	**139,681**	**3,871**	**1,408**	**145,997**
Loss for the year		–	–	–	(1,084)	(1,084)
Share grant expense	16	8	–	1,130	–	1,138
Closing equity at 31 December 2008		**1,045**	**139,681**	**5,001**	**324**	**146,051**
Opening equity as at 1 January 2009		**1,045**	**139,681**	**5,001**	**324**	**146,051**
Loss for the year		–	–	–	(1,006)	(1,006)
Share capital issued		440	26,560	–		27,000
Share Issue costs		–	(368)	–	–	(368)
Share grant expense	16	–	–	72	–	72
Closing equity at 31 December 2009		**1,485**	**165,873**	**5,073**	**(682)**	**171,749**

The accompanying notes on pages 32 to 48 are an integral part of these financial statements.

Notes to the IFRS Consolidated Financial Statements
for the year ended 31 December 2009 (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 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 is 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 29 March 2010.

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, as adopted by the European Union ("IFRSs as adopted by the EU"), 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 IFRS 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 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
The Group has adopted the following new and amended IFRSs as of 1 January 2009:

• IAS 1 *(revised), "Presentation of financial statements"*
The revised standard prohibits the presentation of items of income and expenses (that is "non-owner changes in equity") in the statement of changes in equity, requiring "non-owner changes in equity" to be presented separately from owner changes in equity. All "non-owner changes in equity" are required to be shown in a performance statement. Entities can choose whether to present one performance statement (the consolidated statement of comprehensive income) or two statements (the income statement and a consolidated statement of comprehensive income). The Group has elected to present two statements: an income statement and a statement of comprehensive income. The financial statements have been prepared under the revised disclosure requirements.

• *IFRS 2 (amendment), "Share-based payment"*
The revised standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation there of subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group and Company have adopted IFRS 2 (amendment) from 1 January 2009. The amendment does not have a material impact on the Group or Company's financial statements.

• *IFRS 7 (amendment), "Financial instruments – Disclosures"*
The amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy.

• *IAS 23 (revised), Borrowing Costs*
The revised standard removes the option of immediately recognising an expense on borrowing costs that relate to assets that take a substantial period of time to get ready for use. The adoption of this standard has no impact on the Group or Company financial statements.

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2009, but are not currently relevant for the Group:
- IFRIC 13, "Customer loyalty programmes".
- IFRIC 15, "Agreements for the construction of real estate".
- IFRIC 16, "Hedges of a net investment in a foreign operation".
- IAS 39 (amendment), "Financial instruments: Recognition and measurement".

The following standards and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods, but the Group has not early adopted them:

- IFRIC 17, "Distribution of non-cash assets to owners" (effective on or after 1 July 2009). The interpretation was published in November 2008. This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. IFRS 5 has also been amended to require that assets are classified as held for distribution only when they are available for distribution in their present condition and the distribution is highly probable. The Group and Company will apply IFRIC 17 from 1 January 2010. It is not expected to have a material impact on the Group or Company's financial statements.
- IAS 27 (revised), "Consolidated and separate financial statements", (effective from 1 July 2009). The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss. The Group will apply IAS 27 (revised) prospectively to transactions with non-controlling interests from 1 January 2010.
- IFRS 3 (revised), "Business combinations" (effective from 1 July 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair vale or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Group will apply IFRS 3 (revised) prospectively to all business combinations from 1 January 2010.
- IAS 38 (amendment), "Intangible Assets". The amendment is part of the IASB's annual improvements project published in April 2009 and the Group and Company will apply IAS 38 (amendment) from the date IFRS 3 (revised) is adopted. The amendment clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and it permits the grouping of intangible assets as a single asset if each asset has similar useful economic lives. The amendment will not result in a material impact on the Group or Company's financial statements.
- IFRS 5 (amendment), "Non-current assets held for sale and discontinued operations". The amendment is part of the IASB's annual improvements project published in April 2009. The amendment provides clarification that IFRS 5 specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. It also clarifies that the general requirement of IAS 1 still apply, particularly paragraph 15 (to achieve a fair presentation) and paragraph 125 (sources of estimation uncertainty) of IAS 1. The Group and Company will apply IFRS 5 (amendment) from 1 January 2010. It is not expected to have a material impact on the Group or Company's financial statements.
- IAS 1 (amendment), "Presentation of financial statements". The amendment is part of the IASB's annual improvements project published in April 2009. The amendment provides clarification that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time. The Group and Company will apply IAS 1 (amendment) from 1 January 2010. It is not expected to have a material impact on the Group or Company's financial statements.
- IFRS 2 (amendments), "Group cash-settled share-based payment transaction" (effective from 1 January 2010). In addition to incorporating IFRIC 8, "Scope of IFRS 2", and IFRIC 11, "IFRS 2 – Group and treasury share transactions", the amendments expand on the guidance in IFRIC 11 to address the classification of Group arrangements that were not covered by that interpretation. The new guidance is not expected to have a material impact on the Group or Company's 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% 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 purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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

Notes to the IFRS Consolidated Financial Statements continued

2. Summary of significant accounting policies continued

The Company and its subsidiaries outside the Russian Federation maintain their financial statements in accordance with IFRS. 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 IFRS.

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.

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.

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 ruble ("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 as a separate component of equity.

The major exchange rates used for the revaluation of the closing balance sheet at 31 December 2009 were:

- GBP1:US$1.5653 (2008: GBP 1:US$1.4605)
- US$1:RUR 30.2442 (2008 US$1:RUR 29.3804)

2.5 Oil and gas exploration assets

The Company applies 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 according to nature. When development is completed on a specific field, it is transferred to production 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 intangible assets 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
E&E 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 E&E 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 E&E 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

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 2008 or 31 December 2009.

(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 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 the income statement.

2.9 Acquisitions, asset purchases and disposals

Acquisitions of oil and gas properties are accounted for under the purchase method where the business 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 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.

2.11 Trade and other receivables

Trade and other receivables are presented at recoverable amounts. 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 the balance sheet date in the countries where the Company's subsidiaries and associates 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 balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

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 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.

(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 VAT, 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 VAT. For oil sales, this is at the physical point of delivery, i.e. the loading of a customer's truck. For gas sales, this is typically the point of entry to the gas distribution system. In 2008 and 2009 all of the Group's revenue related to oil sales collected directly by customers.

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

3. Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency 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.

At 31 December 2009, 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$812,000 (2008: US$234,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of RUR denominated trade payables and financial assets. At 31 December 2009, 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$14,000 (2008: US$nil) higher/lower, mainly as a result of foreign exchange gains/losses on translation of GBP denominated trade payables and financial assets.

Notes to the IFRS Consolidated Financial Statements continued

3. Financial risk management continued

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

At 31 December 2009	RUR US$ 000	US Dollars US$ 000	GBP US$ 000	Total US$ 000
Financial assets				
Cash and cash equivalents	**4,032**	**28,219**	**392**	**32,643**
Term bank deposit	**–**	**1,000**	**–**	**1,000**
Total financial assets	**4,032**	**29,219**	**392**	**33,643**
Financial liabilities (before provision for UK taxes)	**3,060**	**56**	**46**	**3,162**

At 31 December 2008	RUR US$ 000	US Dollars US$ 000	GBP US$ 000	Total US$ 000
Total financial assets – cash	844	22,229	20	23,093
Financial liabilities (before provision for UK taxes)	2,245	171	–	2,416

During 2008 the Group used foreign exchange forward contracts to manage financial risks from fluctuation in foreign exchange rates. No foreign exchange forward contracts were used in 2009.

(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$33,643,000 and US$23,093,000 at 31 December 2009 and 2008 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.

Rating of financial institution (Fitch)	**31 December 2009**	31 December 2008
AA+	**–**	–
AA–	**12,552**	19,216
A–	**1,000**	–
BBB+	**19,752**	3,457
Other	**339**	420
Total bank balance	**33,643**	23,093

(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. During 2009, the Company raised US$27 million of equity funds which allowed sufficient cash headroom prior to drilling a sub-salt exploration well. Should the Group decide to undertake further exploration drilling on the sub-salt structures in the Karpenskiy and Pre-Caspian Licence Areas beyond the currently planned programmes, or if development is planned for any successful efforts, significant additional funding would be required.

The Group expects to fund its exploration and development programme, as well as its administrative and operating expenses, through 2009 using a combination of existing working capital 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.

3.2 Capital risk management

The Group's objectives when managing 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.

3.3 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/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. In addition, judgement is applied in determining the cash generating unit to be assessed for impairment.

(b) Useful lives of property, plant and equipment

The Group applies a range of useful lives to assets, which are classified as property, plant and equipment. The useful lives of oil and gas properties are determined by reference to associated reserves estimates. Estimates of oil and gas reserves are inherently subjective. Significant judgement is required in estimating the useful life of such assets.

(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.

5. Cost of sales and administrative expenses – Group

Cost of sales and administrative expenses are as follows:

Year ended 31 December	2009 US$ 000	2008 US$ 000
Cost of sales	**5,775**	607
Exploration and evaluation expenses	**1,466**	5,598
Operating and administrative expenses	**3,728**	7,186
Total operating and administrative expenses	**10,969**	13,391

Total operating and administrative expenses are analysed as follows:

Year ended 31 December		2009 US$ 000	2008 US$ 000
Exploration and evaluation	(a)	**1,466**	5,598
Mineral extraction tax		**4,465**	280
Field operating expenses		**327**	–
Depreciation and amortisation		**881**	100
Salaries and staff benefits	(b)	**938**	858
Directors' emoluments and other benefits	(c)	**857**	2,162
Audit fees	(d)	**285**	285
Taxes other than payroll and mineral extraction		**112**	110
Legal and consulting services	(e)	**410**	2,964
Other		**1,228**	1,034
Total		**10,969**	13,391

Notes to the IFRS Consolidated Financial Statements continued

5. Cost of sales and administrative expenses – Group continued

(a) Exploration and evaluation

During 2009 expenditure on seismic studies certain drilling expenditures relating to supra-salt exploration on the Karpenskiy Licence were expensed as management considered that the expenditure was not related closely enough to specific oil and gas reserves to allow its capitalisation in accordance with IFRS 6 "Exploration for and evaluation of mineral resources". In 2008, the E&E expense was primarily related to seismic studies on the Pre-Caspian Licence Area and supra-salt seismic studies on the Karpenskiy Licence.

(b) Staff and salaries

The average monthly number of employees (including Executive Directors) employed by the Group was:

Year ended 31 December	2009	2008
Exploration and production	**29**	22
Administration and support	**15**	16
Total	**44**	38

Their aggregate remuneration comprised:

Year ended 31 December	2009 US$ 000	2008 US$ 000
Wages and salaries	**716**	701
Payroll taxes and social contribution	**166**	157
Staff benefits	**56**	–
Total	**938**	858

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

Year ended 31 December	2009	2008
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 2009 and 31 December 2008 are provided in the Directors' Remuneration Report. Included in Directors' emoluments were share grant expenses of US$72,000 (2008: US$1,138,000).

(d) Audit fees – Group and Company

Disclosure of the fees paid to the Company's auditors and its associates is given in Note 22.

(e) Legal expense

An amount of US$2,366,000 is included in legal expenses in 2008 in respect of the 2008 court proceedings brought by a minority shareholder of Trans Nafta in relation to the purchase of Gaznefteservice from Trans Nafta in 2006. The costs include legal and other consultation services related to preparation for the court proceedings. The court proceedings were withdrawn in November 2008 following resolution of the matter.

6. Interest income – Group

Interest income comprises interest earned during the period on cash balances with different financial institutions (Note 13).

7. Other gains and losses – Group

Year ended 31 December	2009 US$ 000	2008 US$ 000
Realised gain on forward currency contract	–	4,179
Foreign exchange gain/(loss)	**163**	(3,160)
Other gains	**20**	237
Total other gains and losses	**183**	1,256

Realised gains on forward currency contracts for the years ended 31 December 2008 includes net gain of US$560,000 from two open forward currency contracts recognised at fair value in 2007 and a net gain of US$3,619,000 from forward currency contracts settled during 2008.

8. Current and deferred income tax – Group

Year ended 31 December	2009 US$ 000	2008 US$ 000
Current tax:		
Current income tax	**(584)**	(1,600)
Adjustments to tax charge in respect of prior periods	**563**	–
Total current tax	**(21)**	(1,600)
Deferred tax:		
Origination and reversal of timing differences	**(716)**	1,358
Total deferred tax	**(716)**	1,358
Total tax	**(737)**	(242)

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	2009 US$ 000	2008 US$ 000
Profit/(loss) before income tax and minority interest	**881**	(10,057)
Tax calculated at domestic tax rates applicable to (profits)/losses in the respective countries	**(163)**	2,180
Tax effect of items which are not deductible or assessable for taxation purposes:		
Additional deemed taxable income	**(469)**	(1,075)
Non-deductible expenses	**(218)**	(786)
UK taxes on overseas income	**–**	(700)
Current tax – adjustments in respect of prior years	**563**	167
Tax losses for which no deferred tax asset was recognised	**(400)**	(28)
Other tax adjustments	**(50)**	–
Income tax charge	**(737)**	(242)

The weighted average applicable tax rate was 18.5% (2008: 21.7%).

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 2009	Differences recognition and reversal	31 December 2008
Tax effects of taxable temporary differences:			
Exploration assets	**(1,380)**	(1,160)	(220)
Inventories	**(5)**	(12)	7
Total	**(1,385)**	(1,172)	(213)
Tax effect of deductible temporary differences:			
Tax losses carry forward	**2,117**	261	1,856
Trade and other receivables	**340**	(18)	358
Property, plant and equipment	**132**	130	2
Share grant expenses	**7**	7	–
Total	**2,596**	380	2,216
Net tax effect of temporary differences	**1,211**	(792)	2,003
Movement due to current period results (income statement)		(716)	
Movement due to current period results (statement of changes in shareholder equity)		7	
Foreign exchange movement on brought forward deferred tax balances (statement of changes in shareholder equity)		(83)	

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. The Group did not recognise deferred income tax assets of US$460,000 (2008: US$28,000) in respect of losses (US$428,000) and timing differences (US$32,000) in Volga Gas plc and in Volga Gas Cyprus which were carried forward at 31 December 2009.

Notes to the IFRS Consolidated Financial Statements continued

9. Basic and diluted profit/(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	**2009**	2008
Net profit/(loss) attributable to equity shareholders (per share)	**0.004**	(0.191)
Basic weighted number of shares	**66,915,354**	54,008,474

10. Intangible assets – Group

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

	Work in progress: E&E	E&E	Development	Producing assets	Total
At 1 January 2008	3,972	8,407	21,735	–	34,114
Additions	2,065	261	139	–	2,465
Disposals	–	–	4	–	4
Exchange adjustments	(965)	(1,424)	(3,598)	–	(5,987)
At 31 December 2008	5,072	7,244	18,280	–	30,596

	Work in progress: E&E	**E&E**	**Development**	**Producing assets**	**Total**
At 1 January 2009	**5,072**	**7,244**	**18,280**	**–**	**30,596**
Additions	**9,147**	**679**	**290**	**9**	**10,125**
Disposals	**(197)**	**–**	**–**	**–**	**(197)**
Transfers	**–**	**(1,576)**	**–**	**1,576**	**–**
At 31 December 2009	**14,022**	**6,347**	**18,570**	**1,585**	**40,524**
Accumulated amortisation					
At 1 January 2009	**–**	**–**	**–**	**–**	**–**
Depreciation	**–**	**–**	**–**	**(55)**	**(55)**
At 31 December 2009	**–**	**–**	**–**	**(55)**	**(55)**
Exchange adjustments	**306**	**(252)**	**(507)**	**77**	**(376)**
At 31 December 2009	**14,328**	**6,095**	**18,063**	**1,607**	**40,093**

11. Property, plant and equipment – Group

Movements in property, plant and equipment, for the years ended 31 December 2009 and 2008 are as follows:

	Development assets	Land and buildings	Producing assets	Other	Total
Cost					
At 1 January 2008	3,676	528	1,658	104	5,966
Additions	24,862	207	296	542	25,907
Disposals	(294)	–	–	–	(294)
Transfers	(4,039)	–	4,039	–	–
At 31 December 2008	24,205	735	5,993	646	31,579
Accumulated depreciation					
At 1 January 2008	–	–	(8)	(19)	(27)
Depreciation	–	–	(86)	(14)	(100)
At 31 December 2008	–	–	(94)	(33)	(127)
Exchange adjustments	(3,763)	(119)	(925)	(95)	(4,902)
At 31 December 2008	20,442	616	4,974	518	26,550

	Development assets	Land and buildings	Producing assets	Other	Total
Cost					
At 1 January 2009	20,442	616	5,054	546	26,658
Additions	13,298	157	81	28	13,564
Disposals	(1,445)	–	(8)	–	(1,453)
Transfers	(6,177)	–	6,177	–	–
At 31 December 2009	26,118	773	11,304	574	38,769
Accumulated depreciation					
At 1 January 2009	–	–	(80)	(28)	(108)
Depreciation	–	–	(822)	(13)	(835)
At 31 December 2009	–	–	(902)	(41)	(943)
Exchange adjustments	(297)	(10)	125	(16)	(198)
At 31 December 2009	25,821	763	10,527	517	37,628

12. Other non-current assets – Group

As at 31 December	2009 US$ 000	2008 US$ 000
VAT recoverable	6,189	7,209
Other non-current assets	40	36
Total other non-current assets	6,229	7,245

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

The security deposit on acquisition of fixed assets of US$19.8 million (2008: US$20.4 million) relates to an advance paid by the Company to Trans Nafta for the Group's share of costs associated with the construction of a Gas Processing Unit ("GPU") to be jointly owned by the Company and Trans Nafta. The payment reflected in the Cash flow statement differs from the amount shown in the non-current assets due to the foreign exchange difference.

In October 2008, the Group reached resolution in relation to a legal claim regarding its 2006 purchase of Gaznefteservice from Trans Nafta. As part of the resolution between the parties, the Group and Trans Nafta entered into a preliminary sale and purchase agreement under which the parties agreed to combine their GPUs, both of which were under construction at the time of the legal action. The combined GPU will be owned and operated on a 75/25 basis by the Group and Trans Nafta. The Group made an advance to Trans Nafta of RUR600 million (approximately US$20.4 million).

In March 2010, a final agreement was signed between the Group and Trans Nafta to complete the acquisition by the Group of a direct interest in the GPU assets. Under the terms of the agreement a sum of RUR187 million (approximately US$6.2 million) has been paid to Trans Nafta. The GPU is to be managed and operated by ZAO Gamma, a company owned 75% by the Group and 25% by Trans Nafta.

13. Term deposits, cash and cash equivalents – Group

At 31 December	2009 US$ 000	2008 US$ 000
Cash at bank and on hand	14,171	22,753
Short-term bank deposits	18,472	340
Total cash and cash equivalents	32,643	23,093
Term bank deposit	1,000	–

Notes to the IFRS Consolidated Financial Statements continued

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

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

At 31 December Bank	Currency	2009 US$ 000	2008 US$ 000
Cyprus			
Bank of Cyprus	RUR	–	3
	US$	–	8
United Kingdom			
The Royal Bank of Scotland	US$	**12,160**	19,196
The Royal Bank of Scotland	GBP	**392**	20
Russian Federation			
Unicreditbank	RUR	**3,697**	432
Other banks and cash on hand	RUR	**339**	409
Unicreditbank	US$	**16,055**	3,025
Total cash at bank and short term deposits		**32,643**	23,093
Republic of Ireland			
EBS Building Society	US$	**1,000**	–
Total term deposit		**1,000**	–

14. Inventories – Group

At 31 December	2009 US$ 000	2008 US$ 000
Production and other spares	**3,533**	1,462
Crude oil inventory	**81**	23
Total inventories	**3,614**	1,485

15. Other receivables – Group

At 31 December	2009 US$ 000	2008 US$ 000
VAT receivable	**1,355**	–
Prepayments	**1,338**	8,314
Other accounts receivable	**259**	135
Total other receivables	**2,952**	8,449

16. Share capital and share premium – Group

The following table summarises the movement in the share capital and share premium of the Company for the years ended 2008 and 2009.

	Number of shares	Share capital US$ 000	Share premium US$ 000
At 1 January 2008	53,623,948	1,037	139,681
Issue of shares:			
– shares issued to directors	393,852	8	–
At 31 December 2008	54,017,800	1,045	139,681

	Number of shares	**Share capital US$ 000**	**Share premium US$ 000**
At 1 January 2009	**54,017,800**	**1,045**	**139,681**
Issue of shares:			
– public placement	**27,000,000**	**440**	**26,560**
– share issue costs	**–**	**–**	**(368)**
At 31 December 2009	**81,017,800**	**1,485**	**165,873**

The total number of authorised Ordinary Shares is 330,720,100 (2008: 330,720,100) with a par value of £0.01 per share (2007: £0.01 per share).

Share-based compensation

Share options and other share-based awards granted to certain directors. The Group had two share-based payment schemes in 2008, details of which are given in the Directors' Remuneration Report. There were no shares issued to directors under such schemes during 2009.

2007 Restricted Share Awards
The following table summarises information on the shares issued to the Directors of the Company in exchange for services provided under the 2007 Restricted Share Awards:

Directors	Number of shares allotted at 1 January 2008	Number of shares allotted for the period	Number of shares allotted at 31 December 2008
Executive directors:			
Mikhail Ivanov	262,549	262,551	525,100
Alistair Stobie	131,299	131,301	262,600
Non-executive directors:			
Ronald Freeman	5,000	–	5,000
Stephen Ogden	5,000	–	5,000
	403,848	393,852	797,700

US$1,138,000 of the total fair value determined was charged to the income statement for the year ended 31 December 2008 (Note 5). As of 31 December 2008 there are no outstanding restricted share agreements under this programme.

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 thousand share options to Tony Alves under the ESOP. The options vest in eight semi-annual tranches over a period of four 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, options over 71,092 shares were eligible for vesting. Share grant expenses of US$72,000 have been made in 2009 (2008: nil).

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	**2009 Executive Share Option Plan**	2007 Restricted Share Award
Share price	**76.5p**	US$6.29
Exercise price	**100.0p–200.0p**	US$0.02
Expected volatility	**107.7%**	8.48%
Expected life	**0–4 years**	0–3 years
Risk free rate	**3.0%**	5.71%–6.15%
Expected dividends	**None**	None

17. Other reserves – Group

At 31 December	**2009 US$ 000**	2008 US$ 000
Currency translation adjustment	**(18,063)**	(16,026)
Share grant expense	**5,073**	5,001
Total other reserves	**(12,990)**	(11,025)

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.

Notes to the IFRS Consolidated Financial Statements continued

18. Trade and other payables – Group

At 31 December	2009 US$ 000	2008 US$ 000
Trade payables	**2,688**	2,416
Taxes other than profit tax	**316**	–
Customer advances	**158**	–
Total	**3,162**	2,416

The maturity period of the Group's financial liabilities, comprising only trade and other payables at 31 December 2009 and 2008 is as follows:

Maturity period at 31 December 2009	0 to 3 months	3 to 12 months	Over 1 year	Total
Trade and other payables	**2,419**	**549**	**194**	**3,162**

Maturity period at 31 December 2008	0 to 3 months	3 to 12 months	Over 1 year	Total
Trade and other payables	2,265	151	–	2,416

19. Investments – Company

Investments in subsidiaries 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 development	100%	May 2006
Gaznefteservice	Russia	Oil and gas exploration and development	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 venture operating company	75%	January 2009

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 2008 US$ 000	Additions US$ 000	Disposals US$ 000	31 December 2009 US$ 000
Investments in Woodhurst Holdings	119,254	24,429	–	**143,683**
Investments in Volga Gas (Cyprus) Ltd.	1,051	–	–	**1,051**
Total investments	120,305	24,429	–	**144,734**

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

20. Other reserves – Company

At 31 December	2009 US$ 000	2008 US$ 000
Share grant expense	**5,073**	5,001
Total other reserves	**5,073**	5,001

21. Accumulated (loss)/profit – Company

At 31 December	2009 US$ 000	2008 US$ 000
Retained losses	**(1,006)**	(1,084)
Accumulated profit at start of year	**324**	1,408
Accumulated (loss)/profit 31 December	**(682)**	324

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	2009 US$ 000	2008 US$ 000
Fees payable to Company's auditor for the audit of parent company and consolidated financial statements	**235**	235
Fees payable to the Company's auditor and its associated firms for other services:		
– The audit of Company's subsidiaries pursuant to legislation	**20**	9
– Other services pursuant to legislation	**50**	50
– Tax services	**201**	90
– Other, training	**–**	5
Total	**506**	389

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 2009 US$ 000	2008 US$ 000
Baring Vostok (Cyprus) Limited	Affiliated with controlling shareholder	Rent, services	**133**	86
Vladimir Koshcheev	Director	Services	**13**	3

(a) Other related parties

The following transactions were carried out with companies nominally held by the Group's employees but not controlled by the Group.

Related party	Nature of transactions	Year ended 31 December 2009 US$ 000	2008 US$ 000
OOO Geo Eko	Long-term loan (interest rate 1%)	**24**	13
OOO Geopotential	Long-term loan (interest rate 1%)	**23**	13

(b) Year-end balances arising from transactions with related parties

	31 December 2009 US$ 000	31 December 2008 US$ 000
Due to related parties		
Baring Vostok (Cyprus) Limited	**12**	12

All transactions with related parties were made on commercial basis.

24. Contingencies and commitments

24.1 Capital commitments

(a) Pre-Caspian Gas Company ("PGK")

(i) Karpenskiy Licence Area

In accordance with the amended Karpenskiy Licence Agreement ("Amended KLA") PGK was required to acquire 400 km^2 of 3D seismic studies and to drill 14 wells. At the balance sheet date the Company had fulfilled all of its licence commitments.

(ii) Pre-Caspian Licence Area

In accordance with the license agreement for the Pre-Caspian License Area, PGK was required to acquire an additional 500 km of 2D seismic in 2009. At balance sheet date the Company had completed its seismic commitments on the Pre-Caspian Licence Area. In order to maintain its licence interest, the Company will be required to commence drilling a well before 31 December 2011. This expenditure is not at present committed.

(iii) Urozhainoye-2 Licence Area

The Company is required to commence drilling a well in the Urozhainoye-2 Licence Area during 2010. Management estimates the cost of such a well to be US$4.0 million.

Notes to the IFRS Consolidated Financial Statements continued

24. Contingencies and commitments continued

(b) Gaznefteservice ("GNS") – Vostochny-Makarovskoye Licence Area
In accordance with the Vostochny Makarovskoye licence agreement, GNS was required to drill at least one well by July 2008. As of the balance sheet date the licence commitments have been met.

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 2009, 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 Gaznefteservice	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.

25. Post-balance sheet events

Acquisition of 75% interest in a Gas Processing Unit

On 4 March 2010 the Group announced that an agreement has been signed with Trans Nafta ("TN") to purchase a 75% direct interest in gas processing facilities which will be used for the Group's Vostochny Makarovskoye ("VM") gas and condensate field.

As a result of this agreement, Gaznefteservice ("GNS"), a company which is wholly owned by the Group, will have a direct 75% interest in a Gas Processing Unit ("GPU") constructed on a site approximately 7 km from the VM field. The plant is to be operated by a company which is 75% owned by GNS. Under the terms of the agreement a sum of RUR187 million (approximately US$6.2 million) has been paid. In November 2008, a sum of RUR600 million (approximately US$20 million) was paid as an advance on the purchase of the interest in the GPU. As disclosed in Note 12, the initial payment remains recorded at the balance sheet date as a security deposit on acquisition of fixed assets.

Notice of Meeting

Notice is hereby given that the annual general meeting 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 14 June 2010 at 09.00 for the following purposes:

Ordinary business

1. To receive and adopt the Company's accounts for the year ended 31 December 2009 and the directors' report.

2. To declare a final dividend of £nil.

3. To reappoint Michael Calvey, who retires by rotation, as a director.

4. To reappoint Mikhail Ivanov, who retires by rotation, as a director.

5. To reappoint Stephen Ogden, who retires by rotation, as a director.

6. To reappoint PricewaterhouseCoopers LLP as auditors of the Company until the conclusion of the next general meeting at which accounts are laid before the Company.

7. To authorise the directors to determine the remuneration of the auditors of the Company.

Special business

To consider and, if thought fit, to pass resolution 7 as an ordinary resolution and resolution 8 as a special resolution.

8. That, the directors be and they are hereby generally and unconditionally 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) 15 months from the passing of this Resolution, or (ii) the conclusion of the Annual General Meeting of the Company to be held in 2011, 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.

9. 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 8 set out in this Notice convening the Annual General Meeting (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 8 set out in this Notice, 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.

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

BY ORDER OF THE BOARD
Antonio Maria Alves
Company Secretary
14 April 2010

Notice of Meeting continued

Notes:

1. 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.
2. A form of proxy is enclosed. To be effective, it must be deposited at the office of the Company's registrars so as to be received not later than 48 hours before the time appointed for holding the annual general meeting. 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.
3. 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.
4. 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 RO33 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 48 hours before the meeting date.
5. Only those members entered on the register of members of the Company at 09.00 a.m. on 12 June 2010 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 the close of business on 12 June 2010 or, in the event that this meeting is adjourned, in the register of members after the close of business 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.

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

Glossary of Technical Terms continued

possible reserves	are those unproven reserves that, on the available evidence and taking into account technical and economic factors, have a 10.0% 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 50.0% 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 90.0% 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

Russian Classification of Reserves

The Russian reserves system is based solely on the analysis of geological attributes. Explored reserves are represented by categories A, B, and C1; preliminary estimated reserves are represented by category C2; and potential resources are represented by category C3.

Category A reserves are calculated on the part of a deposit drilled in accordance with an approved development project for the oil or natural gas field. They represent reserves that have been analysed in sufficient detail to define comprehensively the type, shape and size of the deposit; the level of hydrocarbon saturation; the reservoir type; the nature of changes in the reservoir characteristics; the hydrocarbon saturation of the productive strata of the deposit; the content and characteristics of the hydrocarbons; and the major features of the deposit that determine the conditions of its development.

Category B represents the reserves of a deposit (or portion thereof), the oil or natural gas content of which has been determined on the basis of commercial flows of oil or natural gas obtained in wells at various hypsometric depths. Category B reserves are computed for a deposit (or a portion thereof) that has been drilled in accordance with either a trial development project or an approved development scheme.

Category C1 represents the reserves of a deposit (or of a portion thereof) whose oil or natural gas content has been determined on the basis of commercial flows of oil or natural gas obtained in wells and positive results of geological and geophysical exploration of non-tested wells. Category C1 reserves are computed on the basis of results of geological exploration work and production drilling and must have been studied in sufficient detail to yield data from which to draw up either a trial development project or a development scheme.

Category C2 reserves are preliminary estimated reserves of a deposit calculated on the basis of geological and geophysical research of unexplored sections of deposits adjoining sections of a field containing reserves of higher categories and of untested deposits of explored fields. Category C2 reserves are used to determine the development potential of a field and to plan geological, exploration and production activities.

Category C3 resources are prospective reserves prepared for the drilling of (i) traps within the oil-and-gas bearing area, delineated by geological and geophysical exploration methods tested for such area and (ii) the formation of explored fields which have not yet been exposed by drilling. The form, size and stratification conditions of the assumed deposit are estimated from the results of geological and geophysical research. The thickness, reservoir characteristics of the formations, the composition and the characteristics of hydrocarbons are assumed to be analogous to those for explored fields. Category C3 resources are used in the planning of prospecting and exploration work in areas known to contain other reserve bearing fields.

In accordance with the Law on Subsoil mineral reserves in Russia are subject to mandatory state examination, a precondition of the granting of a production licence. The state examination of reserves is conducted by subsidiary organisations of the Federal Agency on Subsoil Use, including the State Reserve Commission, Central Reserve Commission and its regional departments. Once a subsoil user is granted an exploration, development or production licence, it is required to file annual reports reflecting changes in reserves. Subsoil users' reserve reports are submitted annually for examination and approval by the Central Reserve Commission or, if there has been a substantial change in reserves, by the State Reserve Commission.

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Notes

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