Volga Gas plc

Annual Report and Accounts

for the year ended 31 December 2017

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

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Overview of 2017

- Successful implementation of Redox gas sweetening
- Construction of LPG recovery unit – expect to commence production during Q2 2018
- Recovery in oil prices and Russian Ruble offset lower production while implementing Redox
- Revenues of US$37.1 million (2016: US$39.4 million) in spite of 24% lower sales volumes
- EBITDA[1] down 9% at US$8.8 million (2016: US$9.6 million)
- Profit before tax of US$168,000 (2016: US$1.9 million) due to higher depletion charge
- Reduction in proved reserves of 27% reflected in 2017 year-end accounts

OVERVIEW

Successful implementation of Redox gas processing

- Reduced gas plant throughput during implementation phase
- Throughput recovered to 18 mmcf/d by December 2017
- Significant reduction in variable gas processing costs

Construction of LPG extraction plant

- Commissioning to be achieved during H1 2018
- Incremental product sales

Horizontal drilling on the Uzen oil field

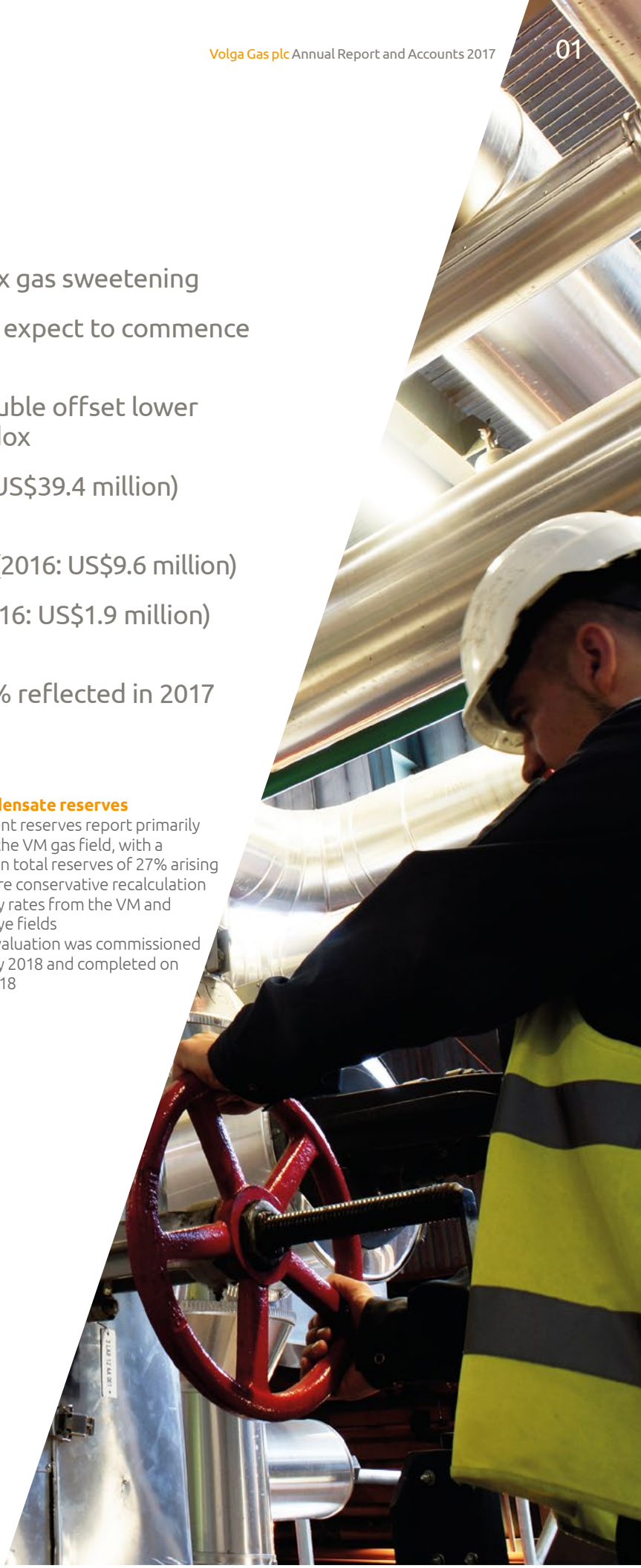
- Completed horizontal well development of shallower reserves on the Uzen field
- Incremental production in 2018 and beyond

Resilient financial performance in 2017

- Revenues of US$37.1 million (2016: US$39.4 million) in spite of 24% lower sales volumes
- EBITDA[1] down 9% to US$8.8 million (2016: US$9.6 million)
- Strong recovery in oil prices and Russian Ruble offset 24% reduction in sales volumes
- Profit before tax of US$168,000 (2016: US$1.9 million)

Gas and condensate reserves

- Independent reserves report primarily impacted the VM gas field, with a reduction in total reserves of 27% arising from a more conservative recalculation of recovery rates from the VM and Dobrinskoye fields
- Reserve evaluation was commissioned in February 2018 and completed on 12 April 2018

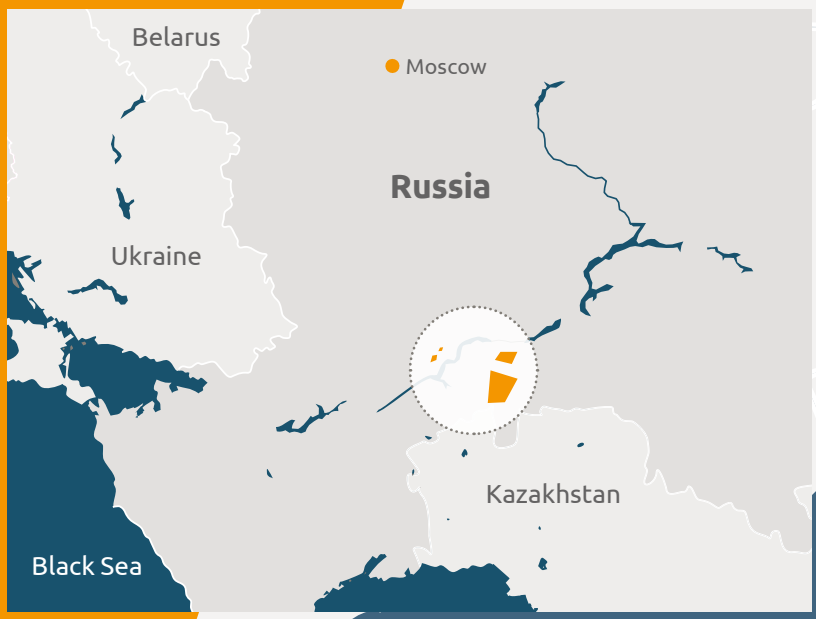


* Reconciliation of EBITDA is disclosed in the operational and financial summary on page 12.

Volga at a Glance

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

1. Karpenskiy
2. Vostochny Makaroyskoye
3. Dobrinskoye
4. Urozhainoye-2



Dobrinskoye gas processing plant

2017 Progress
Conversion to Redox-based gas sweetening to significantly reduce processing costs and substantially eliminate waste disposal requirements.

Construction of LPG extraction plant to increase revenues.

2018 Objectives
- Complete implementation of Redox sweetening and construction of second reaction vessel.
- Complete LPG plant commissioning and commence LPG production during Q2 2018.

Vostochny Makarovskoye ("VM") gas/condensate field

2017 Progress
Managed production primarily from the VM#3 and VM#4 wells.

Upgrade to production management systems.

2018 Objectives
- Complete reservoir and technical studies on the VM field. Undertake workovers on VM#1 and VM#2 wells to mitigate formation water production and enhance productivity.

Dobrinskoye gas/condensate field

2017 Progress
Managed production from the Dobrinskoye #26 well.

2018 Objectives
- Sidetrack of #26 well to increase production rates.

Uzenskoye oil field

2017 Progress
Maintain production and seek to maximise extraction of oil from vertical wells.

Horizontal well drilled into the undeveloped shallower reservoir in Uzen.

2018 Objectives
- Seek to optimise extraction of oil from existing wells, including the new horizontal well.
- Upgrade of production facilities, especially to water separation equipment.

Commercial

2017 Progress
Commenced direct gas sales to Gazprom and achieved improvement in netback.

2018 Objectives
- Marketing of new LPG product stream.

Reserve report

2017 Progress
New independent reserves report resulted in 27% reduction in proved reserves.

2018 Objectives
- Complete reservoir and other technical studies to increase production and optimise extraction of reserves in place.

Chairman's Statement

MIKHAIL IVANOV
CHAIRMAN

Dear Shareholder,

During 2017 conditions for the oil and gas industry worldwide and for Russia generally have been more stable than in the recent past. This stability has enabled Volga Gas to undertake important steps to enhance its operations materially, the most important of which was switching the gas sweetening process utilised at the Dobrinskoye gas processing plant, the Group's principal production facility, to a Redox-based system. This has reduced the chemical costs of the operation and has eliminated the need to dispose of bulky spent processing chemicals. During the implementation of this process, and whilst the operational team optimises the management of the new process, the plant throughput has had to be reduced. However, with the improved oil and gas market conditions, this has not had as material an impact on the Group's revenues in 2017 as may otherwise have occurred.

The change to a Redox gas sweetening process was achieved with only modest capital expenditure as minimal modifications to the existing plant were required. During 2017, the main focus of the capital investment was in two projects that are expected to provide incremental revenues and cash flow to the Group: the construction of a plant at the gas processing facility to capture for sale the liquid petroleum gases ("LPG") – propane and butane – that are currently vented and flared; and the drilling of a new horizontal oil well to access the hitherto undeveloped reserves in the Uzen oil field located in the Group's Karpenskiy licence area. The LPG project is expected to commence producing and selling product from April 2018. When it is fully operational, the LPG plant could add up to 400 barrels of oil equivalent per day of incremental sales volumes. These projects are discussed in greater detail by the Chief Executive Officer in the Operational Review.

Given the constraints to gas and condensate production experienced in 2017, the Board is pleased to report that revenues have been broadly maintained at US$37.1 million (2016: US$39.4 million), EBITDA at US$8.8 million (2016: US$9.6 million) and operating cash flow before working capital movements at US$9.0 million (2016: US$10.4 million). This has enabled the Group to undertake an increased capital expenditure programme during 2017 and, in spite of some overruns in the costs of the Uzen horizontal well, to end the year with healthy cash balances and remain in a positive net cash position after taking into account borrowings. This is in addition to paying US$5.0 million in dividends to shareholders in 2017 (2016: nil).

Unfortunately, Volga Gas has recently experienced higher formation water content at certain production wells at Vostochny Makarovskoye ("VM") and so the Board thought it appropriate to commission an updated independent reserves report and prudent to adopt its findings in full. This report, dated 12 April 2018, has resulted in a 27% reduction in the proved reserves and a 28% reduction in the proved and probable reserves of oil, gas and condensate and we are actively looking into technical and operational solutions to mitigate the impact of the reserves reduction. The reserves reduction is caused by a recalculation of recovery rates from the VM and Dobrinskoye gas fields, rather than any changes to the geological model or estimates of original hydrocarbons in place. This has had a material impact in reducing the operating profits of the Group to US$0.1 million (2016: US$2.51 million), due to an increase in the depletion charge to US$8.6 million (2016: US$5.0 million). Further details of the impact of the reduction of the reserves are set out in the operating and financial reviews between pages 6 and 11.

In spite of the reduction in reserves, the Group still holds significant, fully developed reserves in its three principal fields. These reserves form the basis of sustainable production with growth potential in the near term. These assets provide a platform for the Group to grow in the future, through successful exploration and by selective value-accretive acquisitions. The Board believes that Volga Gas has a stable foundation and the financial and operational capability to develop and extend these assets to provide long-term value for our shareholders.

The Board remains committed to a policy of enhanced dividend distribution and is planning to modify its dividend policy towards higher rates of distribution, having in mind the requirements of the business and the need to maintain its financial strength. Within these constraints, the Board would consider distributing up to 75% of its free cash flow as dividends. For the time being however, the Board considers it prudent to defer a decision on the dividend level until the incremental cash flow from the investments undertaken in 2017 begins to be realised. A further decision will be taken by the interim results stage in September 2018.

While the immediate outlook for the oil industry remains broadly positive, the finances of the Group will continue to be conservatively managed. Capital investment commitments will continue to be at a modest rate and focused on enhancing the profits from the gas and condensate production and on optimising the production from the reserves of the Company.

MIKHAIL IVANOV
CHAIRMAN

Chief Executive's Report

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

The principal objective for Volga Gas in 2017 was to effect a transformation in the technology used to process the gas and condensate at the Dobrinskoye gas plant, from which the Group derives the overwhelming majority of its production, revenue and profits. During 2016 and early 2017, after extensive investigations and pilot tests, management concluded that a switch to Redox-based sweetening would be most advantageous – not only for reduced cost but also for the elimination of waste material that required disposal. This also had the advantage that it could be implemented with minimal modifications to the existing plant, saving significantly on capital expenditure that other alternatives would require.
In May 2017, we commenced the switch to Redox processing and from June 2017 onwards all of the gas processed at Dobrinskoye was with Redox. Although the change was achieved at low capital cost, in the first months after implementation, the plant throughput was kept at low levels while the process management was optimised. Throughput at the gas plant was gradually increased and in December 2017 was averaged 533,000 m³ per day (18.8 mmcf/d). However, the period of lower throughput at the gas plant was primarily responsible for an overall reduction in Group production, being 24% lower than 2016. Offsetting the reduction in volumes in 2017, oil prices and the Russian Ruble both recovered steadily through the year and consequently the impact of lower sales volumes on the financial performance of the Group was less than it may have been otherwise. This is discussed in greater detail in the Financial Review.
In addition to the switch to Redox gas sweetening, the two major projects undertaken by Volga Gas during 2017 were the construction of an LPG unit at Dobrinskoye and the drilling of the horizontal well Uzen #101 on the Uzen oil field in our Karpenskiy licence. These projects were the main use of the capital investment undertaken by Volga Gas in 2017 and are expected to contribute materially to future revenues and profits. I will cover these projects in greater detail below.

Reserves update

Subsequent to the 2017 year end, the Company commissioned a new independent reserve report by OOO Geostream Assets Management ("Geostream") as, late in 2017, the presence of increased formation water was observed during gas production from certain of the production wells on the VM field. The report, dated 12 April 2018, has resulted in a reduction of 27% in the proved and of 28% in the proved plus probable reserve numbers for the Group's oil and gas reserves. Although the estimate of original hydrocarbons in place is unchanged, the presence of formation water during gas production has led Geostream to apply a more conservative calculation of ultimately recoverable reserves from the VM field. Management considers the new reserve estimates to be consistent with the currently available field data and, accordingly, has adopted the revised reserve estimates as the Group's oil, gas and condensate reserves for the 2017 year-end accounts. The Group's reserve statement is shown in the Operational Review on page 9. The impact of the reserve revision has been to increase the depletion, depreciation and amortisation charge of the Group compared to 2016, with consequent reductions in the profit and net book value of the Group's assets. While the reserve revisions have not triggered any impairment charges, subsequent reserve evaluations may or may not lead to further revisions which may impair the assets. Following the revised reserve estimates that have been adopted, we are actively looking into technical and operational solutions to mitigate the impact of the reserves reductions and to maximise gas production through the Dobrinskoye gas plant.

2018 objectives and medium-term strategy

Management has the following key objectives in 2018:

- To increase the efficiency and processing capacity at the gas plant using Redox gas sweetening from the rate of 533,000 m³ per day achieved at the end of 2017.
- Having nearly completed construction of the LPG plant, to commence production and optimise the marketing of the product.
- To complete the reservoir and technical studies on the VM field and to commence actions including workovers and reperforations of the well bores to mitigate future formation water production, thereby restoring maximum gas production and the extraction of reserves in place.
- Optimise the production of oil from the new horizontal well Uzen #101 and to manage the more mature oil wells in the field.

Current trading and outlook

Between January and March 2018, Group production averaged 4,084 barrels of oil equivalent per day, in line with management's plan, given the anticipated higher levels of planned maintenance downtime in the period. For the coming months, management expects to maintain an average daily production of gas and condensate in the region of 3,800 boepd, resulting in Group production of approximately 4,500 boepd, excluding incremental volumes from the LPG project, which when the project is fully operational is expected to add a further 400 boepd. International oil prices strengthened at the start of 2018 and have remained relatively stable. Although it is a minor part of the Group's output, oil production has increased as a result of additional volumes from the horizontal well Uzen #101 which has more than offset the natural decline in the mature oil wells.
In the current environment, and at current production rates to which may be added additional sales of LPG, management expects the Group's financial performance in 2018 to improve on that of 2017. Meanwhile, new capital expenditure commitments remain within projected cash generation, permitting a resumption of a sustainable distribution policy for shareholders.

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

Operational Review

Operations overview

Operations overview

As outlined on the previous page, Group production in 2017, at an average daily rate of 4,948 boepd, was 24% lower than the 6,507 boepd achieved in 2016. The principal reason for this was the planned reduction of gas processing plant throughput necessary as the Redox-based gas sweetening process was implemented and optimised over a period of several months. There was also some decline in the mature production wells in the Uzen oil field and the increased presence of formation water in certain of the production wells at VM in late 2017.

The impact on revenues was partly offset by a continued recovery in oil prices through the year and the Ruble stabilising at higher levels. As a result of the lower proportion of export sales in 2017, taking into account selling expenses, netback revenues (defined as revenues less selling expenses as shown in the income statements) in 2017 were US$34.8 million, only marginally lower than the US$35.4 million in 2016.

The benefits of savings from the lower process chemicals costs were offset by higher rates of Mineral Extraction Tax arising from higher oil prices and the scheduled adjustments to the rate formulas and by increases in administrative expenses. As a consequence, EBITDA for 2017 was US$8.8 million (2016: US$9.6 million).

Besides the implementation of Redox-based processing at the Dobrinskoye gas plant, the key operational activities in 2017 were construction of the LPG plant and, in the separate oil production business, the drilling of new horizontal wells on the Uzen field.

Gas/condensate production

The Dobrinskoye and VM fields are managed as a single business unit. Production from the fields is processed at the gas plant located next to the Dobrinskoye field, extracting the condensate and processing the gas to pipeline standards before input into Gazprom's regional pipeline system via an inlet located at the plant. The VM field was developed with wells drilled by Volga Gas, while the Dobrinskoye wells were acquired from previous licensees.

By the end of 2016, development drilling on the VM field was essentially completed, with a total of four wells in the principal reservoir, the Evlano Livinskiy carbonate, and a further well in the secondary Bobrikovskiy sandstone reservoir.

Production during 2017 averaged 19.1 mmcf/d of gas and 1,163 bpd of condensate (2016: 25.5 mmcf/d of gas and 1,557 bpd condensate) an overall decrease of 25% in equivalent barrels of oil terms. As outlined above, this was principally a result of the decision to operate the gas processing plant at lower throughput rates as the Redox processing was implemented and optimised. Between June 2017 and December 2017, the daily throughput increased steadily, as discussed below, and production increased accordingly.

Between January and April 2017, while the gas was being sweetened with the old Sulfanox process, production was generally running at close to the gas plant's maximum physical capacity and averaged 30.5 mmcf/d of gas and 1,730 bpd of condensate. However, during late 2017 and early 2018, the presence of formation water in certain of the production wells on VM was detected. Consequently, management commissioned a new reserve report. The report, date 12 April 2018, concluded that as a result of more conservative calculation of ultimate recovery rates, the Company should recognise a significant reduction in reserves, mainly in the VM field.

Management is looking into technical and operational solutions to mitigate the impact of the reserves reductions, including conducting well interventions on the VM field, workovers and reperforations of the well bores. On Dobrinskoye, which is a more mature gas field, there are also plans to drill a sidetrack on well #26 to develop a likely undepleted portion of the reservoir.

The proven and Probable reserves and the revisions adopted in full for the 2017 year-end results are detailed in the table on page 9.

Gas/condensate sales

Historically, the Group's gas was sold to Trans Nafta under contract at a fixed Ruble contract. However, from December 2016, gas sales have been made directly to Gazprom. This has resulted in an increase in the net realisations, although the Group now pays a transit tariff for delivery via the Gazprom pipeline network to the point of sale.

In US Dollar terms, however, the stronger Ruble, as well as an increase in the Ruble selling price, led to the average gas sales realisations rising 36% in 2017 to US$2.06/mcf (2016: US$1.51).

Since November 2015, we have been utilising export channels for condensate as an alternative to domestic sales in periods of low domestic demand. Domestic market conditions in 2017 were generally more favourable and consequently condensate exports declined significantly and ceased altogether from the end of March 2017. In total, approximately 15% of condensate sales were exported during 2017, compared to 48% of the total condensate sales in 2016.

During 2017, the average condensate netback price (after accounting for export taxes and transportation costs) increased 38% to US$34.37 per barrel (2016: US$24.83).

Average unit production costs on the gas condensate fields increased moderately to US$5.39 per boe in 2017 (2016: US$5.33). The recovery in the Ruble, in which effectively all the costs are denominated, and the lower throughput rates in the second half of 2017 increased the impact of the fixed cost element of the operating expenses and offset the benefits of lower chemical costs associated with the switch to Redox.

Operational Review continued

Gas processing plant

The Dobrinskoye gas processing plant was originally designed and constructed to utilise a Sulfanox-based gas sweetening process, which had the benefit of low capital cost but carried high chemical usage and generated substantial volumes of waste requiring careful disposal. The plant was designed with a maximum throughput capacity of one million m^3/day (35.3 mmcf/d).

During 2016, a number of alternatives were tested and, by the end of 2016, management decided that a switch to a Redox-based sweetening process would be optimal and required only minor modifications to the existing plant equipment. Between April and June 2017, industrial-scale testing of the Redox process was undertaken while the modifications were carried out. In June, the plant was switched over entirely to Redox-based processing.

During the initial months of the new process, between June 2017 and August 2017, the plant throughput was kept at relatively low levels as the process management was optimised. Throughput increased gradually through the remainder of 2017, from the average rate of 213,000 m^3/day (7.5 mmcf/d) in June 2017 to reach 533,000 m^3/day (18.8 mmcf/d) in December 2017, slightly above management's short-term throughput target. In addition, during November 2017, inefficient operations of the system pumps had caused up to 40% of the processed gas being below pipeline specification. This issue has been dealt with and since December 2017 all of the processed gas is available for sale.

Based on the experience of operating the Redox process to date, management identified the need to add two further oxidising vessels to the current plant configuration. Having recently completed this, management expects improvements in efficiency, reduced operational downtime and higher effective operating capacity.

The other key development at the gas plant in 2017 was the construction of a new unit for the capture, storage and sale of LPG. LPGs, primarily comprising propane and butane, are currently either included in the sales gas stream or flared. The LPG project will provide an additional product stream which is expected to increase total sales volumes by approximately 400 boepd and to enhance profitability.

Although construction was largely accomplished before the end of 2017 as planned, due to delays in delivery of certain items of equipment and to regulatory clearance, completion of the project was delayed by approximately three months. As of March 2018, the LPG project is commencing the commissioning process and should start production during the second quarter of 2018.

In spite of the delays to the project, the LPG project is expected to be completed at a total capital cost of US$5.5 million.

Oil production and development

Since 2009, the Uzen field has been producing oil from a cretaceous Aptian reservoir at a depth of approximately 1,000 metres. As the oil was produced, the oil-water contact in the reservoir rose and the wells at the edge of the field were shut in as water cut increased. By the start of 2017, production was derived from three active wells – down from a peak of five in 2010. With careful management, production has been continued, albeit at declining rates. The existing mature wells produced at an average rate of 595 bopd in 2017 (2016: 708 bopd).

The principal development activity of 2017 on the Uzen field was on the proved undeveloped reserves in the shallower Albian reservoir, using a horizontal well. Drilling of the new horizontal well #101 commenced on 27 April 2017. Although mainly being drilled to develop the proved but currently undeveloped Albian reservoir in the Uzen field, the well was initially sidetracked to investigate potential unproven structures. While one possible target was dry, a second small oil accumulation was encountered, providing only a minor increment to Group reserves.

Drilling operations on the horizontal section of well #101 were concluded as anticipated in July 2017, having completed a horizontal section of total length of 627 metres. Logging while drilling indicated a total productive zone in the well of 506 metres, exhibiting average porosity of 32% and oil saturation of 68%. Between October and December 2017, well #101 was intermittently flow tested. Following the installation of a flow line from the well site to the main Uzen field facilities in December 2017, well #101 has been put on continuous production. Between January and March 2018, well #101 has been producing at an average rate of approximately 300 bopd.

As a result of the extra sidetracks drilled and additional precautions taken to deliver a stable and secure production well, the costs of drilling well #101 increased to approximately US$7.1 million compared to a budget cost of US$3.8 million.

Following a revised conversion from tonnes to barrels, as the oil contained in the Albian reservoir has slightly higher density than the oil in the Aptian reservoir, there is a modest restatement in the Uzen oil reserves as expressed in barrels. There is no change in the tonnage of reserves.

Exploration

During 2017, as a result of the decision to focus on income-generating investments, exploration activity was confined to internal technical studies.

Nevertheless, the Group has identified a number of exploration targets in the Karpenskiy Licence Area at shallow horizons of between 1,000 and 2,000 metres' depth. These provide low-cost opportunities to add potentially material oil reserves. While management recognises the potential of these prospects, the immediate priority is to maximise the value and cash generation from proven reserves.

The Group has fulfilled all its licence commitments on the Karpenskiy Licence Area and further drilling in the area is discretionary. Nevertheless, future development of the oil potential in the Group's licences is a key element of management's medium-term strategy.

Oil, gas and condensate reserves as of 1 January 2018

In February 2018, Volga Gas commissioned an updated reserve report of the Group's oil, gas and condensate reserves. Management considers the new reserve estimates contained in this report, dated 12 April 2018, to be a reasonable reflection of the field data currently available, and accordingly they have been adopted by the Company as a fair statement of reserves.

The following table shows the proven and probable reserves as at 31 December 2017 and changes from previous estimates.

Oil, gas and condensate reserves

	Oil and condensate (mmbbl)	Gas (bcf)	LPG (tonnes) (000)	Total (mmboe)
As at 31 December 2016				
Proved reserves	10.951	98.5	277	30.620
Proved plus probable reserves	12.153	131.5	367	38.405
Production: 1 January –31 December 2017	0.667	7.0	–	1.831
Revisions:				
Proved reserves	(0.457)	(34.2)	(129)	(7.664)
Proved plus probable reserves	(0.361)	(46.9)	(162)	(10.104)
As at 31 December 2017				
Proved reserves	**9.827**	**57.4**	**148**	**21.125**
Proved plus probable reserves	**11.125**	**77.6**	**205**	**26.470**
Revision as % of 2016 reserves less 2017 production				
Proved reserves	(5%)	(37%)	(47%)	(27%)
Proved plus probable reserves	(3%)	(38%)	(44%)	(28%)

Notes:

1. Volga Gas (through its wholly owned subsidiaries PGK and GNS) is the operator and has a 100% interest in four licences to explore for and produce oil, gas and condensate in the Volga region.
2. The reserve estimates as at 31 December 2016 were independently assessed by OOO Geostream Assets Management. The estimates at 31 December 2017 are results of an updated study conducted by OOO Geostream Assets Management dated 12 April 2018. The full reserve report is available on the Company's website: www.volgagas.com.
3. The reserve estimates were prepared in metric units: tonnes for oil, condensate and LPG and standard cubic metres for gas. The conversion ratios from tonnes to barrels applied in the table above were 7.833 barrels per tonne of oil, 8.75 barrels per tonne of condensate and 11.75 barrels per tonne of LPG. One cubic metre equates to 35.3 cubic feet and one barrel of oil equivalent is given by 6,000 standard cubic feet of gas.
4. The above reserve estimates, prepared in accordance with the PMRS reserve definitions prepared by the Oil and Gas Reserves Committee of the SPE, have been reviewed and verified by Mr Andrey Zozulya, Director and Chief Executive Officer of Volga Gas plc, for the purposes of the Guidance Note for Mining, Oil and Gas companies issued by the London Stock Exchange in June 2009. Mr Zozulya holds a degree in Geophysics and Engineering from the Groznensky Oil & Gas Institute and is a member of the Society of Petroleum Engineers.

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

Financial Review

VADIM SON
CHIEF FINANCIAL OFFICER

Results for the year

In 2017, the Group generated US$37.1 million in turnover (2016: US$39.4 million) from the sale of 644,506 barrels of crude oil and condensate (2016: 837,837 barrels) and 6,378 million cubic feet of natural gas (2016: 9,210 million cubic feet).

The average price realised for liquids sold in the domestic market was the equivalent of US$35.49 per barrel (2016: US$30.59 per barrel). During 2017, approximately 15% of condensate sales were to export customers (2016: 48%). As a consequence, selling expenses such as export taxes and transportation costs fell substantially in 2017 to US$2.2 million (2016: US$ 4.1 million). For domestic sales, the selling price for liquids is effectively a wellhead netback price. The average netback price for liquids sales, calculated by deducting selling expenses from revenue attributed to oil and condensate sales, in 2017 was US$35.80 (2016: US$25.70).

The gas sales price during 2017 averaged US$2.06 per thousand cubic feet (2016: US$1.51 per thousand cubic feet), the increase being attributable to higher Ruble selling prices as well as the movement in the Ruble/US Dollar exchange rate. The average sales price of gas in Rubles increased in 2017 by 10.8% compared to 2016 (no increase in 2016 over 2015). In December 2016, the Company commenced sales directly to Gazprom, which was partly responsible for the increase in realised price. Production activities generated a gross profit of US$8.2 million in 2017 (2016: US$13.1 million).

In 2017, the total cost of production decreased to US$9.3 million (2016: US$11.0 million), with variable costs driven by lower production volumes, some Ruble inflation and the effect of the recovery in the Ruble on our predominantly Ruble-denominated costs. Unit field operating costs were steady at US$3.74 per boe (2016: US$3.95 per boe), partly as a result of cost efficiencies, offset by fixed costs shared among lower volumes. Production-based taxes were US$10.9 million (2016: US$10.3 million) reflecting the impact of higher oil prices and Ruble exchange rates on Mineral Extraction Tax ("MET") rates as well as the impact of further formula changes that came into effect on 1 January 2017. This was partly offset by lower production volumes. MET paid in 2017 represented 31.4% of netback revenues (2016: 29.0% of netback revenues).

Operating and administrative expenses in 2017 were US$5.8 million (2016: US$4.5 million), reflecting the stronger Ruble as well as certain one-off expenses.

The Group experienced a 9% reduction in EBITDA (defined in the operational and financial summary on page 12 as operating profit before non-cash charges, including exploration expenses, depletion and depreciation) to US$8.8 million (2016: US$9.6 million).

The unit rate of Depletion, Depreciation and Amortisation ("DD&A") increased to US$5.02 per boe (2016: US$2.12 per boe) as a result of both the reduction in reserves in the VM and Dobrinskoye fields and higher than anticipated expenditures on the Uzen horizontal well as well, as the strength of the Ruble, in which the depletion pool is recorded. This was offset by the 24% decrease in production. The DD&A charge in 2017 was US$8.6 million (2016: US$5.0 million) with consequent reductions in profit and net book value of the Group assets.

With no significant exploration and evaluation expenses in 2017 (2016: US$0.3 million) or other provisions (2016: provision of US$1.8 million for the write off of development assets), the Group recorded an operating profit for 2017 of US$113,000 (2016: US$2.5 million).

Including net interest income of US$0.2 million (2016: US$0.2 million) and other net losses of US$142,000 (2016: net loss of US$0.8 million) the Group recognised a profit before tax of US$168,000 (2016: US$1.9 million) and reported net profit after tax of US$330,000 (2016: US$1.2 million) after a current tax charge of US$243,000 and a deferred tax credit of US$405,000 (2016: deferred tax charge of US$0.7 million).

Cash flow

Group cash flow from operating activities was US$6.3 million (2016: US$13.3 million). Net working capital movements contributed cash outflow of US$2.3 million in 2017 (2016: net inflow of US$2.9 million), which included movements in accounts payable of US$2.9 million (2016: cash inflow of US$3.8 million from export customer prepayments). Included in net cash flow for 2017 were payments of profit tax of US$0.5 million (2016: US$2,000). With higher capital expenditures in 2017, the net outflow from investing activities was US$12.6 million (2016: US$5.0 million). With dividend payments of US$5.0 million in 2017 (2016: nil), net cash outflow from financing activities was US$5.2 million (2016: inflow of US$4.0 million from debt drawdown).

Dividend

In July 2014, the Board announced the adoption of a policy to distribute approximately 50% of consolidated net profit after tax as a cash dividend. In 2017 the Company paid a dividend of US$0.007 per ordinary share in respect of 2016 and, in addition, a special dividend of US$0.055 per ordinary share. In light of the significant capital investment in 2017 and in the interests of prudence, the Board will defer any decision on further distribution until the interim results stage, when the impact of the new projects on financial performance will be clearer. However, the Board is considering a policy of basing future dividends on cash generation as well as earnings and, subject to the requirements of the Group, of distributing up to 75% of free cash flow.

Capital expenditure

During 2017 capital expenditure of US$12.4 million was incurred (2016: US$4.2 million), of which US$12.3 million was incurred on development and producing assets (2016: US$3.9 million) and US$0.1 million on exploration and evaluation (2016: US$0.3 million). Capital expenditure in 2017 comprised drilling and workovers on the Uzen oil field, construction of the LPG plant and minor upgrades to the gas processing plant.

Profitability by product

While the Group operates as a single business segment, as described in note 2.3 to the accounts on page 36, management estimates the relative profitability, which for this purpose is defined to be gross profit less selling expenses, by product to be as follows:

	2017		2016	
US$ 000	Oil	Gas and condensate	Oil	Gas and condensate
Revenue	8,075	28,991	7,523	31,889
MET	(3,816)	(7,120)	(3,064)	(7,191)
Depreciation	(967)	(7,613)	(480)	(4,557)
Other cost of sales	(1,067)	(8,253)	(1,254)	(9,714)
Selling expenses	(189)	(2,032)	(221)	(3,831)
Gross profit net of selling expenses	2,036	3,973	2,504	6,596

Balance sheet and financing

As at 31 December 2017, the Group held cash and bank deposits of US$8.6 million (2016: US$19.7 million). All of the Group's cash balances are held in bank accounts in the UK and Russia. Approximately 48% (2016: 64%) of the Group's cash is held in US Dollars and 50% (2016: 34%) held in Russian Rubles.

In December 2016, the Group drew down from a RUR 240 million (US$4.0 million) bank facility, which was utilised to fund purchases of equipment for the LPG project. Total debt as at 31 December 2017 was US$4.0 million (2016: US$4.0 million). Repayments of the loan by monthly amortisation commenced in December 2017. As at 31 December 2017, there was a technical breach of certain loan covenants. Management is confident of receiving a waiver of this breach from the lender, but pending receipt of this waiver, the entire loan is classified as current.

As at 31 December 2017, the Group's intangible assets were US$3.8 million (2016: US$3.5 million). Property, plant and equipment increased to US$62.3 million (2016: US$55.9 million), reflecting capital investment incurred in 2017 as well as the impact of foreign exchange adjustments, offset by higher depletion. The carrying values of the Group's assets relating to its main cash-generating units have been subject to impairment testing. The result of the impairment tests, including sensitivity analysis around the central economic assumptions and taking into account the reduction in oil and gas reserves, as detailed in note 4(b) to the accounts, showed no present requirement for impairment.

For the year ending 31 December 2017, the Group recorded a currency retranslation income of US$3.5 million (2016: income of US$10.5 million) in its other comprehensive income, relating to the movement of the Ruble against the US Dollar.

The Group's committed capital expenditures are less than expected cash flow from operations and cash-on-hand and such expenditures can be managed in light of the volatility in international oil prices and the Ruble. The Group may consider additional debt facilities to fund the longer-term development of its existing licences and operational facilities as appropriate.

The Group's financial statements are presented on a going concern basis, as outlined in note 2.1 to the accounts.

VADIM SON
CHIEF FINANCIAL OFFICER

Financial Review continued

Five-year operational and financial summary

Sales volumes	2017	2016	2015	2014	2013
Oil and condensate (barrels '000)	**644**	828	439	604	547
Gas (mcf)	**6,378**	9,320	4,545	5,671	3,128
Total (boe '000)	**1,707**	2,381	1,196	1,549	1,069

Operating results (US$ 000)	2017	2016	2015	2014	2013
Oil and condensate sales	**23,952**	25,380	11,041	27,220	26,067
Gas sales	**13,114**	14,032	6,786	12,203	8,554
Revenue	**37,066**	39,412	17,827	39,423	34,621
Field operating costs	**(6,379)**	(9,367)	(6,016)	(7,805)	(5,946)
Production-based taxes	**(10,936)**	(10,255)	(5,877)	(8,344)	(8,095)
Depletion, depreciation and amortisation	**(8,580)**	(5,037)	(2,345)	(4,656)	(2,611)
Other production expenses	**(2,941)**	(1,601)	(1,352)	(1,709)	(1,799)
Cost of sales	**(28,836)**	(26,260)	(15,589)	(22,514)	(18,451)
Gross profit	**8,230**	13,152	2,238	16,909	16,170
Selling expenses	**(2,221)**	(4,052)	(319)	–	–
Exploration expense	**–**	(265)	(635)	–	(2,519)
Write-off of development assets	**(65)**	(1,798)	(2,950)	–	(1,439)
Operating, administrative and other expenses	**(5,831)**	(4,526)	(3,377)	(4,157)	(4,029)
Operating (loss)/profit	**113**	2,511	(5,043)	12,752	8,183

Net realisation	2017	2016	2015	2014	2013
Oil and condensate (US$/barrel)	**37.19**	30.65	25.16	45.07	47.63
Gas (US$/mcf)	**2.06**	1.51	1.49	2.15	2.73

Operating data (US$/boe)	2017	2016	2015	2014	2013
Production and selling costs	**3.74**	3.93	5.03	5.04	5.56
Production-based taxes	**6.40**	4.31	4.91	5.39	7.58
Depletion, depreciation and other	**5.03**	2.12	1.98	3.01	2.44

EBITDA calculation (US$ 000)	2017	2016	2015	2014	2013
Operating profit/(loss)	**113**	2,511	(5,043)	12,752	8,183
Exploration expense	**–**	265	635	–	2,519
DD&A and other non-cash expense	**8,645**	6,857	5,319	4,656	4,050
EBITDA	**8,758**	9,633	911	17,408	14,752
EBITDA per boe	**5.13**	4.05	0.76	11.24	13.81

Netback realisation for oil and condensate is calculated by deducting selling expenses from oil, gas and condensate sales.

Principal Risks and Uncertainties

The Group is subject to various risks relating to political, economic, legal, social, industry, business and financial conditions. The following risk factors, which are not exhaustive, are particularly relevant to the Group's business activities:

Volatility of oil prices

The supply, demand and prices for oil are influenced by factors beyond the Group's control. These factors include global and regional demand and supply, exchange rates, interest and inflation rates and political events. A significant prolonged decline in oil and gas prices could impact the profitability of the Group's activities.

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

The Group does not currently hedge its crude oil production to reduce its exposure to oil price volatility as the structure of taxes applied to oil and condensate production in Russia effectively reduce the exposure to international market prices for oil. In addition, the Ruble exchange rate has tended to move with the oil price, reducing the overall volatility of oil prices when translated into Russian Rubles.

Market risks

The Group's revenues generated from oil and condensate production have typically been from sales to local domestic customers. There have been periods when the local market has been unable to purchase condensate, causing temporary suspension of production and loss of revenues. Since November 2015, the Group has developed export channels for its condensate into regional export markets to mitigate this risk. Gas sales are made to Gazprom. The region in which the Group operates is reliant on external gas supplies. Consequently the risk of insufficient demand for the Group's gas is considered low. Gas sales have generally been conducted as expected, subject to occasional constraints during pipeline maintenance operations.

Oil and gas production taxes

The Group's sales generated from oil and gas production are subject to Mineral Extraction Taxes ("MET"), which form a material proportion of the total costs of sales. The rates of these taxes are subject to changes by the Russian government, which relies heavily on such taxes for its revenues. Changes to rate formulas which came into effect during 2015 and 2016 materially increased the rates on crude oil, condensate and natural gas. With oil prices recovering from recent lows, MET rates have increased in line with current formulas. As of 2019, the Russian government is planning trials of a profit-based oil and gas taxation regime to replace the production-based MET. At present, the impact on the Group's operations of any such change of tax regime is unknown.

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 involves a high degree of risk. These risks include the uncertainty that the Group will discover sufficient commercially exploitable oil or gas resources in unproven areas of its licences. Unsuccessful exploration efforts may result in impairment to the balance sheet value of exploration assets. However, the Group's current plans involve limited expenditure in exploration-related activities.

In February 2018, the Group commissioned an updated reserve evaluation based on reporting standards set by the Society of Petroleum Engineers. The reserve report, delivered to and adopted by management on 12 April 2018, resulted in a downward revision by approximately 27% to the Group's reserves as at 31 December 2017. Management considers the new reserve estimate to be in line with the currently available field data and accordingly has chosen to adopt the preliminary estimates as the statement of the Group's oil, gas and condensate reserves. The Group's reserve statement is shown in the Operational Review on page 9. The impact of the reserve revision has been to increase the depletion, depreciation and amortisation charge of the Group, with consequent reductions in the profit and net book value of the Group's assets. While the reserve revisions do not appear to have triggered an impairment, subsequent reserve evaluations may lead to further revisions which may impair the assets. Furthermore, if the results of producing the Group's fields are significantly different to expectations, there may be changes in the future estimates of reserves. These may impact both the future profitability and the balance sheet carrying values of 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, including waste materials generated by the sweetening process formerly in use at the Dobrinskoye gas processing plant. 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 regard 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.

Principal Risks and Uncertainties continued

The Group liaises closely with the Federal Service of Environmental, Technological and Nuclear Resources of the Saratov and Volgograd Oblasts on potential environmental impact of its operations and conducts environmental studies both as required by, and in addition to, its licence obligations to mitigate any specific risk. The Group's operations are regularly subject to independent environmental audit. The Group did not incur any material costs relating to the compliance with environmental laws during the period.

Risk of operating oil and gas properties

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

Foreign currency risk

The Group's capital expenditures and operating costs are predominantly in Russian Rubles ("RUR") while a minority of administrative expense are in US Dollars, Euros and Pounds Sterling. Revenues are predominantly received in RUR, so the operating profitability is not materially exposed to moderate short-term exchange rate movements. The functional currency of the Group's operating subsidiaries is the RUR and the Group's assets and liabilities are predominantly RUR denominated. As the Group's presentational currency is the US Dollar, fluctuations in the exchange rate of the RUR against the US Dollar impact the Group's financial statements.

Business in Russia

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

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

The Group's operations and financial management have not been impacted directly by any sanctions to date.

Legal systems

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

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

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

Liquidity risk

At 31 December 2017, the Group had US$8.6 million (2016: US$19.7 million) of cash and cash equivalents, of which US$7.9 million was held in bank accounts in Russia (2016: $6.1 million). As at 31 December 2017, total bank debt was US$4.0 million (2016: US$4.0 million). The Group has fully drawn on the debt facilities available as at 31 December 2017 and 31 December 2016. The Group intends to fund its ongoing operations and development activities from its cash resources and cash generated by its established operations. At 31 December 2017, the Group had budgeted capital expenditures of US$5.9 million, of which the significant items were US$1.4 million for completion of the LPG project and US$3.2 million for drilling of sidetrack wells and other development activities. There were approximately US$1.6 million of accounts payable relating to capital expenditures and other expenses incurred in the year ended 31 December 2017 (2016: US$4.8 million).

The Board considers that the Group will have sufficient liquidity to meet its obligations. All current and planned capital expenditures are discretionary and may be deferred or cancelled in the light of the Group's cash generation and liquidity position.

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

Capital risk

The Group manages capital to ensure that it is able to continue as a going concern whilst maximising the return to shareholders. The Group is not subject to any externally imposed capital requirements. The Board regularly monitors the future capital requirements of the Group, particularly in respect of its ongoing development programme. Management expects that the cash generated by the operating fields will be sufficient to sustain the Group's operations and committed capital investment for the foreseeable future and has a policy of maintaining a minimum level of liquidity to cover forward obligations. Further short-term debt facilities may be arranged to provide financial headroom for future development activities.

Bribery

The Company is subject to numerous requirements and standards, including the UK Bribery Act. In addition, the Group is subject to anti-bribery and anti-corruption laws and regulations in all jurisdictions in which it operates. Failure to comply with regulations and requirements, such as failure to implement adequate systems to prevent bribery and corruption, could result in prosecution, fines or penalties imposed on the Company or its officers or suspension of operations. The Group's mitigation measures include compliance-related activities, training, monitoring, risk management, due diligence and regular review of policies and procedures. We prohibit bribery and corruption in any form by all employees and by those working for, or connected with, the business. Employees are expected to report actual, attempted or suspected bribery or other issues related to compliance to their line managers or through our confidential reporting process, which is available to all staff as well as third parties.

Fraud

The Group has been exposed to fraudulent transfers of funds from its bank accounts and is at various times at risk to attempted fraud. The Group has established enhanced protection of its information technology infrastructure, operational systems and procedures against fraudulent activities.

VADIM SON
CHIEF FINANCIAL OFFICER

The Strategic Report, which comprises pages 2 to 15 was approved by the Board on 12 April 2018 and signed on its behalf by

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

Board of Directors

MIKHAIL IVANOV
NON-EXECUTIVE CHAIRMAN

Appointed to the Board:
25 July 2006
Appointed as Chairman:
5 June 2015
Committee membership: **n/a**

Mr Ivanov was Chief Executive Officer of the Company from its foundation until 5 May 2015. Mr Ivanov was also a Partner and Director of Oil and Gas Projects at Baring Vostok Capital Partners. He has a long history of involvement in the oil sector. He worked for over ten years at Schlumberger, the international oil services company, where he served as head of its Iran operations and was responsible for business development in Russia. Prior to joining Schlumberger, he founded and headed two companies that focused on oil production and service. Mr Ivanov holds an MS degree in Geophysics from Novosibirsk State University and an MBA from the Kellogg School of Management of Northwestern University. He is an elected member of the Society of Petroleum Engineers.

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER, EXECUTIVE DIRECTOR

Appointed to the Board:
5 May 2015
Committee membership: **n/a**

Mr Zozulya is a Russian citizen and has over 20 years' experience in the oil sector in Russia, both with major oil and oil service companies, including over ten years with Schlumberger. He also has experience of operating in the Saratov region in which Volga Gas' operations are based. He has a degree in Geophysics and Engineering from the Groznensky Oil & Gas Institute and is a member of the Society of Petroleum Engineers.

MICHAEL CALVEY
NON-EXECUTIVE DIRECTOR

Appointed to the Board:
29 September 2006
Committee membership:
Audit, Nomination

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

RONALD FREEMAN
NON-EXECUTIVE DIRECTOR

Appointed to the Board:
14 March 2007
Committee membership: **Audit, Nomination, Remuneration**

Mr Freeman is a member of the Executive Committee of the Atlantic Council of the United States (Washington DC), and a past independent director on the Boards of Sberbank, Severstal and Troika Dialog. 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 acquisitions 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).

ALEKSEY KALININ
NON-EXECUTIVE DIRECTOR

Appointed to the Board:
29 September 2006
Committee membership:
Remuneration

Mr Kalinin served as Chairman of the Board from 14 March 2007 until 5 June 2015, remaining as a Non-Executive Director. Mr Kalinin is a Senior Partner of Baring Vostok Capital Partners. He joined Baring Vostok in 1999 from Alfa Capital, where he served for six years as the Director of the Department for Direct Investments. Aleksey represents the interests of Baring Vostok's funds on the Board of Directors of a wide range of portfolio companies. He has a doctorate from the Moscow Power Engineering Institute, where he conducted scientific research, lectured for 12 years and served as the Director of the Youth Center for Scientific and Technical Creativity.

VLADIMIR KOSHCHEEV
NON-EXECUTIVE DIRECTOR

Appointed to the Board:
29 September 2006
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.

STEPHEN OGDEN
NON-EXECUTIVE DIRECTOR

Appointed to the Board:
14 March 2007
Committee membership: **Audit, Nomination, Remuneration**

Mr Ogden is a Non-Executive Director of the West African shopping mall operator Persianas. He was previously a Non-Executive Director of United Confectioneries (Russia), Heineken Russia and Metropolis Media (former Yugoslavia). Mr Ogden 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 and politics from Durham University, England, and is a qualified British chartered accountant.

Find out more
www.volgagas.com

Corporate Governance Statement

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

Compliance

As Volga Gas plc is quoted on the AIM market of the London Stock Exchange, it is neither required to comply with the 2014 UK Corporate Governance Code that was published by the Financial Reporting Council (the "Code") nor issue a statement of compliance with it. Nevertheless, the Board fully supports the principles set out in the Code and seeks to follow these as best practice wherever this is appropriate having regard to the size of the Company, the resources available to it and the interpretation of the Code in the Quoted Companies Alliance Corporate Governance Code for Small and Mid-sized Quoted Companies.

Details are provided below of how the Company applies the elements of the Code that are deemed appropriate.

Board of Directors

Role of the Board

The Board's role is to provide 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.
- Dividend policy, share buy-backs or other distributions.
- Management structure and appointments.
- Mergers, acquisitions and disposals.
- Capital raising.
- Significant changes in accounting policies.
- Appointment or removal of directors or the company secretary.

Board composition

The Board currently comprises one executive director and six non-executive directors, of whom three are deemed to be independent and three non-independent:

- Mikhail Ivanov – Non-Executive Chairman
- Andrey Zozulya – Executive Director and CEO
- Michael Calvey – Non-Executive
- Ronald Freeman – Independent Non-Executive
- Aleksey Kalinin – Non-Executive
- Vladimir Koshcheev – Independent Non-Executive
- Stephen Ogden – Independent 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.

Notwithstanding, under the provisions of the 2014 UK Corporate Governance Code as a "Smaller Company" the Company meets the requirements to have at least two independent non-executives on the Board.

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

The Board has established the following committees:

Audit Committee

The Audit Committee was established 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 keeps the independence and objectivity of the auditor under review and a formal statement of independence is received from the external auditor each year. The Audit Committee meets at least twice each year.

Remuneration Committee

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

The Remuneration Committee is responsible for reviewing the performance of the directors and 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 Remuneration Committee meets at least twice each year.

The Directors' Remuneration Report is set out on pages 23 to 24.

Nomination Committee

The Nomination Committee was established 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 Officer 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 six times during the year ended 31 December 2017 (2016: four times) with the following attendance:

	2017	2016
Mikhail Ivanov	**5**	4
Andrey Zozulya (attended all meetings since appointment)	**5**	4
Michael Calvey	**5**	4
Ronald Freeman	**5**	4
Aleksey Kalinin	**5**	4
Vladimir Koshcheev	**5**	4
Stephen Ogden	**6**	4

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 Freeman, Kalinin and Zozulya 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").

In addition to formal Board meetings, management prepare detailed financial and operational reports on a monthly basis which is disseminated and discussed within the Board.

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 represent the Company at forums where private investors are present.

Shareholders have the opportunity to meet and question the Board at the Annual General Meeting which will be held on 7 June 2018, at which the Chairman, the Chairman of the Audit Committee and all executive directors are expected to be available. The notice of the AGM is posted to all shareholders at least 21 working days before the meeting. Financial and other information is available on the Company's website (www.volgagas.com).

By order of the Board

CAROS CONSULTING LTD
COMPANY SECRETARY
12 April 2018

Report of the Directors

The directors present their report together with the Group's audited consolidated financial statements for the period from 1 January 2017 to 31 December 2017.

Results and dividend

The Group's results are set out on pages 28–34 and show a net profit of US$330,000 for the year ended 31 December 2017 (2016: net profit of US$1.2 million). The directors do not currently propose to pay a dividend in respect of the year ended 31 December 2017. On 26 May 2017, the Company paid a dividend of $0.007 per ordinary share in respect of the profits earned in the year ended 31 December 2016, and a special dividend of $0.055 per ordinary share.

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 admitted to trading on the AIM market of the London Stock Exchange 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. During the year, the Group owned 100% interests in four licence areas in the Saratov and Volgograd regions: Karpenskiy, Vostochny Makarovskoye, Dobrinskoye, and Urozhainoye-2.

The Group's business strategy is to maximise the economics of production from the Vostochny Makarovskoye, Dobrinskoye and Uzenskoye fields and to explore the potentially prospective structures on the Group's licence areas. The Group also evaluates acquisition opportunities as part of its overall strategy of growing value for its shareholders.

Highlights of the Group's activities for the period ended 31 December 2017 are:

- Successful implementation of the Redox-based gas sweetening process at the Dobrinskoye gas plant.
- Reduction in variable costs consequent to the gas sweetening process.
- Drilling of the horizontal well #101 on the Uzen oil field.

The Group's activities are described in greater detail in the Chief Executive's Report on page 5 and in the Operational Review on pages 6 to 9. The principal risks associated with the Group's activities are set out in the Principal Risks and Uncertainties section on pages 13 to 15.

Key performance indicators

Given the nature of the business and that the Group has only three operating fields, the directors are of the opinion that further analysis using KPIs is not appropriate for an understanding of the development, performance or position of our business at this time. The directors are of the opinion that the Operational Review on pages 6–9 provides the relevant information.

Going concern

Having made appropriate enquiries and having examined the major areas that could affect the Group's financial position, the directors are satisfied that the Group has adequate resources to continue in operation for the foreseeable future. Accordingly, they consider it appropriate to adopt the going concern basis in preparing the financial statements as described in note 2.1.

Directors

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

Messrs Freeman, Kalinin and Zozulya 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 1p each	
	31 December 2017	31 December 2016
Mikhail Ivanov	**1,000,000**	1,000,000
Andrey Zozulya	**270,000**	100,000
Michael Calvey[1]	**–**	–
Ronald Freeman	**55,000**	55,000
Aleksey Kalinin[1]	**–**	–
Vladimir Koshcheev	**419,210**	419,210
Stephen Ogden	**205,000**	205,000

1 Mr Calvey and Mr Kalinin are Co-Managing Partners of Baring Vostok Capital Partners Limited, a related party to Baring Vostok Investments PCC Limited, Baring Vostok 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 12 April 2018, the following parties had notifiable interests of 3% or greater in the nominal value of the Company's issued 1p ordinary shares:

	Number of shares	Percentage
Baring Vostok Nominees Ltd[1]	**39,620,000**	48.90
Mr Nicholas Mathys	**10,610,000**	14.02
Dehus Dolmen Nominees Ltd[2]	**7,906,889**	9.76
Baring Vostok Investments PCC Limited[3]	**4,860,460**	5.93
BNP Paribas Investment Partners S.A.	**3,336,860**	4.12
BlackRock Investment Management (UK) Limited	**3,094,791**	3.82
JP Morgan Asset Management (UK) Limited	**2,761,720**	3.41

1 Baring Vostok Nominees Ltd is a nominee vehicle which holds the interests of the limited partnerships which comprise Baring Vostok Private Equity Fund III.
2 Dehus Dolmen Nominees Ltd is a nominee vehicle which holds the interests of the limited partnerships which comprise Baring Vostok Private Equity Fund IV.
3 Baring Vostok Investments PCC Limited is a closed-end investment company registered in Guernsey and advised by Baring Vostok Capital Partners Group Limited, which also advises the Baring Vostok Private Equity Funds.

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. All outstanding options lapsed on 31 May 2017. During 2017 no further options (2016: nil) were granted and no options remain outstanding.

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 Group.

Creditors payment policy and practice

The Group aims to pay all its creditors promptly. For trade creditors it is the Group's policy to:

(i) agree the terms of the payment at the start of the business with that supplier;
(ii) ensure that suppliers are aware of the terms of the payment; and
(iii) pay in accordance with contractual and other obligations.

Political and charitable contributions

No political or charitable contributions were made in the year (2016: nil).

Employment policies

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

Employee communication

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

Health, safety and the environment

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

The Group 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 Group has ensured that all its activities minimise the impact on this sensitive environment.

UK Bribery Act

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

Market Abuse Regime ("MAR")

On 1 July 2016 the MAR came into effect. The Company has updated its procedures and records in respect of insider information and dealings by persons discharging managerial responsibilities ("PDMRs"), or their connected persons in compliance with the new regime.

Share capital

The Company has authorised ordinary share capital of 330,720,100 shares of 1p each. Under a special resolution by the shareholders of the Company on 19 May 2017, 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-pre-emptively, in accordance with Sections 570 and 573 of the Companies Act 2006. This authority will expire the earlier of (i) 15 months from the passing of the Resolution, or (ii) the conclusion of the Annual General Meeting of the Company to be held in 2018.

Report of the Directors continued

Capital risk management
The Group's objectives when managing the balance of equity and debt capital are (a) to safeguard the Group's ability to continue as a going concern, (b) provide returns for shareholders and benefits for other stakeholders and (c) to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. To date the Group has been funded primarily by equity capital. It is the Group's policy to fund its capital investments primarily from retained cash and cash generated from operations, although modest levels of debt may continue to be utilised when the Board considers it appropriate.

Corporate Governance
The Company's statement on Corporate Governance can be found in the Corporate Governance Statement on pages 18 and 19 of these financial statements and forms part of this report by reference.

Statement of disclosure of information to auditor
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 auditor is 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 auditor is aware of that information.

Auditor
The Group's auditor, KPMG LLP, has indicated its willingness to continue in office and in accordance with Section 489 of the Companies Act 2006, a resolution concerning its reappointment will be proposed at the next Annual General Meeting.

Statement of Directors' responsibilities in respect of the Annual Report, Strategic Report, Directors' Report and the financial statements
The directors are responsible for preparing the Annual Report, Strategic Report and the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and Parent Company financial statements for each financial year. As required by the AIM Rules for Companies of the London Stock Exchange, they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Parent Company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company financial statements, the directors are required to:
- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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 auditor does not involve consideration of these matters and, accordingly, the auditor accepts 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 Rule 26 of the AIM Rules for Companies.

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

CAROS CONSULTING LTD
COMPANY SECRETARY
12 April 2018

Directors' Remuneration Report

In common with the Board's commitment to compliance with the appropriate aspects of the 2014 UK Corporate Governance 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 the Corporate Governance Statement on page 18. The Remuneration Committee advises the Board on Group compensation policy as it relates to executive directors and other key members of management, and may obtain advice from independent remuneration consultants appointed by the Company. The Remuneration Committee comprises Ronald Freeman (Chairman), Stephen Ogden and Aleksey Kalinin, who are all 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's 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. The executive directors are eligible for payment of cash bonuses and participation in any share-based incentive plan the Board implements. For the year ended 31 December 2017, the Chief Executive Officer may, on meeting certain specified operational and financial objectives agreed with the Remuneration Committee, be awarded a bonus payment of up to 100% of his basic salary.

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. Reappointment 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	Benefits US$ 000	Bonus US$ 000	Fees US$ 000	Aggregate remuneration for the year 31 December 2017 US$ 000	Aggregate remuneration for the year 31 December 2016 US$ 000
Executive directors						
A. Zozulya	181	14	130	–	**325**	259
A. Alves (resigned 10 June 2016)	–	–	–	–	**–**	166
Non-executive directors						
M. Calvey	–	–	–	–	**–**	–
R. Freeman	–	–	–	50	**50**	50
M. Ivanov	–	–	–	120	**120**	120
A. Kalinin	–	–	–	–	**–**	–
V. Koshcheev	–	–	–	–	**–**	–
S. Ogden	–	–	–	50	**50**	50

Directors' emoluments comprised salaries and benefits of US$195,000 (2016: US$311,000), bonuses of US$130,000 (2016: US$65,000) and non-executive directors' fees of US$220,000 (2016: US$220,000). There were no share grant expenses in 2017 (2016: nil).

During the year ended 31 December 2017, Mr Zozulya was awarded a performance-related bonus of US$130,000. He elected to invest substantially all of this in the shares of the Company. Accordingly, the Company purchased 170,000 of its ordinary shares in the market and transferred these shares to Mr Zozulya.

Directors' Remuneration Report continued

Directors' interests in the share capital of the Company

The directors' interests in the share capital of the Company are disclosed in the Report of the Directors on page 20. There have been no changes in the interest of any director between 1 January 2018 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, up to 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 the lifetime of the ESOP no options were exercised and on 31 May 2017 all remaining outstanding options granted under the ESOP lapsed. During 2017, no further options were granted (2016: nil). There were no share grant expenses in 2017 (2016: nil).

By order of the Board

CAROS CONSULTING LTD
COMPANY SECRETARY
12 April 2018

Company registration number: 05886534

Independent Auditor's Report

to the members of Volga Gas plc

1 Our opinion is unmodified

We have audited the financial statements of Volga Gas plc ("the Company") for the year ended 31 December 2017, which comprise the Group Income statement, the Group Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Changes in Equity, and the related notes, including the accounting policies in note 2.

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 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRSs as adopted by the EU");
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

2 Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, as per the table on page 26.

3 Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at US$350k (2016: US$360k), determined with reference to a benchmark of Group revenues, of which it represents 1% (2016: 1%). We consider Group revenues to be the most appropriate benchmark for overall levels of activity within the business and are measured in terms of revenue which is also considered one of the more prominent metrics in assessing overall Group performance.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding US$18k (2016: US$18k), in addition to other identified misstatements that warranted reporting on qualitative grounds.

For both the current and prior year, the Group audit team performed the audit of the Group (including the Parent Company financial information) as if it was a single aggregated set of financial information.

The Parent Company materiality was therefore lower than the materiality we would otherwise have determined with reference to a benchmark to the Parent Company net assets, and represents 5% (2016: 5%) of this benchmark. As such, materiality for the Parent Company financial statements as a whole was set at US$315k (2016: US$360k) to allow for aggregation risk on consolidation.

4 We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least 12 months from the date of approval of the financial statements. We have nothing to report in these respects.

5 We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic Report and Directors' Report

Based solely on our work on the other information:

- we have not identified material misstatements in the Strategic Report and the Directors' Report;
- in our opinion, the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Independent Auditor's Report continued

to the members of Volga Gas plc

	The risk	Our response
Impairment of tangible and intangible assets Tangible assets: US$62.3 million (2016: US$55.9 million) Intangible assets: US$3.8 million (2016: US$3.5 million) Refer to pages 37-38 (accounting policy) and pages 42-43 (financial disclosures)	**Forecast-based valuation** A sustained low oil and gas price environment combined with ongoing changes in the Group's production operations could have a significant impact on the recoverable amount of the Group's tangible and intangible assets. Forecasting the recoverable amount of the Group's CGUs, both of which have had impairment indicators identified, is a highly subjective area due to the inherent uncertainty involved in forecasting and discounting future cash flows, specifically around oil and gas prices, USD/RUB exchange rates, reserve estimates, especially taking into account significant decrease in gas and gas condensate proved reserves during the period, and future cost estimates. Moreover, there was significant capital expenditure during the reporting period towards implementation of Redox gas processing, construction of an LPG extraction plant and drilling of a new horizontal oil well, meaning there is a risk that such additional investments are not recoverable.	Our procedures included: — **Impairment triggers analysis**: We assessed the directors' judgements in considering if any impairment indicators were present by considering whether the appropriate business developments during the year were incorporated in that analysis. — **Historical comparisons**: We assessed the reasonableness of the budgets considering historical accuracy of previous forecasts. — **Evaluating assumptions**: We challenged the Group's key assumptions and estimates by comparing them to externally derived and historical data, as well as to our own assessments. We have consulted KPMG valuation specialists to assist us in the review of discount rates used in the model. — **Evaluating reserves estimation**: We assessed competence and objectivity of the Group's external experts to satisfy ourselves they were appropriately qualified to carry out estimation of reserves included in the model. We performed procedures to assess the reliability of the data provided to the external expert. We considered whether the updated reserves estimates were included appropriately in the Group's impairment review forecasts. — **Sensitivity analysis**: We performed sensitivity analysis on the key assumptions to assess whether a reasonably possible change in these assumptions could trigger an impairment charge. — **Integrity of the model**: We assessed reasonableness of the model used, challenged whether all appropriate cash flows are included, as well as reviewed mathematical accuracy of the model. — **Assessing transparency**: We assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of tangible and intangible assets.
Recoverability of Parent Company's investment in subsidiaries and receivables due from Group companies Investment in subsidiaries: US$28.3 million (2016: US$50.5 million) Loans due from Group companies: US$25.2 million (2016: US$4.7 million) Refer to pages 38-39 (accounting policy) and pages 52 to 54 (financial disclosures)	**Low risk, high value** The carrying amounts of the Parent Company's investments in subsidiaries and receivables due from Group companies represent 99% (2016: 94%) of the Company's total assets. Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the Parent Company financial statements, this is considered to be the area that had the greatest effect on our overall Parent Company audit.	Our procedures included: — **Tests of detail**: Comparing the carrying amount of all investments and intercompany debtors with the relevant subsidiaries' financial statements to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making. — **Subsidiary audits**: The Group engagement team has performed the audit work for the trading subsidiaries of the Group, including the impairment review of tangible and intangible assets as described above, and considered the implication of that work on those subsidiaries' profits and net assets.

6 We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

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

We have nothing to report in these respects.

7 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 22, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

8 The purpose of our audit work and to whom we owe our responsibilities

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

MARK SMITH
(SENIOR STATUTORY AUDITOR)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL

12 April 2018

Group Income Statement

(presented in US$ 000)

Year ended 31 December	Notes	2017	2016
Continuing Operations			
Revenue	5	**37,066**	39,412
Cost of sales	6	**(28,836)**	(26,260)
Gross profit		**8,230**	13,152
Selling expenses	6	**(2,221)**	(4,052)
Operating and administrative expenses	6	**(5,831)**	(4,525)
Exploration and evaluation expense	–	**–**	(265)
Write-off of development assets	6(d)	**(65)**	(1,798)
Operating profit		**113**	2,511
Interest income	7	**197**	183
Interest expense		**–**	(3)
Other losses – net	8	**(142)**	(763)
Profit for the year before tax		**168**	1,928
Current income tax	9	**(243)**	(2)
Deferred income tax	9	**405**	(739)
Profit for the year before non-controlling interests		**330**	1,187
Attributable to:			
The owners of the Parent Company		**330**	1,187
Basic and diluted profit per share (in US Dollars)	10	**0.0041**	0.0146
Weighted average number of shares outstanding		**81,017,800**	81,017,800

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 to not present the Parent Company income statement. The profit for the Parent Company for the year was US$571,000 (2016: loss of US$1,023,750).

Group Statement of Comprehensive Income

(presented in US$ 000)

Year ended 31 December	Notes	2017	2016
Profit for the year attributable to equity shareholders of the Company		**330**	1,187
Other comprehensive income:			
Items that are or may be reclassified subsequently to profit or loss			
Currency translation differences		**3,452**	10,495
Reversal of share grant reserve	17	**5,233**	–
Total comprehensive income for the year		**9,015**	11,682
Attributable to:			
The owners of the Parent Company		**9,015**	11,682

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Group Balance Sheet

(presented in US$ 000)

At 31 December	Notes	2017	2016
Assets			
Non-current assets			
Intangible assets	11	**3,756**	3,460
Property, plant and equipment	12	**62,329**	55,908
Other non-current assets		**–**	4
Deferred tax assets	9	**1,618**	1,536
Total non-current assets		**67,703**	60,908
Current assets			
Cash and cash equivalents	13	**8,617**	19,718
Inventories	14	**1,228**	981
Other receivables	15	**2,529**	3,007
Total current assets		**12,374**	23,706
Total assets		**80,077**	84,614
EQUITY AND LIABILITIES			
Equity			
Share capital	16	**1,485**	1,485
Other reserves	17	**(77,403)**	(75,622)
Accumulated profits	18	**141,787**	141,224
Equity attributable to the shareholders of the Parent		**65,869**	67,087
Non-current liabilities			
Asset retirement obligation		**184**	175
Deferred tax liabilities	9	**3,202**	3,429
Bank loans	20	**–**	3,802
Total non-current liabilities		**3,386**	7,406
Current liabilities			
Trade and other payables	19	**6,818**	9,963
Current portion of bank loans	20	**4,004**	158
Total current liabilities		**10,822**	10,121
Total equity and liabilities		**80,077**	84,614

Approved by the Board of Directors on 12 April 2018 and signed on its behalf by

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Group Cash Flow Statement

(presented in US$ 000)

Year ended 31 December	Notes	2017	2016
Profit for the year before tax		**168**	1,928
Adjustments to profit before tax:			
Depreciation of property, plant and equipment	12	**8,647**	5,060
Exploration and evaluation expense	11	**–**	265
Write-off of development assets		**272**	1,749
Provision for obsolete inventory		**155**	536
Other net non-cash operating gains	6(c)	**(646)**	–
Foreign exchange differences	8	**586**	892
Operating cash flow prior to working capital		**9,142**	10,430
Working capital changes			
Decrease/(increase) in trade and other receivables		**901**	(1,091)
(Decrease)/increase in payables		**(2,880)**	3,745
(Increase)/decrease in inventory		**(308)**	201
Cash flow from operations		**6,885**	13,285
Income tax paid		**(509)**	(2)
Net cash flow generated from operating activities		**6,346**	13,283
Cash flows from investing activities			
Expenditure on exploration and evaluation	11	**(112)**	(499)
Purchase of property, plant and equipment	12	**(12,440)**	(4,534)
Net cash used in investing activities		**(12,552)**	(5,033)
Cash flows from financing activities			
Equity dividends paid		**(5,000)**	–
Bank loans (repaid)/drawn		**(165)**	3,947
Net cash (used in)/provided by financing activities		**(5,165)**	3,947
Effect of exchange rate changes on cash and cash equivalents		**270**	752
Net (decrease)/increase in cash and cash equivalents		**(11,101)**	12,949
Cash and cash equivalents at beginning of the year	13	**19,718**	6,769
Cash and cash equivalents at end of the year	13	**8,617**	19,718

The accompanying notes on pages 34 to 51 are an integral part of these financial statements.

Company Balance Sheet

(presented in US$ 000)

Company registration number: 05886534

At 31 December	Notes	2017	2016
Assets			
Non-current assets			
Investments	21	**28,324**	50,475
Intercompany loans receivable	23	**21,200**	4,711
Total non-current assets		**49,524**	55,186
Current assets			
Cash and cash equivalents	13	**678**	3,415
Intercompany receivables		**3,984**	–
Other receivables	15	**44**	11
Total current assets		**4,706**	3,426
Total assets		**54,230**	58,612
EQUITY AND LIABILITIES			
Equity			
Share capital	16	**1,485**	1,485
Share grant expense reserve	17	**–**	5,233
Accumulated profit	18	**51,377**	50,573
Total equity		**52,862**	57,291
Current liabilities			
Intercompany payables		**1,363**	1,321
Trade and other payables	19	**5**	–
Total current liabilities		**1,368**	1,321
Total equity and liabilities		**54,230**	58,612

Approved by the Board of Directors on 12 April 2018 and signed on its behalf by

ANDREY ZOZULYA
CHIEF EXECUTIVE OFFICER

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Company Cash Flow Statement

(presented in US$ 000)

Year ended 31 December	Notes	2017	2016
Profit/(loss) for the period before tax		**571**	(1,024)
Adjustments to profit/(loss) before tax:			
Interest income accrued		**(1,231)**	–
Other non-cash income		**(378)**	–
Foreign exchange differences		**278**	–
Operating cash flow prior to working capital		**(760)**	(1,024)
Working capital changes			
Increase in receivables		**(19)**	(68)
Decrease in payables		**(258)**	(22)
Cash flow from operations		**(1,037)**	(1,114)
Income tax paid		**–**	–
Net cash flow used in operating activities		**(1,037)**	(1,114)
Cash flows from investing activities			
Decrease in intercompany receivables		**3,300**	–
Net cash from investing activities		**3,300**	–
Cash flows from financing activities			
Equity dividends paid		**(5,000)**	–
Net cash used in financing activities		**(5,000)**	–
Effect of exchange rate changes on cash and cash equivalents		**–**	–
Net decrease in cash and cash equivalents		**(2,737)**	(1,114)
Cash and cash equivalents at the beginning of the year	13	**3,415**	4,529
Cash and cash equivalents at end of the year	13	**678**	3,415

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Group Statement of Changes in Shareholders' Equity

(presented in US$ 000)

	Notes	Share capital	Currency translation reserves	Share grant reserve	Accumulated profit	Total equity
Opening equity at 1 January 2017		**1,485**	**(80,855)**	**5,233**	**141,224**	**67,087**
Profit for the year		**–**	**–**	**–**	**330**	**330**
Reversal of share grant reserve	17	**–**	**–**	**(5,233)**	**5,233**	**–**
Currency translation differences		**–**	**3,452**	**–**	**–**	**3,452**
Total comprehensive income		**–**	**3,452**	**5,233**	**5,563**	**3,782**
Transactions with owners						
Equity dividends paid		**–**	**–**	**–**	**(5,000)**	**(5,000)**
Total transactions with owners		**–**	**–**	**–**	**(5,000)**	**(5,000)**
Closing equity at 31 December 2017		**1,485**	**(77,403)**	**–**	**141,787**	**65,869**
Opening equity at 1 January 2016		1,485	(91,350)	5,233	140,037	67,724
Profit for the year		–	–	–	1,187	1,187
Currency translation differences		–	10,495	–	–	10,495
Total comprehensive income		–	10,495	–	1,187	11,682
Total transactions with owners						
Total transactions with owners		–	–	–	–	–
Closing equity at 31 December 2016		1,485	(80,855)	5,233	141,224	67,087

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Company Statement of Changes in Shareholders' Equity

(presented in US$ 000)

	Notes	Share capital	Share grant reserve	Accumulated profit	Total equity
Opening equity at 1 January 2017		**1,485**	**5,233**	**50,573**	**57,291**
Profit for the year		**–**	**–**	**571**	**571**
Equity dividends paid		**–**	**–**	**(5,000)**	**(5,000)**
Reversal of share grant reserve		**–**	**(5,233)**	**5,233**	**–**
Closing equity at 31 December 2017		**1,485**	**–**	**51,377**	**52,862**
Opening equity at 1 January 2016		1,485	5,233	51,597	58,315
Loss for the year		–	–	(1,024)	(1,024)
Equity dividends paid		–	–	–	–
Closing equity at 31 December 2016		1,485	5,233	50,573	57,291

The accompanying notes on pages 35 to 55 are an integral part of these financial statements.

Notes to the IFRS Consolidated Financial Statements

For the year ended 31 December 2017
(presented in US$ 000)

1. General information

Volga Gas plc (the "Company" or "Volga") is a public limited company registered in England and Wales with registered number 5886534. The Company was incorporated on 25 July 2006. The principal activities of the Company and its subsidiaries (the "Group") are the acquisition, exploration and development of hydrocarbon assets and production of hydrocarbons in the Volga Region of the Russian Federation. Its registered office is 6th floor, 65 Gresham Street, London EC2V 7NQ. The Company's shares are admitted to trading on the AIM market of the London Stock Exchange.

These Group consolidated financial statements were authorised for issue by the Board of Directors on 12 April 2018.

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

Both the Parent Company financial statements and the Group financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), as adopted by the European Union ("EU"), International Financial Reporting Interpretations Committee ("IFRIC") interpretations, and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

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

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

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report in pages 2 to 15; the financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Financial Review on pages 10 and 11. In addition, the Group's objectives, policies and processes for measuring capital, financial risk management objectives, details of financial instruments and exposure to credit and liquidity risks are described in note 3. Having reviewed the future cash flow forecasts of the Group in the light of the reductions in oil and gas reserves and in consideration of the current financial condition of the Group, the directors have concluded that the Group will continue to have sufficient funds in order to meet its obligations as they fall due for at least the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the annual financial statements.

2.2 Adopted IFRS not yet applied

The following adopted IFRSs have been issued but have not been applied by the Group in these financial statements. Their adoption is not expected to have a material effect on the financial statements unless otherwise indicated:

- IFRS 9 Financial Instruments (effective date 1 January 2018).
- IFRS 9 replaces the guidance in IAS 39 Financial Instruments: Recognition and Measurement on the classification and measurement of financial assets and financial liabilities, impairment of financial assets and on hedge accounting.
- IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. IFRS 9 also introduced a new impairment model with a forward-looking expected credit loss ("ECL") model.

Based on the assessment, the Group does not expect the application of IFRS 9 to have a significant impact on its financial statements, other than the disclosure impact which the Group is finalising.

- IFRS 15 Revenue from Contracts with Customers (effective date 1 January 2018).
- IFRS 15 replaces the guidance in IAS 11 Construction Contracts and IAS 18 Revenue. IFRS 15 provides a single model for accounting for revenue arising from contracts with customers, focusing on the identification and satisfaction of performance obligations.

The Group does not expect the application of IFRS 15 to have a significant impact on its financial statements.

- IFRS 16 Leases (effective date 1 January 2019).

IFRS 16 replaces existing leases guidance in IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases, and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. Based on the assessment and lease contract review, the impact of implementation of the standard will be limited to leases of administrative buildings and offices. As such, the Group does not expect the application of IFRS 16 to have significant impact on its financial statements.

Notes to the IFRS Consolidated Financial Statements continued

For the year ended 31 December 2017
(presented in US$ 000)

2. Summary of significant accounting policies continued

Annual Improvements to IFRS Standards 2014-2016 Cycle (date 1 January 2018):

— Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions (effective date 1 January 2018).

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

— Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses (effective date 1 January 2017).

— Amendments to IAS 7: Disclosure Initiative (effective date 1 January 2017).

These amendments were adopted by the Group in the year, and do not have a material impact on its financial statements.

2.3 Consolidation

Subsidiaries

The consolidated financial statements include the financial statements of the Company and its subsidiaries. Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing control, the Group takes into consideration potential voting rights that are currently exercisable. The acquisition date is the date on which control is transferred to the acquirer. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

Investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment.

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

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

A list of the Company's subsidiaries is provided in note 21.

2.4 Segment reporting

Segmental reporting follows the Group's internal reporting structure.

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

The CODM receives monthly IFRS-based financial information for the Group and its development and production entities. There were two development and production entities during both 2016 and 2017. These entities both engage in upstream production, gathering and sale of hydrocarbons, with common operational management and control. Management has determined that the operations of these production and development entities are sufficiently homogenous (all are concerned with upstream oil and gas development and production activities) for these to be aggregated for the purpose of IFRS 8, "Operating Segments". Common economic drivers for the operations are international oil prices, export and Mineral Extraction Taxes and the costs of drilling, completing and operating wells and production facilities. The Group has other entities that engage as either head office or in a corporate capacity or as holding companies. Management has concluded that due to application of the aggregation criteria that separate financial information for segments is not required.

No geographic segmental information is presented as all of the companies' operating activities are based within a localised area of the Russian Federation.

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

The Group's gas sales, representing a substantial proportion of revenues, are made to a single customer. Details are provided in note 3.1 (b).

2. Summary of significant accounting policies continued

2.5 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 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.

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

The major exchange rates used for the revaluation of the closing balance sheet at 31 December 2017 were:

- GBP 1.3485: US$ (2016: 1.233)
- EUR 1.1956: US$ (2016: 1.052)
- US$ 1:57.6002: RUR (2016: 60.657)

2.6 Oil and gas assets

The Company and its subsidiaries apply the successful efforts method of accounting for exploration and evaluation ("E&E") costs, in accordance with IFRS 6, "Exploration for and Evaluation of Mineral Resources". Costs are accumulated on a field-by-field basis.

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.

(a) Exploration and evaluation assets

Costs directly associated with an exploration well, including certain geological and geophysical costs, and exploration and property leasehold acquisition costs, are capitalised as intangible assets 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.

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

(b) Development 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. When development is completed on a specific field, it is transferred to producing assets as part of property, plant and equipment. No depreciation or amortisation is charged during the development phase.

Notes to the IFRS Consolidated Financial Statements continued

For the year ended 31 December 2017
(presented in US$ 000)

2. Summary of significant accounting policies continued

(c) Oil and gas production assets

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 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.

(d) Depreciation/amortisation

Oil and gas properties are depreciated or amortised using the unit-of-production method. Unit-of-production rates are based on proved 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.

(e) Impairment – exploration and evaluation assets

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

(f) Impairment – proved oil and gas production properties

Proven oil and gas properties 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.

(g) 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.

2.7 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

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

2.8 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 2017 or 31 December 2016.

2. Summary of significant accounting policies continued

(b) Loans and receivables

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

2.9 Inventories

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

2.10 Trade and other receivables

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

2.11 Cash and cash equivalents

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

2.12 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.

2.13 Trade payables

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

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

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

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

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

2.15 Employee benefits

(a) Share-based compensation

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

Notes to the IFRS Consolidated Financial Statements continued

For the year ended 31 December 2017
(presented in US$ 000)

2. Summary of significant accounting policies continued

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 the Black-Scholes option pricing model. This value is recognised as an expense over the vesting period on a straight-line basis. The estimate is revised, as necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.

(b) Social obligations

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

2.16 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of oil and gas in the ordinary course of the Group's activities. Revenue is shown net of value added tax, returns, rebates and discounts and after eliminating sales within the Group. Revenue from the sale of oil or gas is recognised when the oil/gas is delivered to customers and title has transferred. In 2016 and 2017, the Group's revenue related to sales of crude oil and condensate collected directly by or delivered to customers and gas sales made at the entry to the gas distribution system.

2.17 Prepayments

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

2.18 Provisions

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

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

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

3. Financial risk management

3.1 Financial risk factors

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

(a) Market risk

(i) Foreign exchange risk

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

At 31 December 2017, 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$220,000 (2016: US$476,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of RUR-denominated trade payables and financial assets. At 31 December 2017, if the US Dollar had weakened/strengthened by 5% against the Euro ("EUR") with all other variables held constant, post-tax profit for the year would have been US$600 (2016: US$1,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of EUR-denominated interest charges and financial liabilities. At 31 December 2017, 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$6,000 (2016: US$7,000) higher/lower, mainly as a result of foreign exchange gains/losses on translation of GBP-denominated trade payables and financial assets.

3. Financial risk management continued

If the US Dollar had weakened/strengthened by 5% against the RUR with all other variables held constant, shareholders' equity would have been US$3.3 million (2015: US$2.9 million) higher/lower, as a result of translation of RUR-denominated assets. The sensitivity of shareholders' equity to changes in the exchange rates between US Dollar against GBP or EUR is immaterial.

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

At 31 December 2017	Rubles US$ 000	US Dollars US$ 000	Euros US$ 000	Sterling US$ 000	Total US$ 000
Financial assets					
Cash and cash equivalents	**4,342**	**4,178**	**–**	**97**	**8,617**
Trade and other financial receivables	**2,251**	**–**	**–**	**–**	**2,251**
Total financial assets	**6,593**	**4,178**	**–**	**97**	**10,868**
Financial liabilities (before provision for UK taxes)	**8,225**	**–**	**–**	**–**	**8,225**

At 31 December 2016	Rubles US$ 000	US Dollars US$ 000	Euros US$ 000	Sterling US$ 000	Total US$ 000
Financial assets					
Cash and cash equivalents	6,747	12,810	13	148	19,718
Trade and other financial receivables	2,262	–	–	–	2,282
Total financial assets	9,029	12,810	13	148	22,000
Financial liabilities (before provision for UK taxes)	11,389	–	–	–	11,389

(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. The Group is not directly exposed to the levels of international marker prices of crude oil or oil products, although these clearly influence the prices at which it sells its oil and condensate. Mineral Extraction Taxes ("MET") are calculated by reference to Urals oil prices and are therefore directly influenced by this. Taking into account the marginal rates of export taxes and MET, management estimates that if international oil prices had been US$5 per barrel higher or lower and all other variables been unchanged, the Group's profit before tax would have been US$1.5 million higher or lower (2016: $2.7 million).

(iii) Cash flow and fair value interest rate risk

As the Group currently 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$8,617,000 and US$19,718,000 at 31 December 2017 and 2016 respectively.

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

The Group's oil and condensate sales are normally undertaken on a prepaid basis and accordingly the Group has no trade receivables and consequently no credit risk associated with the related trade receivables. Gas sales accounting for 35.4% of Group revenues in 2017 (2016: 35.6%) were made to Gazprom (2016: to Trans Nafta). As at 31 December 2017 there were trade receivables of US$1.3 million (31 December 2016: US$2.0 million) relating to gas sales. As at 31 December 2017 there was no provision for bad debts (2016: nil).

Rating of financial institution (Fitch)		31 December 2017 US$ 000	31 December 2016 US$ 000
Barclays Bank	A	**762**	3,627
ZAO Raiffeisenbank	BBB-	**7,850**	15,840
Unicreditbank	BBB-	**–**	214
Other		**5**	37
Total bank balance		**8,617**	19,718

Notes to the IFRS Consolidated Financial Statements continued

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3. Financial risk management continued

(c) Liquidity risk

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

The Group expects to fund its capital investments, as well as its administrative and operating expenses, through 2018 using a combination of cash generated from its oil and gas production activities, existing working capital and, when appropriate, medium-term bank borrowings. If the Group is unsuccessful in generating enough liquidity to fund its expenditures, the Group's ability to execute its long-term growth strategy could be significantly affected. The Group may need to raise additional equity or debt finance as appropriate to fund investments beyond its current commitments.

(d) Capital risk management

The Group manages capital to ensure that it is able to continue as a going concern whilst maximising the return to shareholders. The Group is not subject to any externally imposed capital requirements. The Board regularly monitors the future capital requirements of the Group, particularly in respect of its ongoing development programme. Management expects that the cash generated by the operating fields will be sufficient to sustain the Group's operations and future capital investment for the foreseeable future. During December 2016, one of the Group's operating subsidiaries entered into a loan agreement of RUR 240 million to fund its LPG project (see note 20). This loan, which has a three-year amortising term, benefits from an interest rate subsidy provided by the regional government. Further short-term debt facilities may be arranged to provide financial headroom for future development activities.

3.2 Fair value estimation

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

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

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

4. Critical accounting estimates and judgements

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

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

Fixed assets and intangible assets are assessed for impairment when events and circumstances indicate that an impairment condition may exist. The carrying value of fixed assets and intangible assets are 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 determines the cash-generating unit or group of assets that give rise to the cash flows. The cash-generating unit ("CGU") is the lowest level of asset at which independent cash flows can be generated. For this purpose, the directors consider the Group to have two CGUs: the VM and Dobrinskoye fields with the Dobrinskoye gas processing plant are treated as a single CGU, and the Uzen oil field is a separate CGU.

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 and discount rates. Key assumptions and estimates in the impairment models relate to:

- International oil prices: flat real prices reflecting the actual levels pertaining at 31 December 2017 – Urals oil price of US$65 per barrel. No forward price escalation is assumed.
- Selling prices for oil, condensate and LPG that reflect international oil prices, less export taxes at the current applicable official rates and a price differential of $5 per barrel to reflect transportation costs. Based on commercial studies conducted during 2016 and 2017, LPG is expected to achieve a premium per tonne over condensate whereas the models assume price parity.
- Gas sales price of RUR 4,025 per mcm excluding VAT.
- Production profiles based on remaining reserves in the proved category and approved field development plans. For the purposes of impairment testing, the level of reserves used are those recently provided to the Group by the independent consultancy Geostream.
- While it has been included in the production profile, the LPG production has not yet been established, although it is expected to commence in April 2018.

4. Critical accounting estimates and judgements continued

- Capital expenditures required to deliver the above production profiles and to maintain the production assets throughout the field life. Total development capital expenditure assumed is US$5 million with future maintenance capital expenditure of up to US$2 million per annum. The principal items being the completion of the LPG plant and sidetracks to two gas/condensate wells.
- Cost assumptions are based on current experience and expectations and are broadly in line with unit costs experienced in the year ended 31 December 2017, including an annual estimated cost saving of US$4.0 million from the successful implementation of Redox-based gas sweetening.
- Export and mineral extraction taxes reflect rates set by current legislation.
- The model reflects real terms cash flows with no inflationary escalation of revenues or costs.
- A real discount rate of 12% per annum is utilised in the models.
- An exchange rate of RUR57 to US$1.00 is assumed.

Under the base case assumptions, the value in use of each CGU was shown to be in excess of its respective carrying value.

In addition to the base case, a number of sensitivity cases have been carried out: varying oil and gas prices by 10%, varying operating expenditure by 10%, varying capital expenditure by 20%, varying reserves by 10% and using a 15% real discount rate. In aggregate the sensitivities yielded net present values in excess of carrying values for the CGUs; in all of these cases, the net present value under the sensitivities remained above the carrying value of individual CGUs.

Under the base case economic assumptions as outlined above, the reserves at the VM and Dobrinskoye fields would need to drop by a further 26% below the level as at 31 December 2017, and the Uzen oil field reserves would need to drop by 19% below current levels for the value in use to reach the respective carrying value.

A further sensitivity in which LPG was excluded from the production profile brought the value in use down to approximately US$1.5 million, or 2.9% below the level of the carrying value of the VM and Dobrinskoye CGU under the base case assumptions and up to US$8.6 million or 16.6% below the carrying value under the various sensitivity cases outlined above. However, the impairment testing model is based on the existing and approved plans and forecasts in which LPG is one of the drivers of future cash flows. Presently the LPG project is commencing the commissioning process and there is no indication that it will not be operating as expected, though the various sensitivities affecting LPG streams were considered.

Accordingly, as at 31 December 2017, based on the Group's impairment testing of the property, plant and equipment related to each CGU, management concluded that no clear impairment was indicated. However, should there be material adverse changes to the assumptions used in future impairment tests, or should there be further reductions in reserve estimates, there may be impairment of one or both of the CGUs.

(b) Estimation of oil and gas reserves

Estimates of oil and gas reserves are inherently subjective and subject to periodic revision. In addition, the results of drilling and other exploration or development or production activity will often provide additional information regarding the Group's reserve base that may result in increases or decreases to reserve volumes. Such revisions to reserves can be significant and are not predictable with any degree of certainty. Management considers the estimation of reserves to represent a significant judgement in the context of the financial statements as reserve volumes are used as the basis for assessing the useful life of oil and gas assets, applying depreciation to oil and gas assets and in assessing the carrying value of oil and gas assets. Decreases in reserve estimates can lead to significant impairment of oil and gas assets where revisions (positive or negative) can have a significant effect on depreciation rates from period to period. Variation of 10% from the base level of reserves is among the sensitivity tests carried out in impairment testing as described in note 4(a) above.

An independent assessment of the reserves and net present value of future net revenues ("NPV") attributable to the Group's fields, Dobrinskoye, Vostochny Makarovskoye, Sobolevskoye and Uzenskoye, as at 31 December 2016, was prepared in accordance with reserve definitions set by the Oil and Gas Reserves Committee of the Society of Petroleum Engineers ("SPE"). In February 2018, the Group commissioned an update to this report as, late in 2017, the presence of increased formation water was observed during gas production from certain of the production wells on the VM field. The results delivered to management imply a negative revision to reserves of approximately 27% below the level of reserves as at 31 December 2016, as adjusted for production during 2017. The catalyst for this revision was a recalculation of recovery factors following the recent detection of the presence of formation water in certain of the wells in the VM field. Management considers these revised estimates to be reasonable and is adopting them as the Group's reserves. As outlined above, management considers that, for the time being, no clear impairment is indicated, although further downward revisions may necessitate impairment charges in the future.

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(presented in US$ 000)

5. Revenue

Year ended 31 December	2017 US$ 000	2016 US$ 000
Oil	**8,075**	7,523
Condensate	**15,877**	17,857
Gas	**13,114**	14,032
Total revenues	**37,066**	39,412

All revenue is generated from the sale of oil and gas in the ordinary course of the Group's activities. Production is concentrated in the Saratov and Volgograd regions of Russia, as are the sales, apart from the volumes exported, primarily to the Baltic States. In the year ended 31 December 2017, the total value of export sales was US$3,738,000 (2016: US$10,165,000).

6. Cost of sales and administrative expenses – Group

Cost of sales and administrative expenses are as follows:

Year ended 31 December	Notes	2017 US$ 000	2016 US$ 000
Production expenses		**9,320**	10,968
Mineral Extraction Taxes		**10,936**	10,255
Depletion, depreciation and amortisation	(a)	**8,580**	5,037
Cost of sales		**28,836**	26,260

Total expenses are analysed as follows:

Year ended 31 December	Notes	2017 US$ 000	2016 US$ 000
Sales-related expenses	(b)	**2,221**	4,052
Field operating expenses	(c)	**6,379**	9,367
Mineral Extraction Tax		**10,936**	10,255
Depreciation and amortisation		**8,613**	5,059
Exploration and evaluation		**–**	265
Write-off of development assets	(d)	**65**	1,798
Inventory write-off	(e)	**191**	529
Salaries and staff benefits	(f)	**6,103**	3,177
Directors' emoluments and other benefits	(g)	**698**	645
Audit fees	(h)	**293**	314
Taxes other than payroll and mineral extraction		**47**	38
Legal and consulting		**551**	291
Other		**856**	1,110
Total		**36,953**	36,900

(a) Depreciation: Substantially all depreciation relates to oil and gas assets and is included within cost of sales. As a result of the downward revision to the Group's oil and gas reserves, the unit of production rate of depletion has increased materially, leading to approximately a US$2.2 million (2016: nil) increase in the depreciation charge.
(b) Selling expense: Comprises pipeline transit costs and fees related to gas sales as well as export taxes and costs associated with delivering gas condensate sales to export customers.
(c) Field operating expenses: In the year ended 31 December 2017, a provision for the cost of waste removal was reversed, leading to a credit of US$1,009,000 partly offset by other accrued expenses resulting in a net non-cash operating gain of US$646,000 (2016: nil). The amounts shown as field operating expenses above are net of this sum.
(d) Write-off of development assets: In the year ended 31 December 2017, the costs of a redundant water disposal well were written off. In the year ended 31 December 2016, the principal source of the write-off of development assets was the US$1.650 million compensation payable to Schlumberger for logging tools stuck in the Uzen #4 well sidetrack.

6. Cost of sales and administrative expenses – Group continued

(e) Inventory write-off: In the years ended 31 December 2017 and 31 December 2016, certain obsolete and unused items of production equipment were transferred from producing assets to inventory and then written off.

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

Year ended 31 December	2017	2016
Exploration and production	**177**	163
Administration and support	**51**	42
Total	**228**	205

Their aggregate remuneration (excluding executive directors) comprised:

	2017 US$ 000	2016 US$ 000
Wages and salaries	**4,850**	2,476
Payroll taxes and social contribution	**1,122**	656
Staff benefits	**131**	45
Total	**6,103**	3,177

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

Year ended 31 December	2017	2016
Chief Executive and Chief Financial Officers	**1**	1.4
Non-executive directors	**5**	5
Total	**6**	6.4

Only directors are employed by the Company.

(g) Directors' emoluments and other benefits:

	Salary US$ 000	Benefits US$ 000	Bonus US$ 000	Fees US$ 000	Aggregate remuneration for the year 31 December 2017 US$ 000	Aggregate remuneration for the year 31 December 2016 US$ 000
Executive directors				–		
A. Zozulya	181	14	130	–	**325**	259
A. Alves (resigned 10 June 2016)	–	–	–	–	**–**	166
Non-executive directors						
M. Calvey		–	–	–	**–**	–
R. Freeman		–	–	50	**50**	50
M. Ivanov		–	–	120	**120**	120
A. Kalinin		–	–	–	**–**	–
V. Koshcheev		–	–	–	**–**	–
S. Ogden		–	–	50	**50**	50
Chief Financial Officer (non-Board)						
V. Son	98	12	43	0	**153**	68

There were no share grant expenses in 2017 (2016: nil).

(h) Audit fees – Group and Company: Disclosure of the fees paid to the Company's auditor and its associates is given in note 22.

Notes to the IFRS Consolidated Financial Statements continued

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(presented in US$ 000)

7. Finance income – Group

Finance income comprises interest earned during the period on cash balances with different banks (note 13).

8. Other gains and losses – Group

Year ended 31 December	2017 US$ 000	2016 US$ 000
Foreign exchange (loss)	**(586)**	(892)
Gain from settlement of legal dispute	**300**	–
Other gains	**144**	129
Total other gains and losses	**(142)**	(763)

9. Current and deferred income tax – Group

Year ended 31 December	2017 US$ 000	2016 US$ 000
Current tax:		
Current income tax	**(243)**	(2)
Adjustments to tax charge in respect of prior periods	**–**	–
Total current tax	**(243)**	(2)
Deferred tax:		
Origination and reversal of timing differences	**(405)**	(739)
Total deferred tax	**(405)**	(739)
Total tax (charge)/credit	**(162)**	(741)

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	2017 US$ 000	2016 US$ 000
Profit/(loss) before income tax and minority interest	**168**	1,928
Tax calculated at domestic tax rates applicable to (profits)/losses in the respective countries	**(35)**	(386)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	**(64)**	(132)
Tax losses for which no deferred tax asset was recognised	**(28)**	(223)
Recognition of tax effect of previously unrecognised tax losses	**253**	–
Other tax adjustments	**36**	–
Income tax charge	**162**	(741)

The weighted average applicable tax rate was 21.0% (2016: 20.0%).

9. Current and deferred income tax – Group continued

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

	31 December 2017 US$ 000	Differences recognition and reversal US$ 000	31 December 2016 US$ 000	Differences recognition and reversal US$ 000	31 December 2015 US$ 000
Tax effects of taxable temporary differences:					
Property, plant and equipment	**(4,896)**	(668)	(4,228)	(465)	(3,763)
Total	**(4,896)**	(668)	(4,228)	(465)	(3,763)
Tax effect of deductible temporary differences:					
Tax losses carry forward	**2,246**	534	1,712	(1,153)	2,865
Trade and other payables	**1,066**	443	623	623	–
Total	**3,312**	977	2,335	(530)	2,865
Net tax effect of temporary differences	**(1,584)**	309	(1,893)	(995)	(898)

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. As at 31 December 2017, deferred income tax assets of US$1,618,000 (2016: US$1,536,000) and deferred tax liabilities of US$3,202,000 (2016: US$3,429,000) have been recognised. Tax losses in respect of Cyprus and the UK do not expire. The Group has not recognised a deferred tax asset of US$985,070 in respect of tax losses and other short-term timing differences in the UK and Cyprus (2016: US$1,210,070).

10. Basic and diluted profit 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.

Year ended 31 December	2017	2016
Net (loss)/profit per share attributable to equity shareholders	**0.004**	0.015
Diluted net (loss)/profit per share attributable to equity shareholders	**0.004**	0.015
Net (loss)/profit attributable to equity shareholders	**330**	1,187
Basic weighted number of shares	**81,017,800**	81,017,800
Dilutive share options in issue	**–**	–
Diluted number of shares	**81,017,800**	81,017,800

As at 31 December 2017 there were no options outstanding. As at 31 December 2016 outstanding options in amount of 1,137,464 shares were excluded from the weighted average diluted number of shares calculation because their effect would have been anti-dilutive. The average market value of the Company's shares for the purpose of calculating the dilutive effect of share options was based on quoted market prices for the year during which the options were outstanding.

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(presented in US$ 000)

11. Intangible assets – Group

Intangible assets represent exploration and evaluation assets such as licences, studies and exploratory drilling, which are stated at historical cost, less any impairment charges or write-offs.

	Work in progress: exploration and evaluation US$ 000	Exploration and evaluation US$ 000	Total US$ 000
At 1 January 2017	**140**	**3,320**	**3,460**
Additions	**–**	**112**	**112**
Write-offs and impairments	**–**	**(1)**	**(1)**
At 31 December 2017	**140**	**3,431**	**3,571**
Exchange adjustments	**7**	**178**	**185**
At 31 December 2017	**147**	**3,609**	**3,756**

	Work in progress: exploration and evaluation US$ 000	Exploration and evaluation US$ 000	Total US$ 000
At 1 January 2016	117	2,750	2,867
Additions	–	254	254
Write-offs and impairments	–	(240)	(240)
At 31 December 2016	117	2,764	2,881
Exchange adjustments	23	556	579
At 31 December 2016	140	3,320	3,460

12. Property, plant and equipment – Group

Movements in property, plant and equipment for the year ended 31 December 2017 are as follows:

Cost	Development assets US$ 000	Land and buildings US$ 000	Producing assets US$ 000	Other US$ 000	Total US$ 000
At 1 January 2017	**3,559**	**780**	**68,179**	**598**	**73,116**
Additions	**12,332**	**–**	**–**	**–**	**12,332**
Transfers	**(9,375)**	**6**	**9,175**	**194**	**–**
Write-offs and impairments	**(257)**	**(8)**	**(91)**	**(78)**	**(434)**
Exchange adjustments	**224**	**42**	**3,730**	**33**	**4,029**
At 31 December 2017	**6,483**	**820**	**80,993**	**747**	**89,043**
Accumulated depreciation					
At 1 January 2017	**–**	**–**	**(16,619)**	**(589)**	**(17,208)**
Adjustment for assets written off	**–**	**–**	**83**	**78**	**161**
Depreciation	**–**	**(41)**	**(8,413)**	**(194)**	**(8,648)**
Exchange adjustments	**–**	**(1)**	**(985)**	**(33)**	**(1,019)**
At 31 December 2017	**–**	**(42)**	**(25,934)**	**(738)**	**(26,714)**
Net book value					
At 31 December 2017	**6,483**	**778**	**55,059**	**9**	**62,329**

12. Property, plant and equipment – Group continued

Movements in property, plant and equipment for the year ended 31 December 2016 are as follows:

Cost	Development assets US$ 000	Land and buildings US$ 000	Producing assets US$ 000	Other US$ 000	Total US$ 000
At 1 January 2016	1,137	650	55,879	498	58,164
Additions	2,341	–	1,564	–	3,905
Write-offs and impairments	(57)	–	(917)	–	(974)
Transfers	(294)	–	294	–	–
Exchange adjustments	432	130	11,359	100	12,021
At 31 December 2016	3,559	780	68,179	598	73,116
Accumulated depreciation					
At 1 January 2016	–	–	(9,399)	(475)	(9,874)
Adjustment for assets written off	–	–	195	15	210
Depreciation	–	–	(5,028)	(32)	(5,060)
Exchange adjustments	–	–	(2,387)	(97)	(2,484)
At 31 December 2016	–	–	(16,619)	(589)	(17,208)
Net book value					
At 31 December 2016	3,559	780	51,560	9	55,908

13. Cash and cash equivalents – Group and Company

At 31 December	Group		Company	
	2017 US$ 000	2016 US$ 000	2017 US$ 000	2016 US$ 000
Cash at bank and on hand	**8,617**	19,718	**678**	3,415
Total cash and cash equivalents	**8,617**	19,718	**678**	3,415

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

At 31 December		Group		Company	
Bank	Currency	2017 US$ 000	2016 US$ 000	2017 US$ 000	2016 US$ 000
United Kingdom					
Barclays Bank PLC	USD	**665**	3,479	**581**	3,267
Barclays Bank PLC	GBP	**97**	148	**97**	148
Russian Federation					
Unicreditbank	RUR	**–**	82	**–**	–
Unicreditbank	USD	**–**	131	**–**	–
ZAO Raiffeisenbank	RUR	**4,337**	6,628	**–**	–
ZAO Raiffeisenbank	USD	**3,513**	9,200	**–**	–
ZAO Raiffeisenbank	EUR	**–**	13	**–**	–
Other banks and cash on hand	RUR	**5**	37	**–**	–
Total cash and cash equivalents		**8,617**	19,718	**678**	3,415

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(presented in US$ 000)

14. Inventories – Group

At 31 December	2017 US$ 000	2016 US$ 000
Production consumables and spare parts	**787**	796
Crude oil inventory	**441**	185
Total inventories	**1,228**	981

Inventory recognised as cost of sales in the year amounted to US$3,930,000 (2016: US$6,013,000). The write-down of inventories to net realisable value amounted to US$115,000 (2016: nil) and is included in cost of sales.

15. Other receivables – Group and Company

	Group		Company	
At 31 December	2017 US$ 000	2016 US$ 000	2017 US$ 000	2016 US$ 000
VAT receivable	**300**	154	**43**	11
Prepayments	**278**	725	**–**	–
Trade receivables	**1,260**	2,067	**–**	–
Other accounts receivable	**691**	61	**–**	–
Total other receivables	**2,529**	3,007	**43**	11

Prepayments are to contractors and relate to initial advances made in respect of drilling, construction and other projects. Trade receivables relate to sales of gas and condensate. The receivables were settled on schedule subsequent to the balance sheet date.

16. Share capital and share premium – Group

The following summarises the movement in the share capital and share premium of the Company for the years ended 2016 and 2017.

	Number of shares	Share capital US$ 000
At 1 January 2016	81,017,800	1,485
Issues of shares	–	–
At 31 December 2016	81,017,800	1,485
At 1 January 2017	81,017,800	1,485
Issues of shares	–	–
At 31 December 2017	**81,017,800**	**1,485**

The total number of authorised ordinary shares is 330,720,100 (2016: 330,720,100) with a par value of £0.01 per share (2016: £0.01 per share). Subject to the terms of the Company's Articles of Association, each ordinary share has the right of one vote at a General Meeting of the Company and to receive dividends declared by the directors. There are no other classes of shares in the Company either issued or authorised.

17. Other reserves – Group

At 31 December	2017 US$ 000	2016 US$ 000
Currency translation reserves	**(77,403)**	(80,855)
Share grant reserve	**–**	5,233
Total other reserves	**(77,403)**	(75,622)

Currency translation reserve

The currency translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations, to the presentation currency.

Share grant reserve

As of 31 May 2017 all the remaining share options lapsed. No options were exercised during the year ended 31 December 2017 (2016: nil) and no options were issued in either period. Consequently, the share grant reserve has been released and added to the accumulated profits.

18. Accumulated profit – Group and Company

At 31 December	Group 2017 US$ 000	Group 2016 US$ 000	Company 2017 US$ 000	Company 2016 US$ 000
Retained profits	**141,224**	140,037	**50,573**	51,597
Profit/(loss) for the year	**330**	1,187	**571**	(1,024)
Equity dividends paid	**(5,000)**	–	**(5,000)**	–
Reversal of share grant reserve	**5,233**	–	**5,233**	–
Accumulated profit/(loss)	**141,787**	141,224	**51,377**	50,573

Dividends
No dividends were proposed by the Board of Directors in respect of the year ended 31 December 2017 (2016: US$0.062 per ordinary share). Dividends are not recognised as liabilities and there are no tax consequences.

19. Trade and other payables

At 31 December	Group 2017 US$ 000	Group 2016 US$ 000	Company 2017 US$ 000	Company 2016 US$ 000
Trade payables	**1,571**	4,738	**–**	–
Taxes other than profit tax	**2,366**	2,266	**–**	–
Customer advances	**2,597**	2,836	**–**	–
Other payables	**284**	123	**5**	–
Total	**6,818**	9,963	**5**	–

The maturity of the Group's and the Company's financial liabilities are all between zero to three months. Customer advances are prepayments for oil and condensate sales, normally one month in advance of delivery.

20. Bank loan

At 31 December	2017 US$ 000	2016 US$ 000
Non-current liabilities		
Secured bank loan	**–**	3,802
Current liabilities		
Current portion of secured bank loan	**4,004**	158
Total bank loan	**4,004**	3,960

In December 2016, one of the Group's operating subsidiaries received a bank loan in total amount of RUR 240 million (US$3.96 million), which was utilised to fund purchases of equipment for the LPG project and should be fully repaid by 2019 (repayments are scheduled as follows – in 2018: US$2.0 million; 2019: US$2.0 million). As at 31 December 2017, there was a technical breach of certain loan covenants. Management expects to receive a waiver of this breach from the lender, but pending receipt of this waiver, the entire loan is classified as current. Interest is charged at a fixed rate of 11.45% per annum. The bank loan as at 31 December 2017 has been secured by charges over the shares of the Group's Russian operating subsidiaries as detailed in note 21 overleaf.

Notes to the IFRS Consolidated Financial Statements continued

For the year ended 31 December 2017

(presented in US$ 000)

20. Bank loan continued

Changes in liabilities from financing activities

Balance at 1 January	Bank loans 2017 US$ 000	Bank loans 2016 US$ 000
Changes from financing cash flows	**3,960**	–
Proceeds from loans and borrowings	**–**	3,947
Repayment of borrowings	**(165)**	–
Total changes from financing cash flows	**(165)**	3,947
The effect of changes in foreign exchange rates	**209**	10
Other changes:		
Capitalised borrowing costs	**471**	–
Interest expense	**–**	3
Interest paid	**(471)**	–
Total other changes	**–**	3
Balance at 31 December	**4,004**	3,963

21. Investments – Company

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

Name	Jurisdiction	Nature of operations	% owned	From
Woodhurst Holdings Ltd	Cyprus	Intermediate holding company	100%	October 2005
Pre-Caspian Gas Company	Russia	Oil & gas exploration and production	100%	May 2006
Gazneftеservice	Russia	Oil & gas exploration and production	100%	September 2006
Shropak Investments Ltd	Cyprus	Dormant	100%	June 2007
Volga Gas (Cyprus) Ltd	Cyprus	Intermediate holding company	100%	August 2007
Geopotential	Russia	Special purpose entity	100%	October 2008
Volga Gas Finance Ltd	UK	Intermediate holding company	100%	March 2010

To avoid certain legal restrictions on land ownership, in October 2008 Pre-Caspian Gas Company acquired a 99% shareholding in ZAO Gazservice. Subsequently, Pre-Caspian Gas Company sold an unimproved plot of land to ZAO Gazservice at cost basis. During the year ended 31 December 2016, Gazservice was merged into Geopotential.

The registered office addresses of the subsidiaries are as follows:

Name	Registered office address
Woodhurst Holdings Ltd	all at:
Shropak Investments Ltd	Archbishop Makarios Avenue, Capital Centre, 9th Floor, 1505 Nicosia, Cyprus
Volga Gas (Cyprus) Ltd	
Pre-Caspian Gas Company	both at:
Geopotential	65, Ulitsa Kiseleva, Saratov, 410012, Russia
Gazneftеservice	24. Ulista Pushkina, Zhirnovsk, Volgograd Region, 403790, Russia
Volga Gas Finance Ltd	6th floor, 65 Gresham Street, London EC2V 7NQ, UK

21. Investments – Company continued

Company

	31 December 2016 US$ 000	Additions US$ 000	Share premium reduction US$ 000	31 December 2017 US$ 000
Investments in Woodhurst Holdings	48,924	–	(22,151)	26,773
Investments in Volga Gas (Cyprus)	1,551	–	–	1,551
Total investments	**50,475**	**–**	**(22,151)**	**28,324**

The Company funds its activities in the Russian Federation via Woodhurst Holdings ("Woodhurst"), the Company's Cyprus-registered subsidiary. On 10 April 2017, Woodhurst transferred loan assets and investments to its shareholder, Volga Gas plc, by way of a share premium reduction. The investment in Woodhurst was accordingly reduced by the same amount. Further details are shown in note 23.

22. Audit fees – Group and Company

During the year, the Group (including its overseas subsidiaries) obtained the following services from the Company's auditor and associates:

Year ended 31 December	2017 US$ 000	2016 US$ 000
Fees payable to Company's auditor for the audit of Parent Company and consolidated financial statements	**229**	292
Fees payable to Company's auditor for the audit of Parent Company and its associated firms for other services	**17**	–
Audit of the Company's subsidiaries pursuant to legislation	**64**	22
Other services pursuant to legislation	**7**	3
Total	**317**	317

23. Related party transactions – Group and Company

The Group is controlled by Baring Vostok Private Equity Funds III and IV (registered office address for both companies: 1 Royal Plaza, Royal Avenue, St Peter Port, Guernsey, GY1 2HL), 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.

There were no transactions carried out by the Group with related third party entities during either of the years ended 31 December 2016 or 31 December 2017. There were, however, the following outstanding balances from transactions carried out in previous years:

Year-end balances arising from transactions with related parties:

	31 December 2017 US$ 000	31 December 2016 US$ 000
Due to related parties		
Baring Vostok (Cyprus) Limited	**–**	12

All transactions with related parties were made on commercial basis.

The following transactions were carried out between the Company and its wholly owned subsidiaries:

			Year ended 31 December	
Group company	Relationship	Nature of transactions	2017 US$ 000	2016 US$ 000
Woodhurst Holdings Limited	100% directly owned subsidiary	Assignment of loan assets to Volga Gas plc	**8,778**	–
		Assignment of investment in Volga Gas Finance Ltd to Volga Gas plc	**13,373**	–
		Reduction of receivables due	**(3,300)**	–
Volga Gas Finance Limited	100% directly owned subsidiary	Assignment of loan assets to Volga Gas plc	**13,373**	–
Pre-Caspian Gas Company	100% indirectly owned subsidiary	Interest accrued from 10 April 2017 to 31 December 2017	**210**	–
Gazneftеservice	100% indirectly owned subsidiary	Interest accrued from 10 April 2017 to 31 December 2017	**1,014**	–

Notes to the IFRS Consolidated Financial Statements continued

For the year ended 31 December 2017

(presented in US$ 000)

23. Related party transactions – Group and Company continued

With an effective date of 10 April 2017, Woodhurst Holdings Limited assigned loan assets and related interest receivables to Volga Gas plc. With an effective date of 9 June 2017, Woodhurst transferred its investment in Volga Gas Finance to Volga Gas plc. Both of these transactions were undertaken by way of a share premium reduction in Woodhurst Holdings Limited.

On 14 July 2017, Volga Gas Finance Limited assigned its loan receivable assets and accrued interest receivables to Volga Gas plc by way of a dividend in specie.

As a consequence of these transfers, Volga Gas plc had a direct interest in intercompany loans receivable from Pre-Caspian Gas Company and Gazneftеservice. As of the effective dates of these transfers, Volga Gas plc has been accruing interest income on these loans.

Year-end balances arising from transactions with subsidiaries

	31 December 2017 US$ 000	31 December 2016 US$ 000
Accounts receivable from subsidiaries		
Woodhurst Holdings Limited	**1,659**	4,735
Volga Gas (Cyprus) Ltd	**–**	–
Loans receivable from subsidiaries		
Pre-Caspian Gas Company	**2,759**	–
Gazneftеservice	**18,441**	–
Interest receivable from subsidiaries		
Pre-Caspian Gas Company	**303**	–
Gazneftеservice	**2,022**	–
Accounts payable to subsidiaries		
Woodhurst Holdings Limited	**1,357**	1,357
Volga Gas (Cyprus) Ltd	**–**	–

Key management

Key management of the Company is considered to comprise the directors and the Chief Financial Officer, who is not a director. Details of key management compensation are summarised below.

Year ended 31 December	2017 US$ 000	2016 US$ 000
Salaries and short-term benefits	**478**	444
Compensation for loss of office	**–**	39
Fees paid to non-executive directors	**220**	220
Total key management compensation	**698**	713

24. Contingencies and commitments

24.1 Capital commitments

As of the balance sheet date, all material licence work obligations have been met and all of the Group's capital expenditures and work programmes are discretionary. As of the balance sheet date, the Board had approved a work programme for 2018 with a total capital expenditure budget of US$5.9 million, of which US$1.4 million had been contracted. The remainder is expected to be incurred but had not been committed to or contracted as at the balance sheet date.

24.2 Operating leases

The Group has no non-cancellable lease rental obligations.

24.3 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 2017, management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained.

24.4 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.

24.5 Oil field licences

The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oil field licences. Management of the Group corresponds 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 would be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Group.

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

Field	Licence holder	Licence expiry date
Karpenskiy	OOO Pre-Caspian Gas Company	2031
Urozhainoye-2	OOO Pre-Caspian Gas Company	2032
Vostochny Makarovskoye	OOO Gaznefteservice	2026
Dobrinskoye	OOO Gaznefteservice	2026

Volga Gas plc
Annual General Meeting

Notice of Meeting

Notice is hereby given that the Annual General Meeting (the "AGM") of Volga Gas plc (the "Company") will be held at the London office of Baring Vostok at 2nd Floor, 25 Old Burlington Street, London W1S 3AN on 7 June 2018 at 10.00 a.m. for the following purposes:

Ordinary Resolutions

1. To receive and adopt the Company's accounts for the year ended 31 December 2017 and the Directors' Report.
2. To reappoint Ronald Freeman, who retires by rotation, as a director.
3. To reappoint Aleksey Kalinin, who retires by rotation, as a director.
4. To reappoint Andrey Zozulya, who retires by rotation, as a director.
5. To reappoint KPMG LLP as auditor of the Company until the conclusion of the next General Meeting at which accounts are laid before the members of the Company.
6. To authorise the directors to determine the remuneration of the auditor of the Company.
7. That the directors be and they are hereby generally and unconditionally empowered to exercise all the powers of the Company to allot shares in the Company and/or to grant rights to subscribe for or to convert any security for shares in the Company (together "Relevant Securities") up to a maximum aggregate nominal amount of £500,000 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 AGM of the Company to be held in 2019 (unless renewed, varied or revoked by the Company prior to or on such date), save that this authority shall allow the Company to make offers or agreements before the expiry of such authority which would or might require Relevant Securities to be allotted after such expiry and the directors shall be entitled to allot Relevant Securities pursuant to any such offer or agreement as if this authority had not expired; and all unexercised authorities previously granted to the directors to allot Relevant Securities be and are hereby revoked.

Special Resolutions

8. That the directors be and they are hereby empowered pursuant to Sections 570 and 573 of the Companies Act 2006 (the "Act") to allot equity securities (as defined in Section 560 of the Act) for cash; pursuant to the authority conferred by Resolution 7 set out in this Notice convening the AGM (the "Notice") as if Section 561 of that Act did not apply to any such allotment, provided that this power shall be limited to:
   (a) the allotment of equity securities in connection with a rights issue, open offer or other offer of securities in favour of the holders of ordinary shares on the register of members at such record date(s) as the directors may determine where the equity securities respectively attributable to the interests of the ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them on any such record date(s), subject to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements or legal or practical problems arising under the laws of any overseas territory or the requirements of any regulatory body or stock exchange or by virtue of shares being represented by depositary receipts or any other matter; and
   (b) the allotment (otherwise than pursuant to sub-paragraph (a) above) to any person or persons of equity securities up to an aggregate nominal amount of £100,000.
   And the power conferred hereby shall expire upon the expiry of the general authority conferred by Resolution 7 set out in this Notice (unless renewed, varied or revoked by the Company prior to or on such date), save that the Company shall be entitled to make offers or agreements before the expiry of such power which would or might require equity securities to be allotted after such expiry and the directors shall be entitled to allot equity securities pursuant to any such offer or agreement as if the power conferred hereby had not expired.
9. That the Company be generally and unconditionally authorised for the purposes of Section 701 of the Act to make market purchases (within the meaning of Section 693 of the Act) of fully paid ordinary shares of 1p each ("Shares") on such terms and in such manner as the directors of the Company may decide provided that:
   (i) the maximum number of Shares that may be purchased by the Company pursuant to this authority is 12,144,000 (representing approximately 14.99% of the Company's issued ordinary share capital at the date of this Notice;
   (ii) the minimum price (exclusive of expenses) which may be paid for any such Shares shall not be less than the nominal value of that Share at the time of purchase;
   (iii) the maximum price (exclusive of expenses) which may be paid for any Shares purchased pursuant to this authority is an amount equal to the higher of (a) an amount equal to 105% of the average of the middle market prices shown in the quotations for the Company's Shares in the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which that Share is contracted to be purchased; and (b) an amount equal to the higher of the price of the last independent trade of an ordinary share and the highest current independent bid for an ordinary share as derived from the London Stock Exchange; and
   (iv) unless previously varied, revoked or renewed, the authority conferred by this resolution shall expire on the earlier of 30 June 2019 or at the end of the next Annual General Meeting of the Company to be held in 2019, but the Company may make a contract to purchase Shares under this authority before its expiry which will or may be completed wholly or partly after the expiry of this authority, and may complete such a purchase as if this authority had not expired.

Registered office:
6th Floor, 65 Gresham Street
London
EC2V 7NQ

BY ORDER OF THE BOARD
Caros Consulting Ltd
Company Secretary
12 April 2018

Notes:

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

2. Share buy-back (Resolution 9). The purpose of Resolution 9 is to permit the Company to purchase its own shares in the market under the terms described therein. Shares so purchased would be cancelled and the issued share capital of the Company accordingly reduced.

3. Only those members entered on the register of members of the Company at close of business on 5 June 2018 or, in the event that this meeting is adjourned, in the register of members as at close of business 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 close of business on 5 June 2018 or, in the event that this meeting is adjourned, in the register of members after 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.

4. A member entitled to attend, speak and vote at the meeting convened by the Notice set out above is entitled to appoint a proxy to attend, speak and, on a poll, to vote in his place. To appoint more than one proxy you may photocopy this form. Please indicate the proxy holder's name and the number of shares in relation to which they are authorised to act as your proxy (which, in aggregate, should not exceed the number of shares held by you). Please also indicate if the proxy instruction is one of multiple instructions being given. All forms must be signed and should be returned together in the same envelope.

5. A form of proxy is enclosed. To be effective, it must be deposited at the office of the Company's registrars (Link Asset Services, PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU) so as to be received not later than 48 hours before the time appointed for holding the AGM. Completion of the proxy does not preclude a member from subsequently attending and voting at the meeting in person if he or she so wishes.

6. To change your proxy instructions simply submit a new proxy appointment using the methods set out in notes 3 and 4 above. Note that the cut-off time (in note 3 above) for receipt of proxy appointments also applies in relation to amended instructions; any amended proxy appointment received after the relevant cut-off time will be disregarded. Where you have appointed a proxy using the hard-copy proxy form and would like to change the instructions using another hard-copy proxy form, please contact the Company's registrars. If you submit more than one valid proxy appointment, the appointment received last before the latest time for the receipt of proxies will take precedence.

7. In order to revoke a proxy instruction you will need to inform the Company using one of the following methods:

   (a) by sending a signed hard-copy notice clearly stating your intention to revoke your proxy appointment, to the Company's registered office address. In the case of a member which is a company, the revocation notice must be executed under its common seal or signed on its behalf by an officer of the company or an attorney for the company. Any power of attorney or any other authority under which the revocation notice is signed (or duly a certificated copy of such power of authority) must be included with the revocation notice; or

   (b) by sending an email to **info@volgagas.com**

   In either case, the revocation notice must be received by the Company's registrars no later than the cut-off time set out in note 3 above.

8. The register of interests of the directors and their families in the share capital of the Company and copies of contracts of service of directors with the Company or with any of its subsidiary undertakings will be available for inspection at the registered office of the Company during normal business hours (Saturdays and public holidays excepted) from the date of this notice until the conclusion of the AGM.

9. To appoint a proxy or to give or amend an instruction to a previously appointed proxy via the CREST system, the CREST message must be received by the issuer's agent (ID: RA10) no later than 48 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.

10. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided they do not do so in relation to the same shares.

11. Under Section 319A of the 2006 Act, the Company must cause to be answered any question relating to the business being dealt with at the Annual General Meeting put by a member attending the meeting unless answering the question would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, or the answer has already been given on a website in the form of an answer to a question, or it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.

    Members who have any queries about the Annual General Meeting should contact the Company Secretary by email on **info@volgagas.com**. Members may not use any electronic address or fax number provided in this Notice or in any related documents (including the Form of Proxy) to communicate with the Company for any purpose other than those expressly stated.

12. Information regarding the Annual General Meeting, including information required by Section 311A of the 2006 Act, and a copy of this Notice of Annual General Meeting is available from **www.volgagas.com.**

Glossary of Technical Terms

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 of 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
A plant comprising one or more units such that, after conditioning, the gas will be of pipeline quality as specified by Gazprom; such units 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.

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.

mcm
Thousand cubic metres.

mmbbls
Million barrels.

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 gases which are predominantly comprised of hydrocarbon compounds.

Possible reserves
Those unproven reserves that, on the available evidence and taking into account technical and economic factors, have a 10% chance of being produced.

Probable reserves
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% chance of being produced.

Prospective resources
Those quantities of hydrocarbons which are estimated, on a given date, to be potentially recoverable from undiscovered accumulations.

Proved plus probable reserves
Sum of the proved reserves and the probable reserves calculated in accordance with SPE standards.

Proved reserves
These 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% chance of being produced.

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 2007 by the Society of Petroleum Engineers and the World Petroleum Congresses.

Corporate Directory

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Prince Frederick House
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United Kingdom

Auditor
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United Kingdom

Lawyers and solicitors to the Company as to English and Russian law
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