

TU MONDAY



\*L4C0T30G\*

|     |                 |      |
|-----|-----------------|------|
| LD4 | 20/07/2015      | #65  |
|     | COMPANIES HOUSE |      |
|     | *L4AMPICW*      |      |
| LD2 | 30/06/2015      | #287 |
|     | COMPANIES HOUSE |      |

# Regal Petroleum plc

*Annual Report and Accounts  
for the year ended 31 December 2014*

Regal Petroleum plc is an independent oil and gas company, quoted on the AIM market of the London Stock Exchange and focused on gas and condensate field development in Ukraine.

## Inside this Report

### STRATEGIC REPORT

|                                                            |    |
|------------------------------------------------------------|----|
| Principal Developments                                     | 01 |
| Chairman's Review                                          | 02 |
| Operations Review                                          | 04 |
| Finance Review                                             | 06 |
| Operational Environment, Principal Risks and Uncertainties | 09 |

### GOVERNANCE

|                                |    |
|--------------------------------|----|
| Board of Directors             | 14 |
| Corporate Governance Statement | 15 |
| Directors' Report              | 16 |
| Independent Auditors' Report   | 18 |

### FINANCIALS

|                                                |    |
|------------------------------------------------|----|
| Consolidated Income Statement                  | 20 |
| Consolidated Statement of Comprehensive Income | 21 |
| Company Statement of Comprehensive Income      | 21 |
| Consolidated Balance Sheet                     | 22 |
| Consolidated Statement of Changes in Equity    | 23 |
| Consolidated Cash Flow Statement               | 24 |
| Company Balance Sheet                          | 25 |
| Company Statement of Changes in Equity         | 26 |
| Company Cash Flow Statement                    | 27 |
| Notes forming part of the financial statements | 28 |

---

# PRINCIPAL DEVELOPMENTS

## STRATEGIC REPORT

### UKRAINE OPERATIONS

Despite ongoing geopolitical events in Ukraine, the Group's production operations have continued relatively normally, although such events have resulted in volatility and weakening of the Ukrainian Hryvnia exchange rates, disruption to the gas sales market and gas sales price, and the imposition of significant increases in subsoil taxes, which in turn, have adversely affected the Group's financial results

Average production over the year to 31 December 2014 of 152,744 m<sup>3</sup>/d of gas, 52 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG (1,370 boepd in aggregate) (2013: 185,677 m<sup>3</sup>/d of gas and 42 m<sup>3</sup>/d of condensate (1,422 boepd in aggregate) – LPG production commenced at the end of 2013)

Well SV-59 commenced production testing in January 2014, and is now on production

### FINANCE

Revenue for the year to 31 December 2014 of \$34.6 million (2013: \$36.7 million)

Profit for the year to 31 December 2014 of \$5.8 million (2013: \$128.0 million loss)

Cash generated from operations during the year of \$19.5 million (2013: \$21.7 million)

Average realised gas, condensate and LPG prices in Ukraine for the year to 31 December 2014 of \$362/Mm<sup>3</sup> (UAH4,297/Mm<sup>3</sup>), \$95/bbl and \$94/bbl respectively (2013: \$415/Mm<sup>3</sup> (UAH 3,380/Mm<sup>3</sup>) gas and \$91/bbl condensate – LPG production commenced at the end of 2013)

Cash and cash equivalents at 31 December 2014 of \$31.8 million (31 December 2013: \$25.1 million), with cash and cash equivalents at 22 May 2015 of \$31.9 million, held as to \$18.3 million equivalent in Ukrainian Hryvnia and the balance of \$13.6 million equivalent predominately in US Dollars and Sterling

### OUTLOOK

Due to the geopolitical situation in Ukraine, the economic impact of the devaluation of the Ukrainian Hryvnia, the increase in subsoil taxes and the uncertainty in both the gas sales price and gas sales market, a limited development programme is planned for 2015

Focus during 2015 on continued geological, geophysical and well performance studies to improve understanding of the sub-surface at MEX-GOL and SV fields

Funding of 2015 development programme anticipated to be from existing cash and cash equivalents and operational revenues

Geopolitical and economic outlook in Ukraine remains uncertain

## CHAIRMAN'S REVIEW STRATEGIC REPORT

The Group is continuing with the development of its 100% owned and operated Mekhediviska-Golotvshinska ("MEX-GOL") and Svrydivske ("SV") gas and condensate fields in north-eastern Ukraine.

The major events that have taken place in Ukraine during the last year, including the change of Government, civil unrest and military conflict in the east of the country, have meant that there has been a great deal of uncertainty about the political, fiscal and economic outlook in Ukraine.

Nevertheless, the Group's operational activities in Ukraine have continued to be relatively unaffected by the upheaval that is ongoing, and the Group has been able to produce relatively normally at its MEX-GOL and SV fields. However, the continuing geopolitical situation has resulted in significant volatility and weakening of the Ukrainian Hryvnia exchange rates, uncertainty in the gas sales price, the imposition of significant increases in subsoil taxes and disruption to the gas supply market over the 2014/2015 winter period. As well as adversely affecting the Group's financial results for 2014, these continuing uncertainties are making it difficult to commit to major capital investment and causing delays to the further development of the MEX-GOL and SV fields in the near term.

During 2014, the Ukrainian Hryvnia devalued significantly against the US Dollar, falling from UAH8.3/\$1.00 on 1 January 2014 to UAH15.8/\$1.00 on 31 December 2014, which resulted in a substantial foreign exchange translation loss of \$62.5 million for the Group. This has adversely impacted the carrying value of the oil and gas development and producing asset due to the translation of two of the Group's subsidiaries from their functional currency of Ukrainian Hryvnia to the Group's reporting currency of US Dollars. As a result of the significant devaluation of the Ukrainian Hryvnia, the National Bank of Ukraine has imposed comprehensive restrictions on the purchase of foreign currency and the remittance of funds outside Ukraine. These restrictions, and the many other economic issues in Ukraine, have put great strain on the Ukrainian banking system, with increasing risks in the capital strength, liquidity and creditworthiness of a number of banks, and very high rates in the wholesale and overnight markets.

Due to these banking restrictions, the Group is unable to remit funds outside Ukraine, which has resulted in the Group's cash holdings of Ukrainian Hryvnia increasing substantially over the past year.

In light of the deterioration in the banking sector in Ukraine, the Group has started to diversify its banking arrangements between a number of banks in Ukraine. However, at present, the Group holds a significant proportion of its Ukrainian Hryvnia cash deposits in Unex Bank, which is indirectly controlled by Mr V Novinskiy, who also ultimately controls a majority shareholding in the Group. As a result, Unex Bank is a

related party to the Group. Given the situation in Ukraine and the impact on the banking sector, the Group has been able to obtain additional assurances regarding the security of its cash deposits in Unex Bank, including a representation letter from Unex Bank advising that it continues to fulfil all regulatory requirements of the National Bank of Ukraine, as well as a guarantee and security over another asset from companies within the Smart Holding Group in support of the Group's cash deposits in Unex Bank.

The industrial gas price in Ukraine, which is set in Ukrainian Hryvnia, is broadly related to the US Dollar denominated imported price of gas from Russia. In late 2013, the previous Ukrainian Government negotiated a substantial discount to the imported gas price resulting in a corresponding reduction in the industrial gas price during the first quarter of 2014. Following the change of Government in February 2014, the discount was withdrawn by Russia and the industrial gas price increased significantly on 1 April 2014 and continued to increase during 2014. However, although the industrial gas price generally increased in Ukrainian Hryvnia terms, when translated into US Dollars, there has been a decrease due to the devaluation of the Ukrainian Hryvnia. From April 2015, the imported gas price has fallen reflecting the fall in global oil commodity prices over recent months.

At the end of July 2014, the Ukrainian Government implemented a number of emergency fiscal measures designed to assist in alleviating the fiscal and economic pressures affecting the Ukrainian economy. One such measure was the imposition of a significant increase in the subsoil taxes payable by oil and gas companies operating in Ukraine for the period from 1 August 2014 to 31 December 2014. This increase in subsoil taxes had the effect of nearly doubling the taxes payable on the Group's gas production and, consequently, has negatively impacted the cost of sales and the Group's financial results for the 2014 financial year. Although the Government originally stated that this increase in subsoil taxes was a temporary emergency fiscal measure, the Government has now extended the increase in subsoil taxes into 2015. It is currently unclear as to the further duration of these subsoil tax increases but it seems likely that the increases will continue for the rest of 2015.

In late November 2014, the Ukrainian Government made an Order that certain specified industrial organisations were obliged to purchase their gas requirements for the period from 1 December 2014 to 28 February 2015 from Naftogaz, the State-owned gas supplier, rather than from other gas producers in Ukraine. During this period, the Order significantly disrupted the gas supply market in Ukraine and adversely impacted the market gas prices. The Group's gas off-taker was affected by this Order, and consequently the Group had to sell its gas production into the general gas market at the

prevailing prices. The discounted prices achieved were less than those received prior to the imposition of the Order, and consequently resulted in a negative impact on the Group's financial results for the 2014 financial year, and will also have a negative impact on the Group's results for the 2015 year. Although the Order expired on 28 February 2015, the gas supply market has not yet returned to normal and the Group's realised gas price has continued to be less than prior to the imposition of the Order.

As regards the Group's financial performance in the year to 31 December 2014, a profit of \$5.8 million (2013: \$128.0 million loss) was made, although the devaluation of the Ukrainian Hryvnia against the US Dollar has resulted in a significant foreign exchange loss in the foreign exchange reserve. Cash generated from operations during the period was positive at \$19.5 million (2013: \$21.7 million).

Average production over the year ended 31 December 2014 was 152,744 m<sup>3</sup>/d of gas, 52 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG (1,370 boepd in aggregate), which was lower compared with 2013 predominately as a result of normal production decline and a well ceasing to produce (2013: 185,677 m<sup>3</sup>/d of gas and 42 m<sup>3</sup>/d of condensate (1,422 boepd in aggregate) – LPG production commenced at the end of 2013). Average production for the period from 1 January 2015 to 30 April 2015 was 145,960 m<sup>3</sup>/d of gas, 45 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG (1,289 boepd in aggregate).

The geopolitical upheaval, the volatility in the gas price and the Ukrainian Hryvnia, and the fiscal and economic uncertainty in Ukraine during 2014, meant that the Group considered it necessary to reduce its planned capital investment programme. The revised programme during the period was limited to carrying out well workover operations at the SV-61 well, designed to eliminate water ingress into the well, undertaking hydraulic fracturing operations to stimulate the MEX-120 well, and installing additional compression equipment. However, down-hole equipment failures during the operations at both the SV-61 well and the MEX-120 well resulted in the deferral of these operations. More limited stimulation operations were undertaken on the MEX-120 well towards the end of the year, but these have not resulted in any significant additional production from this well.

The SV-59 well was completed at the end of 2013 and hooked up to the gas processing facility in early 2014. Its performance was monitored during a production testing programme in the first quarter of 2014, and the well was then put on production.

In addition, the Group has entered into an agreement with NJSC Nadra, the State owned gas producer, for the lease of the SV-6 well, which is a suspended well owned by NJSC Nadra within the Group's SV licence area. Under this

agreement, the Group will undertake workover operations on the well, which, if successful, will result in the well being brought onto production.

Furthermore, the Group has reached an agreement with Pryodni Resursy, the operator of the adjacent Lutsenky field, under which the Group will purchase "wet" gas and treat it through the Group's gas processing facilities to strip out and sell the liquids. This will not only create an additional revenue stream for the Group, but also improve environmental emissions from the Lutsenky field.

It is with great regret and sadness that I have to report, that despite our endeavours to maintain the highest standards of HSES at our operations, one of our Ukrainian staff suffered a fatal accident whilst undertaking electrical maintenance work. An investigation into the accident by the Ukrainian State Agency for health and safety determined that a latent defect in a high voltage circuit breaker was the cause of the accident. The Group has reiterated its safe working procedures to our Ukrainian staff in the context of this accident and certain additional measures have been implemented to reinforce our HSES regime.

## Business Review and Outlook

The continued instability in Ukraine has meant that planning for the further development of the MEX-GOL and SV fields has been substantially disrupted, and the various political, economic and fiscal uncertainties have made budgeting and commitment to capital investment problematic. The Group has therefore been obliged to take a cautious approach to near term capital investment, whilst undertaking contingent planning for further development of the fields and monitoring the ongoing situation.

Nevertheless, during 2015, further geological, geophysical and well performance studies, aimed at improving the understanding of the sub-surface within the MEX-GOL and SV licences, are continuing, as well as investment in the Group's gas processing facilities and pipeline network, and remedial work on existing wells. Contingent planning is ongoing for the drilling of the MEX-109 well, the hydraulic fracturing of the MEX-120 well and the possible workover of the MEX-102 well.

It is hoped that the situation in Ukraine will improve in due course, allowing better visibility on the political and economic outlook and in turn assisting with the Group's development planning at its MEX-GOL and SV fields.

In conclusion, on behalf of the Board, I would like to thank our staff for the continued dedication and support they have shown, particularly during the difficult events in Ukraine over the last year.

**Keith Henry**  
Executive Chairman

## OPERATIONS REVIEW STRATEGIC REPORT

### Health, Safety, Environment and Security ("HSES")

The Group is committed to maintaining the highest HSES standards and the effective management of these areas is an intrinsic element of the overall business ethos. Through strict enforcement of the Group's HSES Management System, together with regular management meetings, training and the appointment of dedicated safety professionals, the Group strives to ensure that the impact of its business activities on its staff, contractors and the environment is as low as is reasonably practicable. The Group reports safety and environmental performance in accordance with industry practice and guidelines.

Notwithstanding the Group's commitment to these high HSES standards at our operations, the Group greatly regrets to report that one of our Ukrainian staff suffered a fatal accident while undertaking electrical maintenance work. The Ukrainian State Agency for Mining and Industrial Safety conducted an investigation into the accident and determined that a latent defect in a high voltage circuit breaker was the cause of the accident. The Group has reviewed and reiterated its safe working procedures to Ukrainian staff in the context of this accident and certain additional measures have been implemented to reinforce our HSES regime.

### Ukraine Operations

#### Asset Overview

Regal Petroleum Corporation Limited (a wholly owned subsidiary in the Group) holds a 100% working interest and is the operator of the MEX-GOL and SV fields. The licences are the Group's sole project and extend over a combined area of 269 km<sup>2</sup>, approximately 200 km east of Kiev. The two licences are adjacent and the interests are operated and managed as one field.

The fields are located, geologically, towards the middle of the Dnieper-Donets sedimentary basin which extends across the majority of north-east Ukraine. The vast majority of Ukrainian gas and condensate production comes from this basin. The reservoir comprises a series of gently dipping Carboniferous sandstones of Visean age ("B-Sands") inter-bedded with shales that form stratigraphic traps at around 4,700 metres below the surface, with a gross thickness between 800 metres and 1,000 metres. Analysis suggests that these deposits range from fluvial to deltaic in origin. Below these reservoirs is a thick sequence of shale above deeper, similar, sandstones which are encountered at a depth of around 5,800 metres. These sands are of Tournasian age ("T-Sands"). Deeper sandstones of Devonian age ("D-Sands") have also been penetrated in the fields.

### Production

The Group's average production over the year ended 31 December 2014 was 152,744 m<sup>3</sup>/d of gas, 52 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG, which equates to a combined total oil equivalent of 1,370 boepd (2013: 185,677 m<sup>3</sup>/d of gas and 42 m<sup>3</sup>/d of condensate (1,422 boepd in aggregate) – LPG production commenced at the end of 2013).

The Group's average production for the period from 1 January 2015 to 30 April 2015 was 145,960 m<sup>3</sup>/d of gas, 45 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG, which equates to a combined total oil equivalent of 1,289 boepd.

### Operations

The geopolitical upheaval, the volatility in the gas price, the devaluation of the Ukrainian Hryvnia, and the fiscal and economic uncertainty in Ukraine during 2014, meant that the Group considered it necessary to reduce its planned capital investment programme.

The revised programme was limited to carrying out well workover operations at the SV-61 well, designed to eliminate water ingress into the well, undertaking hydraulic fracturing operations to stimulate the MEX-120 well, and installing additional compression equipment. However, down-hole equipment failures during the operations at both the SV-61 well and the MEX-120 well resulted in the deferral of these operations. More limited stimulation operations were undertaken on the MEX-120 well towards the end of the year, but these have not resulted in any significant additional production from this well.

The SV-59 well was drilled to a depth of 5,470 metres, completed and, after initial testing, hooked up to the gas processing facility in early 2014. Its performance was monitored during a production testing programme in the first quarter of 2014, and it was then put on production. The well is currently producing approximately 8,000 m<sup>3</sup>/d of gas, 8.8 m<sup>3</sup>/d of condensate and 1.6 m<sup>3</sup>/d of LPG (113 boepd in aggregate).

The Group has entered into an agreement with NJSC Nadra, the State owned gas producer, for the lease of the SV-6 well, which is a suspended well owned by NJSC Nadra and located within the Group's SV licence area. Workover operations on this well are underway and it is anticipated that these operations will be concluded in the second quarter of 2015. If the workover operations are successful, it is planned to bring the well onto production.

The Group has also reached an agreement with Pryodni Resursy, the operator of the adjacent Lutsenky field, under which the Group will purchase "wet" gas and treat it through the Group's gas processing facilities to strip out and sell the liquids. This will not only create an additional revenue stream for the Group, but also improve environmental emissions from the Lutsenky field.

## Reserves

The Group's estimates of the remaining Reserves and Resources at the MEX-GOL and SV licence areas are derived from an assessment undertaken by independent petroleum consultants, ERC Equipose Limited ("ERCE"), as at 31 December 2013 (the "ERCE Report"), which was announced on 25 March 2014. The estimates below have not been adjusted for production since 1 January 2014.

The ERCE Report estimated the remaining Reserves as at 31 December 2013 in the Visean B-Sands reservoirs of the MEX-GOL and SV fields, based on the drilling of ten further wells, as follows:

|              | Proved<br>(1P)   | Proved + Probable<br>(2P) | Proved + Probable<br>+ Possible (3P) |
|--------------|------------------|---------------------------|--------------------------------------|
| Gas          | 8.3 Bscf         | 50.1 Bscf                 | 71.2 Bscf                            |
| Condensate   | 0.4 MMbbl        | 2.5 MMbbl                 | 4.1 MMbbl                            |
| LPG          | 17.4 Mtonnes     | 105.6 Mtonnes             | 149.8 Mtonnes                        |
| <b>Total</b> | <b>1.9 MMboe</b> | <b>11.7 MMboe</b>         | <b>17.2 MMboe</b>                    |

The ERCE Report estimated the Contingent Resources in the Visean B-Sands reservoirs of the MEX-GOL and SV fields as follows, based on the potential drilling of up to 113 future wells (not currently budgeted):

|              | Contingent Resources<br>(1C) | Contingent Resources<br>(2C) | Contingent Resources<br>(3C) |
|--------------|------------------------------|------------------------------|------------------------------|
| Gas          | 198 Bscf                     | 334 Bscf                     | 519 Bscf                     |
| Condensate   | 8.5 MMbbl                    | 17.4 MMbbl                   | 32.7 MMbbl                   |
| <b>Total</b> | <b>41.5 MMboe</b>            | <b>73.1 MMboe</b>            | <b>119.1 MMboe</b>           |

## FINANCE REVIEW STRATEGIC REPORT

The Group's profit for the year ended 31 December 2014 was \$5.8 million comprising profit on ordinary activities before tax of \$8.1 million (2013: \$162.9 million loss) and tax adjustments of \$2.3 million (2013: \$34.9 million). Revenue in 2014, derived from the sale of the Group's Ukrainian gas, condensate and LPG production, was lower at \$34.6 million (2013: \$36.7 million) due to a combination of reduced production volumes and the devaluation of the Ukrainian Hryvnia against the US Dollar, resulting in lower average gas prices in US Dollar terms.

During 2014, the Ukrainian Hryvnia has significantly devalued against major world currencies, including against the US Dollar, where it has fallen from UAH8.3/\$1.00 on 1 January 2014 to UAH15.8/\$1.00 on 31 December 2014. Due to the translation of two of the Group's subsidiaries from their functional currency of Ukrainian Hryvnia to the reporting currency of US Dollars, the devaluation against the US Dollar has had the effect of reducing both revenues and costs, as well as the carrying value of the Group's assets.

As a result of the significant devaluation of the Ukrainian Hryvnia, the National Bank of Ukraine, among other measures, imposed comprehensive restrictions on the purchase of foreign currency and on the remittance of funds outside Ukraine. These restrictions, and the many other economic issues in Ukraine, have put great strain on the Ukrainian banking system, with increasing risks in the capital strength, liquidity and creditworthiness of a large number of local banks, and very high rates in the wholesale and overnight markets. In addition, there have been significant deposit outflows from the banking system and widespread restructuring of bank clients' maturing liabilities. As a result of recommendations from the International Monetary Fund, significant reforms to the Ukrainian banking sector are being implemented, which are intended to strengthen the capitalisation of the Ukrainian banks.

In light of the deterioration in the banking sector in Ukraine, the Group has started to diversify its banking arrangements between a number of banks in Ukraine. These steps are designed to spread the risks associated with each bank's creditworthiness, but the Ukrainian banking sector remains weakly capitalised and so the risks associated with the banks in Ukraine remain significant, including in relation to the banks with which the Group operates bank accounts. In addition, the severe banking restrictions referred to above, have meant that the Group is unable to remit funds outside Ukraine and as a result, the Group's cash holdings of Ukrainian Hryvnia in Ukraine increased significantly over the past year. Further details are set out in the Operational Environment, Principal Risks and Uncertainties section.

Cash generated from operations during the period was positive at \$19.5 million (2013: \$21.7 million).

For the year ended 31 December 2014, the average realised gas, condensate and LPG prices were \$362/Mm<sup>3</sup> (UAH4,297/Mm<sup>3</sup>), \$95/bbl and \$94/bbl respectively (2013: \$415/Mm<sup>3</sup> (UAH3,380/Mm<sup>3</sup>) gas and \$91/bbl condensate – no comparative is available for LPG since LPG production only commenced at the end of 2013).

During the first four months of 2015, the average realised gas, condensate and LPG prices were \$294/Mm<sup>3</sup> (UAH6,185/Mm<sup>3</sup>), \$52/bbl and \$56/bbl respectively. The current realised gas price is \$280/Mm<sup>3</sup> (UAH5,790/Mm<sup>3</sup>).

The maximum industrial gas price within Ukraine was previously adjusted quarterly by the National Commission for State Energy and Public Utilities Regulation (the "National Commission"), but more recently, due to the volatility in the Ukrainian Hryvnia, this gas price has been adjusted monthly. The industrial gas price is broadly related to the imported price of gas from Russia, which in turn is linked to global oil commodity prices. The Group's realised gas price has historically been close to the maximum industrial gas price set by the National Commission. In December 2013, the previous Government of Ukraine negotiated a significant discount to the imported gas price calculated under the longstanding gas supply agreement between Russia and Ukraine. However, following the change of Government in February 2014, the discount to the imported gas price was cancelled, and with effect from 1 April 2014, the imported gas price reverted to the price calculated under the longstanding gas supply agreement between Russia and Ukraine.

Since then, the industrial gas price set by the National Commission has increased substantially in Ukrainian Hryvnia, but the devaluation of the Ukrainian Hryvnia over the same period has meant that the industrial gas price in US Dollar terms has fallen.

In April 2015, it was announced that the imported gas price calculated under the longstanding gas supply agreement between Russia and Ukraine was to be \$248/Mm<sup>3</sup> for the second quarter of 2015, reflecting the recent decrease in global oil commodity prices.

The industrial gas price set by the National Commission, with effect from 1 May 2015, is \$324/Mm<sup>3</sup> (UAH 6,810/Mm<sup>3</sup> using the exchange rate as at 30 April 2015 of UAH21.0/\$1.00).

In late November 2014, the Ukrainian Government made an Order that certain specified industrial organisations were obliged to purchase their gas requirements for the period from 1 December 2014 to 28 February 2015 from Naftogaz, the State-owned gas supplier, rather than from other gas producers in Ukraine. During this period, the Order significantly impacted the gas supply market in Ukraine, causing disruption to the market and adversely affecting the market gas prices. The Group's gas off-taker was affected by this Order, and consequently the Group had to sell its gas production into the general gas market at the prevailing prices. The prices achieved were less than those achieved prior to the imposition of the Order, and consequently resulted in a negative impact on the Group's financial results for the 2014 financial year, and will also have a negative impact on the Group's financial results for the 2015 year.

Although the Order expired on 28 February 2015, the gas supply market has not yet returned to normal and the Group's realised gas price has continued to be less than prior to the imposition of the Order, averaging 11% below the maximum industrial gas price set by the National Commission during the first four months of 2015.

With effect from 1 August 2014, the Ukrainian Government increased the subsoil taxes payable on gas and condensate production, from 15% to 28% for gas produced from deposits below 5,000 metres and from 28% to 55% for gas produced from deposits above 5,000 metres, and from 18% to 21% for condensate produced from deposits below 5,000 metres and from 42% to 45% for condensate produced from deposits above 5,000 metres. Although the Government stated that these increases in subsoil taxes were a temporary emergency fiscal measure for the period from 1 August 2014 to 31 December 2014, the Government extended the increases in subsoil taxes into 2015. It is currently unclear as to the further duration of these subsoil tax increases but it seems likely that the increases will continue for the rest of 2015. The increases in subsoil taxes negatively impacted cost of sales by \$1.4 million in the 2014 financial year, and will also negatively impact the Group's financial results for the 2015 year.

Cost of sales for the year ended 31 December 2014 was lower at \$22.7 million (2013: \$33.7 million), mainly due to lower production volumes and exchange rate fluctuations, and notwithstanding the increased subsoil taxes. A further impact on cost of sales was lower depreciation resulting from the significant impairment loss in the 2013 year, which brought down the depreciable value of property, plant and equipment. This lower depreciation value was the primary reason for the higher gross profit in the 2014 year.

Administrative expenses for the year were lower at \$5.5 million (2013: \$7.3 million). Of this reduction in administrative expenses, \$1.2 million was due to the devaluation of the Ukrainian Hryvnia against the US Dollar.

The tax charge for the year of \$2.3 million (2013: credit of \$34.9 million) comprises a current tax charge of \$1.0 million (2013: charge of \$1.5 million) and a deferred tax charge of \$1.3 million (2013: credit of \$34.9 million).

The Group has recognised a deferred tax asset of \$20.4 million at 31 December 2014 (31 December 2013: \$35.1 million). This comprises a deferred tax asset of \$7.9 million (31 December 2013: \$7.8 million) in relation to UK tax losses carried forward, and \$12.5 million (31 December 2013: \$27.3 million) relating to the Group's oil and gas development and producing asset in Ukraine, which is recognised on the tax effect of temporary timing differences between the carrying value of such asset and its tax base, following its impairment in 2013. The reduction in the deferred tax asset in 2014 is primarily due to foreign exchange translation losses caused by the devaluation of the Ukrainian Hryvnia against the US Dollar.

Capital investment of \$4.3 million predominately reflects investment in the Group's oil and gas development and production asset for the period (2013: \$23.5 million). Capital investment was lower in the year as a result of the reduction in the field development programme due to the geopolitical and economic uncertainty in Ukraine.

Cash and cash equivalents held at 31 December 2014 were \$31.8 million (31 December 2013: \$25.1 million). The Group's cash and cash equivalents balance at 22 May 2015 was \$31.9 million, held as to \$18.3 million equivalent in Ukrainian Hryvnia and the balance of \$13.6 million equivalent predominantly in US Dollars and Sterling. The movement since 31 December 2013 principally reflects operational cash generated during the year less capital investment in the Group's oil and gas development and producing asset and foreign exchange loss on the translation of the Ukrainian Hryvnia cash balance.

The Group operates bank accounts in Ukraine with Unex Bank which is indirectly controlled by Mr V Novinskiy, who also controls a majority shareholding in the Group. As a result, Unex Bank is a related party to the Group. The Group currently holds a significant proportion of its Ukrainian Hryvnia cash deposits in Unex Bank, but has started to diversify its banking arrangements between other banks in Ukraine.

## **FINANCE REVIEW** continued **STRATEGIC REPORT**

In the meantime, the Group has been able to obtain additional assurances regarding the security of its cash deposits in Unex Bank, including a representation letter from Unex Bank advising that it continues to fulfil all regulatory requirements of the National Bank of Ukraine, as well as a guarantee and security over another asset from companies within the Smart Holding Group in support of the Group's cash deposits in Unex Bank.

Cash from operations has funded the capital investment during the year, and the Group's current cash position and positive operating cash flow are the sources from which the Group expects to fund the 2015 development programme.

During the preparation of the consolidated financial statements for the year ended 31 December 2014, the Group became aware of matters related to the preparation of the consolidated financial statements for the years ended 31 December 2013 and 31 December 2012 that require restatement. The errors, changes in accounting policies and changes in classification were corrected and treated in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors" by restating comparative amounts. The effect and nature of these restatements are detailed in Note 4 to the consolidated financial statements.

The Group manages its revenue, cash from operations and production volumes as key performance indicators. The achieved results for 2014 were revenue of \$34.6 million, cash from operations of \$19.5 million and daily production volumes of 152,744 m<sup>3</sup>/d of gas, 52 m<sup>3</sup>/d of condensate and 21 m<sup>3</sup>/d of LPG, equating to a combined total oil equivalent of 1,370 boepd (2013: 185,677 m<sup>3</sup>/d of gas and 42 m<sup>3</sup>/d of condensate (1,422 boepd in aggregate) – LPG production commenced at the end of 2013). Aggregate production volumes for the 2014 year were 55,751,626 m<sup>3</sup> of gas, 18,841 m<sup>3</sup> of condensate and 7,687 m<sup>3</sup> of LPG, equating to a combined total oil equivalent of 500,095 boe (2013: 67,771,986 m<sup>3</sup> of gas and 15,303 m<sup>3</sup> of condensate (519,071 boe in aggregate))

The ongoing situation in Ukraine has resulted in a significant devaluation of the Ukrainian Hryvnia against the US Dollar, which is likely to affect the carrying value of the Group's assets in the future.

## OPERATIONAL ENVIRONMENT, PRINCIPAL RISKS AND UNCERTAINTIES STRATEGIC REPORT

The Group has a risk evaluation methodology in place to assist in the review of the risks across all material aspects of its business. This methodology highlights technical, operational, external and fiduciary risks and assesses the level of risk and potential consequences. It is periodically presented to the Audit Committee and the Board for review, to bring to their attention potential concerns and, where possible, propose mitigating actions. Key risks recognised are detailed below:

### Risks relating to Ukraine

The Ukrainian economy is currently characterised by high political and economic risks. As a developing economy, in addition to the impact of local political and economic instability, Ukraine's economy is vulnerable to market downturns and economic slowdowns elsewhere in the world.

Since late 2013, the political situation in Ukraine has experienced significant instability with numerous protests and ongoing political uncertainty that has led to a deterioration of the State's finances, volatility of financial markets and a substantial depreciation of the Ukrainian Hryvnia against major foreign currencies. The ratings of Ukrainian sovereign debt have been downgraded by international rating agencies with negative outlook for the future. During 2014, Ukraine's GDP decreased by 6.8% and annual inflation rose to nearly 25%.

The instability started after the failure of the Ukrainian Government to sign the Association and Free Trade Agreement with the European Union at the end of November 2013. Shortly afterwards, the Ukrainian Government announced a deal with Russia for the purchase of up to \$15 billion of Ukrainian Government bonds, of which \$3 billion was provided in December 2013. This triggered protests against the Government's actions beginning in late 2013 that turned into street violence in January and February 2014. At the end of January 2014, the President of Ukraine accepted the resignation of Ukraine's Prime Minister. Following this, the Russian Government suspended its financial support and relations with Russia started to deteriorate.

An agreement between the President and opposition leaders in late February 2014, in an attempt to resolve the situation, ultimately ended up with the Ukrainian Parliament voting to return to the 2004 Constitution, which provided greater sharing of powers between the Parliament and the President, and the President fleeing the country. On 26 February 2014, the Parliament appointed a new Prime Minister and Government. On 25 May 2014, a new President was elected.

In late February 2014, Russian troops occupied Crimea. On 16 March 2014, an unofficial referendum was held in Crimea on its secession from Ukraine, and Russia signed a treaty

with Crimea to annex the territory to Russia. The Ukrainian Parliament declared Crimea as a territory temporarily occupied by Russia.

In April and May 2014, pro-Russian groups in the Donetsk and Luhansk regions demanded autonomy from Ukraine, which led to armed conflict with Ukrainian Government forces, which became progressively worse.

In September 2014, the Ukrainian Government agreed a ceasefire with the pro-Russian groups, but fighting continued and escalated. On 12 February 2015, a further ceasefire agreement was negotiated, and although there has continued to be sporadic fighting, this ceasefire has largely held.

The Group has no assets in Crimea or the areas of conflict in the east of Ukraine, nor do its operations rely on sales or costs incurred there.

The conflict in the region has put further pressure on relations between Ukraine and Russia, and the escalating political tensions have had an adverse effect on the Ukrainian financial markets, hampering the ability of Ukrainian companies and banks to obtain funding from the international capital and debt markets.

During 2014, the Ukrainian Hryvnia devalued significantly against major world currencies, including against the US Dollar, where it has fallen from UAH8.3/\$1.00 on 1 January 2014 to UAH15.8/\$1.00 on 31 December 2014. As at 22 May 2015, the Ukrainian Hryvnia was trading at UAH20.7/\$1.00. As a result, significant external financing is required to maintain the country's economic stability. The National Bank of Ukraine, among other measures, has imposed severe restrictions on the processing of client payments by banks, on the purchase of foreign currency on the inter-bank market and on the remittance of funds outside Ukraine.

The Ukrainian Government has continued to work with the United States, European Union and International Monetary Fund in order to obtain financing and avoid defaulting on its loans. On 30 April 2014, the International Monetary Fund approved a two-year Stand-By Arrangement for Ukraine, amounting to \$17 billion, to support the Government's economic programme designed to restore macroeconomic stability and enhance the efficiency of mechanisms aimed at sustainable economic growth. In May 2014, the Government signed loan agreements worth a total of \$1.48 billion with the World Bank. In June 2014, the economic component of the Association and Free Trade Agreement with the European Union was signed by the Government. On 11 March 2015, the Stand-By Arrangement was replaced by a new funding package from the International Monetary Fund amounting

## OPERATIONAL ENVIRONMENT, PRINCIPAL RISKS AND UNCERTAINTIES continued STRATEGIC REPORT

to \$17.5 billion over a four year period. The agreement for this new funding package stipulates a number of fiscal and economic reforms, including reforms in the banking and energy sectors.

The final resolution and the effects of the political and economic situation in Ukraine are difficult to predict but they are likely to have further severe effects on the Ukrainian economy.

These events have not materially affected the Group's production operations to date, but the ongoing instability is disrupting the Group's development and operational planning for its assets. Furthermore, the political, fiscal and economic instability has impacted the Group's normal business activities, and increased the risks relating to its business operations, financial status, access to secure banking facilities and maintenance of its Ukrainian production licences.

The Ukrainian Government is keen to develop the country's domestic production of hydrocarbons since Ukraine imports the majority of its gas needs from Russia. While this should put the Group in a well-placed position, as experienced previously, there are significant risks to carrying out business in the country. It is considered that the involvement of Energiees Management Limited, as a major shareholder with extensive experience in Ukraine, has helped to mitigate such risks.

### Going concern risk

The Group is exposed to risks relating to Ukraine as well as production, hydrocarbon price and other risks, as detailed in this Operational Environment, Principal Risks and Uncertainties section. In view of this, the Group prepares monthly cash flow forecasts which take into account the risks facing the business, to assess its ability to meet its obligations as they fall due, taking into account the risks of variances in revenues.

Having reviewed the accounts, budgets and forward plans (including sensitivity analysis), the latest operational results, the risks outlined herein, and having taken into account the Group's cash holdings, the current and recent practice of contracting for drilling services on a fixed-price basis, the absence of long term contractual arrangements relating to drilling, the assessment of well results prior to entering into firm commitments for future drilling operations and the lower committed expenditure in Ukraine, the Directors continue to believe that the Group is able to manage its business risks successfully despite the current uncertain political and economic outlook. The Directors have a reasonable expectation that the Group has adequate resources to

continue in operational existence for the foreseeable future regarded as at least 12 months from the date of signing of the Group's financial statements. Therefore they continue to adopt the going concern basis of accounting in preparing the financial statements.

### Production risks

Producing gas and condensate reservoirs are generally characterised by declining production rates which vary depending upon reservoir characteristics and other factors. Future production of the Group's gas and condensate reserves, and therefore the Group's cash flow and income, are highly dependent on the Group's success in operating existing producing wells, drilling new production wells and efficiently developing and exploiting any reserves, and finding or acquiring additional reserves. The Group may not be able to develop, find or acquire reserves at acceptable costs. The experience gained from drilling undertaken to date highlights such risks as the Group targets the appraisal and production of these hydrocarbons.

### Risks relating to further development and operation of the Group's gas and condensate fields in Ukraine

The planned development and operation of the Group's gas and condensate fields in Ukraine is susceptible to appraisal, development and operational risk. This could include, but is not restricted to, delays in delivery of equipment in Ukraine, failure of key equipment, lower than expected production from wells that are currently producing, or new wells that are brought on-stream, problematic wells and complex geology which is difficult to drill or interpret. The generation of significant operational cash is dependent on the successful delivery and completion of the development and operation of the fields. These risks have been demonstrated by the previous downgrade in the Group's remaining reserves which resulted in the reduction in the value in use, and consequent impairment loss relating to the Group's oil and gas development and producing asset in Ukraine. Furthermore, the optimisation of all of the Group's assets is dependent on maintaining constructive relationships between all business stakeholders.

### Exposure to credit, liquidity and cash flow risk

The Group does not currently have any loans outstanding. Local customers are managed in Ukraine and their financial position, the Group's past experience and other factors are evaluated. Internal financial projections are regularly made based on the latest estimates available, and various scenarios are run to assess the robustness of the liquidity of the Group.

The Group currently holds sufficient cash and cash equivalents for the anticipated short to medium term needs of the business. Whilst much of the future capital requirement is expected to be derived from operational cash generated from production, including from wells yet to be drilled, there is a risk that in the longer term insufficient operational cash is generated, or that additional funding, should the need arise, cannot be secured.

#### **Risks relating to the Ukrainian banking sector**

The upheaval in Ukraine has led to a significant deterioration of Ukraine's finances, volatility in financial markets and a substantial depreciation of the Ukrainian Hryvnia against major foreign currencies. As a result, significant external financing is required to maintain the country's economic stability. The National Bank of Ukraine, amongst other measures, has imposed comprehensive restrictions on the processing of client payments by banks, on the purchase of foreign currency on the inter-bank market and on the remittance of funds outside Ukraine. These measures and the many other economic issues in Ukraine have put great strain on the Ukrainian banking system, with increasing risks in the capital strength, liquidity and creditworthiness of a number of banks, and very high rates in the wholesale and overnight markets. In addition, there have been significant deposit outflows from the banking system and widespread restructuring of bank clients' maturing liabilities.

The new funding package to Ukraine, approved by the International Monetary Fund in March 2015, required significant reforms to the Ukrainian banking sector, which are now being implemented. The reforms are being overseen by the National Bank of Ukraine and involve all banks being inspected and assessed, with particular emphasis on lending to a bank's related parties. The inspections are designed to enable the National Bank to assess the financial strength and liquidity of the banks in Ukraine, and may lead to the National Bank imposing remedial measures, ranging from the imposition of requirements for a bank to bolster its capital strength, requirements for a bank to reduce its exposure to related party lending, the appointment of an administrator to manage the priority of payments by a bank, or in the most extreme cases, the liquidation of a bank.

In light of the deterioration in the banking sector in Ukraine, the Group has started to diversify its banking arrangements between a number of banks in Ukraine. These steps are designed to spread the risks associated with each bank's creditworthiness, but the Ukrainian banking sector remains weakly capitalised and so the risks associated with the banks in Ukraine remain significant.

In addition, the severe banking restrictions referred to above, have meant that the Group is unable to remit funds outside Ukraine, which has resulted in the Group's cash holdings of Ukrainian Hryvnia in Ukraine increasing substantially over the past year.

The Group operates bank accounts in Ukraine with Unex Bank which is indirectly controlled by Mr V Novinskiy, who also controls a majority shareholding in the Group. As a result, Unex Bank is a related party to the Group. The Group currently holds a significant proportion of its Ukrainian Hryvnia cash deposits in Unex Bank, but is taking steps to diversify its banking arrangements between other banks in Ukraine.

In the meantime, the Group has been able to obtain additional assurances regarding the security of its cash deposits in Unex Bank, including a representation letter from Unex Bank advising that it continues to fulfil all regulatory requirements of the National Bank of Ukraine, as well as a guarantee and security from companies within the Smart Holding Group in support of the Group's cash deposits in Unex Bank.

The creditworthiness and potential risks relating to the majority of banks in Ukraine are regularly reviewed by the Group, but the ongoing geopolitical and economic events in Ukraine have significantly weakened the Ukrainian banking sector and so the risks associated with the banks in Ukraine remain significant, including in relation to the banks with which the Group operates bank accounts.

#### **Currency risk**

The Group's main activities are (i) investment into the development of the Group's Ukrainian gas and condensate asset; (ii) the production and sale of gas, condensate and LPG; and (iii) the continued exploration for further hydrocarbon reserves.

The Group receives sales proceeds in Ukrainian Hryvnia, and the majority of the capital expenditure costs for the 2015 investment programme will be incurred in Ukrainian Hryvnia, thus revenue and costs are largely matched. As with all currencies, the value of the Ukrainian Hryvnia is subject to foreign exchange fluctuations, but as the Ukrainian Hryvnia does not benefit from the range of currency hedging instruments which are available in more developed economies, the Group had previously adopted a policy that, where possible, funds not required for use in Ukraine be retained on deposit in the United Kingdom, principally in US Dollars. However, the severe banking restrictions, referred to above, on the purchase of foreign currency and the remittance of funds outside Ukraine have meant that the Group has been unable to follow this policy in recent months, and as a result, the Group's cash holdings of Ukrainian Hryvnia in Ukraine have increased significantly over the past year.

## OPERATIONAL ENVIRONMENT, PRINCIPAL RISKS AND UNCERTAINTIES continued STRATEGIC REPORT

Furthermore, during 2014, the Ukrainian Hryvnia significantly devalued against major world currencies, including against the US Dollar, where it has fallen from UAH8.3/\$1.00 on 1 January 2014 to UAH15.8/\$1.00 on 31 December 2014. As at 22 May 2015, the Ukrainian Hryvnia was trading at UAH20.7/\$1.00. In response, the National Bank of Ukraine, among other measures, has imposed severe restrictions on the processing of client payments by banks, on the purchase of foreign currency on the inter-bank market and on the remittance of funds outside Ukraine. In addition, the recent events in Ukraine, as outlined above in "Risks relating to Ukraine", are likely to continue to impact the valuation of the Ukrainian Hryvnia against major world currencies. Further devaluation of the Ukrainian Hryvnia against the US Dollar will affect the carrying value of the Group's assets.

### Ukraine Production Licences

The Group operates in a region where the right to production can be challenged by State and non-State parties. During 2010, this manifested itself in the form of a Ministry Order instructing the Group to suspend all operations and production from its Ukrainian production licences. Whilst the Ministry Order was resolved in 2011, the environment is such that a challenge may arise at any time in the future in relation to the Group's operations, licence history, compliance with licence commitments and/or local regulations. The Group endeavours to ensure compliance with commitments and regulations via Group procedures and controls or, where this is not immediately feasible for practical or logistical considerations, seeks to enter into dialogue with the relevant Government bodies with a view to agreeing a reasonable time frame for achieving compliance or an alternative, mutually agreeable course of action.

The Group's production licences for the MEX-GOL and SV field currently expire in 2024. However, in the estimation of its reserves, it is assumed that the field development will continue until the end of the field's economic life in 2036, and a consequent assumption is made that licence extensions will be granted in accordance with current Ukrainian legislation. Despite such legislation, it is possible that licence extensions will not be granted, which would affect the achievement of full economic field development and consequently the carrying value of the Group's oil and gas development and producing asset in the future.

### Hydrocarbon price risk

The Group derives its revenue principally from the sale of its Ukrainian gas, condensate and LPG production. These revenues are subject to commodity price volatility and political influence. A prolonged period of low gas, condensate and LPG prices may impact the Group's ability to maintain its long-term investment programme with a consequent effect on growth rate which in turn may impact the share price or any shareholder returns. Lower gas, condensate and LPG prices may not only decrease the Group's revenues per unit, but may also reduce the amount of gas, condensate and LPG which the Group can produce economically, as would increases in costs associated with hydrocarbon production, such as subsoil taxes and royalties.

There continues to be significant uncertainty about the future gas price in Ukraine, which has been exacerbated by the major political events that have taken place in Ukraine during recent months. The industrial gas price has been generally related to the imported price of gas from Russia, but in December 2013, the previous Government of Ukraine negotiated a significant discount to the imported gas price calculated under the longstanding gas supply agreement between Russia and Ukraine, which resulted in a reduction in the industrial gas price during the first quarter of 2014. However, following the change of Government in February 2014, the discount of the imported gas price was cancelled, and with effect from 1 April 2014, the imported gas price reverted to the price calculated under the longstanding gas supply agreement between Russia and Ukraine. Furthermore, there is a continuing dispute between Russia and Ukraine as to the interpretation of the gas pricing calculation under their longstanding gas supply agreement. As a result of the continuing uncertainty regarding the industrial gas price, it should be recognised that the industrial gas price may increase or decline significantly.

In late November 2014, the Ukrainian Government made an Order that certain specified industrial organisations were obliged to purchase their gas requirements for the period from 1 December 2014 to 28 February 2015 from Naftogaz, the State-owned gas supplier, rather than from other gas producers in Ukraine. During this period, the Order significantly impacted the gas supply market in Ukraine, causing disruption to the market and adversely affecting the market gas prices. The Group's gas off-taker was affected by this Order, and consequently the Group had to sell its gas production into the general gas market at the prevailing prices. The prices

achieved were less than those achieved prior to the imposition of the Government Order, and consequently resulted in a negative impact on the Group's results for the 2014 financial year, and will also have a negative impact on the Group's results for the 2015 year. Whilst the Order was not extended beyond 28 February 2015, similar regulations may be imposed in the future.

With effect from 1 April 2015, the Ukrainian Government implemented reforms to the gas market in Ukraine, under which the previously State-subsidised domestic gas price will begin to converge with the industrial gas price. Over time, these reforms are likely to have an effect on the internal gas market in Ukraine.

The overall economics of the Group's key asset (being the net present value of the future cash flows from the Ukrainian project) are far more sensitive to long term gas, condensate and LPG prices than short term price volatility. However, short term volatility does affect liquidity risk, as, in the early stage of the project, income from production revenues is offset by capital investment.

#### **Production based taxes**

At the end of July 2014, the Ukrainian Government approved emergency fiscal measures designed to assist in alleviating the fiscal and economic pressures affecting the economy of Ukraine. These imposed significant increases to the subsoil tax rates payable on gas and condensate production. The measures were imposed for the limited period from 1 August 2014 to 31 December 2014, but due to the continuing fiscal and economic pressures affecting the economy of Ukraine, these measures were extended into 2015 and it seems likely that these measures will continue for the rest of 2015. It is uncertain whether the subsoil tax rates will revert to the levels prior to the temporary increases and the subsoil tax rates may be set at another level. In the event that the subsoil tax rates continue to be substantially higher than the levels prior to the increases, it is likely that the Group's financial results will continue to be negatively impacted in the future.

#### **Industry risks**

The Group's ability to execute its strategy is subject to risks which are generally associated with the oil and gas industry. For example, the Group's ability to pursue and develop its projects and development programmes depends on a number of uncertainties, including the availability of capital, seasonal conditions, regulatory approvals, gas, oil, condensate and LPG prices, development costs and drilling success. As a result of these uncertainties, it is unknown whether potential drilling locations identified on proposed projects will ever be drilled or whether these or any other potential drilling locations will be able to produce gas, oil or condensate. In addition,

drilling activities are subject to many risks, including the risk that commercially productive reservoirs will not be discovered. Drilling for hydrocarbons can be unprofitable, not only due to dry holes, but also as a result of productive wells that do not produce sufficiently to be economic. In addition, drilling and production operations are highly technical and complex activities and may be curtailed, delayed or cancelled as a result of a variety of factors. Furthermore, whilst the Group is committed to maintaining the highest standards of health, safety, environmental and security in its operational activities, hydrocarbon drilling and production operations carry inherent risks, which in the event of an incident may significantly affect the operational, production, financial and/or business activities of the Group.

#### **Financial Markets and Economic Outlook**

The performance of the Group will be influenced by global economic conditions and, in particular, the conditions prevailing in the United Kingdom and Ukraine. The economies in these regions have been subject to volatile pressures during the period, with the global economy having experienced a long period of difficulties, and more particularly the recent events that have occurred in Ukraine. If these events continue, worsen or recur, the Group may be exposed to increased counterparty risk as a result of business failures in Ukraine or elsewhere and will continue to be exposed if counterparties fail or are unable to meet their obligations to the Group. The precise nature of all the risks and uncertainties the Group faces as a result of these risks cannot be predicted and many of these are outside of the Group's control.

#### **Risks relating to key personnel**

The Group has a relatively small team of executives and senior management. Whilst this is sufficient for a group of this nature, there is a dependency risk relating to the loss of key individuals.

#### **Strategic Report Approval**

The Strategic Report incorporates the Principal Developments, the Chairman's Review, the Operations Review, the Finance Review and the Operational Environment, Principal Risks and Uncertainties.

By Order of the Board

**Keith Henry**  
Chairman  
26 May 2015

## BOARD OF DIRECTORS

### **Keith Henry**

#### **Executive Chairman**

Keith Henry was appointed as Non-Executive Chairman in April 2008, and took on the role of Executive Chairman in September 2010. Mr Henry has 40 years experience in the development, financing, design, construction and management of projects in the oil and gas, process and energy industries, during which time he was Chief Executive of National Power plc, a FTSE100 company, Kvaerner Engineering and Construction Limited, and Brown & Root Limited. Mr Henry is currently Chairman of Greenko Group plc, the senior independent Director of Sterling Energy plc, and non-executive Director of KSK Power Ventur plc and HPR Holdings Limited. As a non-executive director within the energy sector, Mr Henry previously served as Chairman of Mediterranean Oil and Gas plc, Chairman of Burren Energy plc, Chairman of Helius Energy plc, Chairman of Petrojarl ASA, Deputy Chairman of Petroleum Geo-Services ASA, senior independent Director of Emerald Energy plc, and Director of First Calgary Petroleum Limited and Enterprise Oil plc. Mr Henry is a Fellow of the Royal Academy of Engineering and a chartered civil engineer with a BSc degree from London University and a MSc from the University of Birmingham.

### **Sergei Glazunov**

#### **Finance Director**

Sergei Glazunov was appointed as Finance Director in November 2014, having previously been a Non-Executive Director since February 2012 as a nominee of Regal's majority shareholder, Energiees Management Limited. He is currently the Investment Director of PJSC Smart-Holding. Prior to joining the Smart Holding Group, Mr Glazunov held positions as Deputy CEO at JSC Concern AVEC & Co and Vice President at JP Morgan Chase and Bank One Investment Management Group. He also has extensive teaching and academic research experience working at Wayne State and Michigan State Universities. Mr Glazunov is a Chartered Financial Analyst and holds a MSc in Mathematics from Kiev State University, a MSc in Statistics from Michigan State University and a MBA from Wayne State University.

### **Dr Alastair Graham**

#### **Non-Executive Director**

Alastair Graham was appointed as Non-Executive Director in January 2010. Dr Graham has over 30 years experience in the oil and gas industry having held a number of senior management roles with BP plc ("BP"), including UK Business Development Manager, Upstream Mergers and Acquisitions Manager, V-P of OAO Sidanco in Russia, leader of BP's Southern North Sea gas production business, V-P of BP Exploration Alaska and, most recently, leader of BP's Russia business unit and its shareholder representative for the TNK-BP joint venture. Since retirement from BP in March 2009, Dr Graham has provided consultant advisory services in the

oil and gas sector. He holds a PhD in Geology from the University of Edinburgh, a MBA from the University of Strathclyde and a MA in Natural Sciences from the University of Cambridge.

### **Adrian Coates**

#### **Non-Executive Director**

Adrian Coates was appointed as Non-Executive Director in July 2008. Mr Coates has many years experience in the investment banking industry, having held senior positions with HSBC Bank plc for 10 years, latterly as Global Sector Head, Resources and Energy Group, Global Banking and Markets Division. He has also held senior roles in UBS, Warrior International and Credit Suisse First Boston, with a specialisation in the natural resources sector. His City experience is extensive and he has advised on many substantial corporate transactions. Mr Coates is currently the senior independent Director of Polyus Gold International Limited. Mr Coates holds a MA(Econ) from Cambridge University and a MSc(MBA) from London Business School.

### **Alexey Pertin**

#### **Non-Executive Director**

Alexey Pertin was appointed as Non-Executive Director in April 2011 and is a nominee of Regal's majority shareholder, Energiees Management Limited. He is currently a Director of Energiees Management Limited, Chairman of the Supervisory Board of PJSC Smart-Holding, Deputy Chairman of the Supervisory Board of Metinvest B.V., and Chairman of the Strategic & Investment Committee of the Supervisory Board of Metinvest B.V.. He also holds Director positions with Adeona Holdings Limited, Lovitia Investments Limited and Smart Holding N.V.. Mr Pertin previously held positions as Strategy and Corporate Development Director and Chief Executive Officer of PJSC Smart-Holding. Prior to joining PJSC Smart-Holding, he held various management positions at JSC Severstal-Group, including the positions of Deputy Chief Executive Officer for Business Development at JSC Severstal-Group and Chief Executive Officer of CJSC Izhora Pipe Plant. Mr Pertin graduated from Cherepovets State University and Saint Petersburg State Technical University with qualifications in financial management, and he also holds a MBA from Newcastle Business School, England.

### **Alexey Timofeyev**

#### **Non-Executive Director**

Alexey Timofeyev was appointed as Non-Executive Director in March 2011 and is a nominee of Regal's majority shareholder, Energiees Management Limited. Mr Timofeyev is currently the Chief Executive Officer of PJSC Smart-Holding. Prior to joining the Smart Holding Group, Mr Timofeyev held positions at SJSC Naftogaz Ukrainy (the Ukrainian state oil and gas company), Concern Geo-Alliance UA and SC Ukrkazvydobuvannya, a subsidiary of SJSC Naftogaz Ukrainy. Mr Timofeyev holds a degree in International Economic Relations.

# CORPORATE GOVERNANCE STATEMENT

Companies on the AIM Market of the London Stock Exchange plc are not required to comply with the UK Corporate Governance Code and due to its size the Company is not in full compliance. The Directors however, support high standards of corporate governance and will progressively adopt best practices in line with the UK Corporate Governance Code, so far as is practicable.

## The Board

The Board of the Company consists of an Executive Chairman, a Finance Director and four Non-Executive Directors. The Finance Director and two of the Non-Executive Directors are nominees of Energie Management Limited, the majority shareholder of the Company. The composition of the Board ensures that no one individual or group dominates the decision making process.

The Board is responsible to the shareholders for setting the direction of the Company through the establishment of strategic objectives and key policies. The Board meets regularly and considers issues of strategic direction, approves major capital expenditure, appoints and monitors senior management and any other matters having a material effect on the Company.

All Directors have access to management, including the Company Secretary, and to such information as is needed to carry out their duties and responsibilities fully and effectively.

Furthermore, all Directors are entitled to seek independent professional advice concerning the affairs of the Company, at its expense. All Directors are subject to election by shareholders at the first opportunity following their appointment. In addition, Directors will retire by rotation and stand for re-election by shareholders at least once every three years in accordance with the Company's Articles of Association.

At the date of this report, no Directors have interests in the ordinary shares of the Company.

## Remuneration Committee

The Remuneration Committee, comprising solely of independent Non-Executive Directors and the Executive Chairman who is considered to be independent for this role, is responsible for establishing and developing the Company's general policy on executive and senior management remuneration and determining specific remuneration packages for Executive Directors.

The Remuneration Committee presently comprises Alastair Graham (Chairman), Keith Henry and Adrian Coates.

## Audit Committee

The Audit Committee, comprising solely of independent Non-Executive Directors and the Executive Chairman who is considered to be independent for this role, meets not less than twice a year and considers the Company's financial reporting (including accounting policies) and internal financial controls.

Meetings are normally attended, by invitation, by the Finance Director and a representative of the auditors.

The Audit Committee presently comprises Adrian Coates (Chairman), Keith Henry and Alastair Graham.

During the year, the Audit Committee commissioned an audit tender process, which resulted in the appointment of PricewaterhouseCoopers LLP as the Company's Auditors.

## Nomination Committee

The Directors do not consider that, given the size of the Board, it is appropriate to have a Nomination Committee. The appropriateness of such a committee, will however be kept under regular review by the Company.

## Internal Control

The Directors are responsible for the Group's system of internal control and reviewing its effectiveness. Any such system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Internal controls and business risks were monitored in the course of 2014 through regular Board meetings.

## Code of Conduct

The Group maintains an Anti-Bribery and Corruption Policy in relation to its compliance with the Bribery Act 2010, which sets out the high ethical standards required of the Group's staff in the course of carrying out the Group's business activities regarding dealing with gifts, hospitality, corruption, fraud, the use of inside information and whistle-blowing.

## Communication with Shareholders

The Board recognises that it is accountable to shareholders for the performance and activities of the Company and the Group.

The annual general meeting of the Company will provide an opportunity for the Directors to present to the shareholders a report on current operations and developments and enable the shareholders to express their views about the Company's business.

The Annual Report and Accounts together with other information about the Group is available on the Group's website at [www.regalpetroleum.com](http://www.regalpetroleum.com).

## DIRECTORS' REPORT

The Directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2014.

### Likely Future Events

The future developments relating to the Group are described in the Strategic Report.

### Proposed Dividend

The Directors do not recommend the payment of a dividend (2013: \$nil).

### Capital Structure

Details of the issued share capital, together with details of the movements in the Company's issued share capital during the year are shown in Note 22. The Company has one class of ordinary shares which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association of the Company and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles of Association, the Companies Act 2006 and related legislation. The Articles of Association themselves may be amended by special resolution of the shareholders. The powers of Directors are described in the Main Board Terms of Reference, copies of which are available on request, and the Corporate Governance Statement.

### Directors and Directors' Interests

The Directors who held office during the year and subsequently were as follows:

Keith Henry  
Adrian Coates  
Alastair Graham  
Alexey Timofeyev  
Alexey Pertin  
Sergei Glazunov

None of the Directors who held office at the end of the financial year had any disclosable interest in the shares of the Company or any other Group companies.

According to the register of Directors' interests, no rights to subscribe for shares in or debentures of Group companies were granted to any of the Directors or their immediate families, or exercised by them, during the financial year.

### Directors' Indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its Directors which were made during the year and remain in force at the date of this report.

### Political Contributions

During the year the Group did not make any political contributions (2013: \$nil).

### Post Balance Sheet Events

Details of significant events since the Balance Sheet date are contained in Note 29.

### Substantial Shareholders

At 22 May 2015, the Company had been notified of the following interests of 3% or more in its issued share capital:

| Substantial Shareholder       | Number of shares | % of issued ordinary share capital |
|-------------------------------|------------------|------------------------------------|
| Energiees Management Limited* | 173,128,587      | 54.00%                             |
| CTF Holdings Limited          | 78,337,879       | 24.43%                             |
| Pope Asset Management         | 25,658,991       | 8.00%                              |

\* Energiees Management Limited is 100% owned by Pelidona Services Limited, which is 100% owned by Lovitia Investments Ltd, which is 100% owned by Mr V Novinskiy.

### Directors' Responsibilities Statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Parent Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;

- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

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

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the persons who is a Director at the date of approval of this report confirms that, to the best of their knowledge:

- the financial statements, prepared in accordance with IFRSs, as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

### Statement of Disclosure to Auditors

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all steps required to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

### Independent Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors will be proposed at the next annual general meeting.

On behalf of the Board

**Keith Henry**  
Chairman  
26 May 2015

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF REGAL PETROLEUM PLC

### Report on the financial statements

#### Our opinion

In our opinion:

- Regal Petroleum plc's Group financial statements and Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2014 and of the Group's profit and the Group's and the Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

#### Emphasis of matter

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in Note 1 to the financial statements concerning the operations of the Group, and those of other entities in Ukraine, having been affected and may continue to be affected for the foreseeable future by the continuing political and economic uncertainties in Ukraine. Our opinion is not modified in respect of this matter.

#### What we have audited

Regal Petroleum plc's financial statements comprise:

- the Consolidated and the Company Balance Sheets as at 31 December 2014;
- the Consolidated Income Statement and the Consolidated and the Company Statements of Comprehensive Income for the year then ended;
- the Consolidated and the Company Statements of Changes in Equity for the year then ended;
- the Consolidated and the Company Cash Flow Statements for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report and Accounts, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

#### Opinion on other matter prescribed by the Companies Act 2006

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

#### Other matters on which we are required to report by exception

##### Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

#### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the Directors

As explained more fully in the Directors' Responsibilities Statement set out on pages 16 and 17, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Alison Baker** (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
26 May 2015

**CONSOLIDATED INCOME STATEMENT**

for the year ended 31 December 2014

|                                                                      | Note | 2014<br>\$000 | *Restated<br>2013<br>\$000 |
|----------------------------------------------------------------------|------|---------------|----------------------------|
| Revenue                                                              | 5    | 34,572        | 36,737                     |
| Cost of sales                                                        | 6    | (22,707)      | (33,664)                   |
| <b>Gross profit</b>                                                  |      | <b>11,865</b> | 3,073                      |
| Administrative expenses                                              | 7    | (5,513)       | (7,291)                    |
| Other operating expenses: impairment of property plant and equipment | 14   | —             | (159,199)                  |
| <b>Operating profit/(loss)</b>                                       |      | <b>6,352</b>  | (163,417)                  |
| Interest income                                                      |      | 2,010         | 861                        |
| Finance costs                                                        | 10   | (48)          | (633)                      |
| Other gains and losses                                               |      | (226)         | 269                        |
| <b>Profit/(loss) on ordinary activities before taxation</b>          |      | <b>8,088</b>  | (162,920)                  |
| Income tax (expense)/income                                          | 11   | (2,333)       | 34,892                     |
| <b>Profit/(loss) for the year</b>                                    |      | <b>5,755</b>  | (128,028)                  |
| <b>Earnings/(loss) per ordinary share (cents)</b>                    |      |               |                            |
| Basic and diluted                                                    | 13   | 1.8c          | (39.9)c                    |

\* As restated. See Note 4.

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2014

|                                                                | 2014            | *Restated<br>2013 |
|----------------------------------------------------------------|-----------------|-------------------|
|                                                                | \$000           | \$000             |
| Profit/(loss) for the year                                     | 5,755           | (128,028)         |
| Items that may be subsequently reclassified to profit or loss: |                 |                   |
| Equity – foreign currency translation                          | (62,451)        | (7,985)           |
| Total other comprehensive expense                              | (62,451)        | (7,985)           |
| <b>Total comprehensive expense for the year</b>                | <b>(56,696)</b> | <b>(136,013)</b>  |

\* As restated. See Note 4.

FINANCIALS

# COMPANY STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2014

|                                                 | 2014           | 2013             |
|-------------------------------------------------|----------------|------------------|
|                                                 | \$000          | \$000            |
| Loss for the year                               | (5,766)        | (174,948)        |
| <b>Total comprehensive expense for the year</b> | <b>(5,766)</b> | <b>(174,948)</b> |

**CONSOLIDATED BALANCE SHEET**

at 31 December 2014

|                                | Note | 2014<br>\$000  | *Restated<br>2013<br>\$000 | *Restated<br>2012<br>\$000 |
|--------------------------------|------|----------------|----------------------------|----------------------------|
| <b>Assets</b>                  |      |                |                            |                            |
| <b>Non-current assets</b>      |      |                |                            |                            |
| Intangible assets              |      | 48             | 144                        | 65                         |
| Property, plant and equipment  | 14   | 35,267         | 73,699                     | 235,898                    |
| Trade and other receivables    | 17   | 1,309          | 5,953                      | 7,014                      |
| Corporation tax receivable     |      | 305            | —                          | —                          |
| Deferred tax asset             | 21   | 20,413         | 35,094                     | 3,169                      |
|                                |      | <b>57,342</b>  | 114,890                    | 246,146                    |
| <b>Current assets</b>          |      |                |                            |                            |
| Inventories                    | 16   | 2,099          | 3,872                      | 7,620                      |
| Trade and other receivables    | 17   | 3,436          | 8,785                      | 17,161                     |
| Corporation tax receivable     |      | —              | 768                        | 374                        |
| Cash and cash equivalents      | 18   | 31,836         | 25,084                     | 28,453                     |
|                                |      | <b>37,371</b>  | 38,509                     | 53,608                     |
| <b>Total assets</b>            |      | <b>94,713</b>  | 153,399                    | 299,754                    |
| <b>Liabilities</b>             |      |                |                            |                            |
| <b>Current liabilities</b>     |      |                |                            |                            |
| Trade and other payables       | 19   | (1,929)        | (3,484)                    | (3,805)                    |
|                                |      | <b>(1,929)</b> | (3,484)                    | (3,805)                    |
| <b>Net current assets</b>      |      | <b>35,442</b>  | 35,025                     | 49,803                     |
| <b>Non-current liabilities</b> |      |                |                            |                            |
| Provision for decommissioning  | 20   | (255)          | (810)                      | (6,776)                    |
| Defined benefit liability      |      | (120)          | —                          | —                          |
| Deferred tax liability         |      | —              | —                          | (4,055)                    |
|                                |      | <b>(375)</b>   | (810)                      | (10,831)                   |
| <b>Total liabilities</b>       |      | <b>(2,304)</b> | (4,294)                    | (14,636)                   |
| <b>Net assets</b>              |      | <b>92,409</b>  | 149,105                    | 285,118                    |
| <b>Equity</b>                  |      |                |                            |                            |
| Called up share capital        | 22   | 28,115         | 28,115                     | 28,115                     |
| Share premium account          |      | 555,090        | 555,090                    | 555,090                    |
| Foreign exchange reserve       |      | (69,017)       | (6,566)                    | 1,419                      |
| Other reserves                 | 23   | 4,273          | 4,273                      | 4,273                      |
| Accumulated losses             |      | (426,052)      | (431,807)                  | (303,779)                  |
| <b>Total equity</b>            |      | <b>92,409</b>  | 149,105                    | 285,118                    |

\* As restated. See Note 4.

The financial statements of Regal Petroleum plc, company number 4462555, on pages 20 to 60 were approved by the Board of Directors on 26 May 2015 and signed on its behalf by:

**Keith Henry**  
Director

*Keith Henry*  
KEITH N. HENRY

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

at 31 December 2014

|                             | Called up<br>share capital<br>\$000 | Share<br>premium<br>account<br>\$000 | Merger<br>reserve<br>\$000 | Capital<br>contributions<br>\$000 | * Restated<br>Foreign<br>exchange<br>reserve†<br>\$000 | * Restated<br>Accumulated<br>losses<br>\$000 | Total equity<br>\$000 |
|-----------------------------|-------------------------------------|--------------------------------------|----------------------------|-----------------------------------|--------------------------------------------------------|----------------------------------------------|-----------------------|
| As at 1 January 2013        | 28,115                              | 555,090                              | (3,204)                    | 7,477                             | 1,419                                                  | (303,779)                                    | 285,118               |
| Loss for the year           | —                                   | —                                    | —                          | —                                 | —                                                      | (128,028)                                    | (128,028)             |
| Other comprehensive expense |                                     |                                      |                            |                                   |                                                        |                                              |                       |
| – exchange differences      | —                                   | —                                    | —                          | —                                 | (7,985)                                                | —                                            | (7,985)               |
| Total comprehensive expense | —                                   | —                                    | —                          | —                                 | (7,985)                                                | (128,028)                                    | (136,013)             |
| As at 31 December 2013      | 28,115                              | 555,090                              | (3,204)                    | 7,477                             | (6,566)                                                | (431,807)                                    | 149,105               |

|                               | Called<br>up share<br>capital<br>\$000 | Share<br>premium<br>account<br>\$000 | Merger<br>reserve<br>\$000 | Capital<br>contributions<br>\$000 | Foreign<br>exchange<br>reserve†<br>\$000 | Accumulated<br>losses<br>\$000 | Total<br>equity<br>\$000 |
|-------------------------------|----------------------------------------|--------------------------------------|----------------------------|-----------------------------------|------------------------------------------|--------------------------------|--------------------------|
| As at 1 January 2014          | 28,115                                 | 555,090                              | (3,204)                    | 7,477                             | (6,566)                                  | (431,807)                      | 149,105                  |
| Profit for the year           | —                                      | —                                    | —                          | —                                 | —                                        | 5,755                          | 5,755                    |
| Other comprehensive expense   |                                        |                                      |                            |                                   |                                          |                                |                          |
| – exchange differences        | —                                      | —                                    | —                          | —                                 | (62,451)                                 | —                              | (62,451)                 |
| Total comprehensive expense   | —                                      | —                                    | —                          | —                                 | (62,451)                                 | 5,755                          | (56,696)                 |
| <b>As at 31 December 2014</b> | <b>28,115</b>                          | <b>555,090</b>                       | <b>(3,204)</b>             | <b>7,477</b>                      | <b>(69,017)</b>                          | <b>(426,052)</b>               | <b>92,409</b>            |

\* As restated. See Note 4.

† Predominantly as a result of exchange differences on intra-group loans and other retranslations, where the subsidiaries' functional currency is not the US Dollar.

FINANCIALS

**CONSOLIDATED CASH FLOW STATEMENT**

for the year ended 31 December 2014

|                                                             | Note | 2014<br>\$000  | *Restated<br>2013<br>\$000 |
|-------------------------------------------------------------|------|----------------|----------------------------|
| <b>Operating activities</b>                                 |      |                |                            |
| Cash from operations                                        | 25   | 19,562         | 21,934                     |
| Taxation paid                                               |      | (849)          | (1,921)                    |
| Interest received                                           |      | 1,979          | 861                        |
| <b>Net cash from operating activities</b>                   |      | <b>20,692</b>  | <b>20,874</b>              |
| <b>Investing activities</b>                                 |      |                |                            |
| Purchase of property, plant and equipment                   |      | (5,485)        | (24,700)                   |
| Purchase of intangible assets                               |      | (3)            | (103)                      |
| Proceeds from sale of property, plant and equipment         |      | 22             | 891                        |
| <b>Net cash used in investing activities</b>                |      | <b>(5,466)</b> | <b>(23,912)</b>            |
| <b>Net increase/(decrease) in cash and cash equivalents</b> |      | <b>15,226</b>  | <b>(3,038)</b>             |
| <b>Cash and cash equivalents at beginning of year</b>       |      | <b>25,084</b>  | <b>28,453</b>              |
| Effect of foreign exchange rate changes                     |      | (8,474)        | (331)                      |
| <b>Cash and cash equivalents at end of year</b>             | 18   | <b>31,836</b>  | <b>25,084</b>              |

\* As restated. See Note 4.

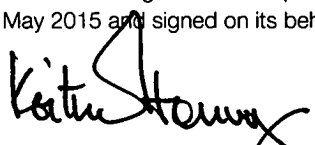
# COMPANY BALANCE SHEET

at 31 December 2014

|                                  | Note | 2014<br>\$000  | 2013<br>\$000 |
|----------------------------------|------|----------------|---------------|
| <b>Assets</b>                    |      |                |               |
| <b>Non-current assets</b>        |      |                |               |
| Property, plant and equipment    | 14   | —              | 15            |
| Investments                      | 15   | 17,279         | 17,279        |
| Loans to subsidiary undertakings | 15   | 67,598         | 70,707        |
| Deferred tax                     | 21   | 7,861          | 7,807         |
|                                  |      | <b>92,738</b>  | 95,808        |
| <b>Current assets</b>            |      |                |               |
| Trade and other receivables      | 17   | 414            | 257           |
| Cash and cash equivalents        | 18   | 14,061         | 16,892        |
|                                  |      | <b>14,475</b>  | 17,149        |
| <b>Total assets</b>              |      | <b>107,213</b> | 112,957       |
| <b>Liabilities</b>               |      |                |               |
| <b>Current liabilities</b>       |      |                |               |
| Trade and other payables         | 19   | (260)          | (238)         |
|                                  |      | <b>(260)</b>   | (238)         |
| <b>Net current assets</b>        |      | <b>14,215</b>  | 16,911        |
| <b>Total liabilities</b>         |      | <b>(260)</b>   | (238)         |
| <b>Net assets</b>                |      | <b>106,953</b> | 112,719       |
| <b>Equity</b>                    |      |                |               |
| Called up share capital          | 23   | 28,115         | 28,115        |
| Share premium account            |      | 555,090        | 555,090       |
| Accumulated losses               |      | (476,252)      | (470,486)     |
| <b>Total equity</b>              |      | <b>106,953</b> | 112,719       |

The financial statements of Regal Petroleum plc, company number 4462555, on pages 20 to 60 were approved by the Board of Directors on 26 May 2015 and signed on its behalf by:

Keith Henry  
Director

  
KEITH N. HENRY

**COMPANY STATEMENT OF CHANGES IN EQUITY**

at 31 December 2014

|                        | Share<br>capital<br>\$000 | Share<br>premium<br>account<br>\$000 | Accumulated<br>losses<br>\$000 | Total equity<br>\$000 |
|------------------------|---------------------------|--------------------------------------|--------------------------------|-----------------------|
| As at 1 January 2013   | 28,115                    | 555,090                              | (295,538)                      | 287,667               |
| Loss for the year      | —                         | —                                    | (174,948)*                     | (174,948)             |
| As at 31 December 2013 | 28,115                    | 555,090                              | (470,486)                      | 112,719               |

\* See Note 15, which shows the results for the year 2013 were principally affected by the provision against subsidiary loans.

|                               | Share<br>capital<br>\$000 | Share<br>premium<br>account<br>\$000 | Accumulated<br>losses<br>\$000 | Total<br>equity<br>\$000 |
|-------------------------------|---------------------------|--------------------------------------|--------------------------------|--------------------------|
| As at 1 January 2014          | 28,115                    | 555,090                              | (470,486)                      | 112,719                  |
| Loss for the year             | —                         | —                                    | (5,766)                        | (5,766)                  |
| <b>As at 31 December 2014</b> | <b>28,115</b>             | <b>555,090</b>                       | <b>(476,252)</b>               | <b>106,953</b>           |

# COMPANY CASH FLOW STATEMENT

for the year ended 31 December 2014

|                                                               | Note | 2014<br>\$000  | 2013<br>\$000  |
|---------------------------------------------------------------|------|----------------|----------------|
| <b>Operating activities</b>                                   |      |                |                |
| Cash used in operations                                       | 25   | (3,107)        | (1,534)        |
| Interest received                                             |      | 460            | 49             |
| <b>Net cash used in operating activities</b>                  |      | <b>(2,647)</b> | <b>(1,485)</b> |
| <b>Investing activities</b>                                   |      |                |                |
| Purchase of property, plant and equipment                     |      | —              | (4)            |
| Investment in Group companies                                 | 15   | —              | (2,763)        |
| Repayment of loans from Group companies                       | 15   | 91             | —              |
| <b>Net cash generated from/(used in) investing activities</b> |      | <b>91</b>      | <b>(2,767)</b> |
| <b>Net decrease in cash and cash equivalents</b>              |      | <b>(2,556)</b> | <b>(4,252)</b> |
| <b>Cash and cash equivalents at beginning of year</b>         |      | <b>16,892</b>  | <b>20,999</b>  |
| Effect of foreign exchange rate changes                       |      | (275)          | 145            |
| <b>Cash and cash equivalents at end of year</b>               | 18   | <b>14,061</b>  | <b>16,892</b>  |

FINANCIALS

## NOTES

forming part of the financial statements

### 1. Operating Environment

Regal Petroleum plc (the "Company") and its subsidiaries (the "Group") is a gas, condensate and LPG production group.

Regal Petroleum plc is a company quoted on the AIM Market of the London Stock Exchange plc and incorporated in England and Wales under the Companies Act 2006. The Company's registered office is at 16 Old Queen Street, London SW1H 9HP and its registered number is 4462555. The principal activities of the Group and the nature of the Group's operations are set out in the Directors' Report.

As of 31 December 2014 and 2013 the Company's immediate parent company was Energiees Management Limited, which is 100% owned by Pelidona Services Limited, which is 100% owned by Lovitia Investments Ltd, which is 100% owned by Mr V Novinskiy. Accordingly, the Company was ultimately controlled by Mr V Novinskiy.

The Group's gas and condensate extraction facilities are located in Ukraine. The major events that have taken place in Ukraine during the year, including the change of the Government and civil unrest, have meant that there has been, and continues to be, a great deal of uncertainty about the political and economic outlook in Ukraine. Further details of these risks relating to Ukraine, can be found within the Operational Environment, Principal Risks and Uncertainties section of the Strategic Report.

For the reasons outlined in the Operational Environment, Principal Risks and Uncertainties section of the Strategic Report, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future regarded as at least 12 months after the date of signing of the Financial Statements. Accordingly, the going concern basis has been adopted in preparing its consolidated financial statements for the year ended 31 December 2014. The use of this basis of accounting takes into consideration the Company's and the Group's current and forecast financing position, additional details of which are provided in the "Going concern risk" section of the Strategic Report.

### 2. 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.

#### Basis of Preparation

The Group has prepared its consolidated financial statements ("the financial statements") under International Financial Reporting Standards ("IFRSs"), as adopted by the European Union. The financial statements are prepared on the historical cost basis as modified by the initial recognition of financial instruments based on fair value.

#### Adoption of New Standards and Interpretations

In the current year, the following new and revised Standards and Interpretations have been adopted. Their application has not had any significant impact on the amounts reported or the disclosures in these financial statements.

- IFRS 10, Consolidated Financial Statements. Under IFRS 10, subsidiaries are all entities (including structured entities) over which the group has control. The group controls an entity when the group has power over that entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity.
- IFRS 11, Joint Arrangements. Under IFRS 11, investments in joint arrangements are classified either as joint operations or joint ventures, depending on the contractual rights and obligations each investor has rather than the legal structure of the joint arrangement.
- IFRS 12, Disclosure of Interests in Other Entities, which requires new disclosures by entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.
- IAS 32, Offsetting Financial Assets and Financial Liabilities, the amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.

## 2. Accounting Policies continued

### New standards, amendments and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

- IFRS 9, Financial instruments, addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income ("OCI") and fair value through profit and loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted subject to EU endorsement. The Group is yet to assess IFRS 9's full impact.
- IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 and earlier application is permitted subject to EU endorsement. The Group is assessing the impact of IFRS 15.

The Directors do not expect that the adoption of the Standards and Interpretations listed above will have a material impact on the financial statements of the Group.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

### Basis of Consolidation

The consolidated financial statements incorporate the financial information of the Company and entities controlled by the Company (and its subsidiaries) made up to 31 December each year. Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group 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. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

### Subsidiaries

The acquisition of subsidiaries is accounted for using the acquisition method. On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill, and any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the Income Statement in the period of acquisition. The results of subsidiaries acquired or disposed of during the year are included in the consolidated Income Statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. All intra-group transactions, balances, income and expenses are eliminated on consolidation. Unrealised losses are also eliminated. When necessary, amounts reported by subsidiaries have been adjusted to conform with the Group's accounting policies.

## NOTES

forming part of the financial statements continued

### 2. Accounting Policies continued

#### Segment reporting

The Group's only class of business activity is oil and gas exploration, development and production. The Group's primary operations are located in Ukraine, with its head office in the United Kingdom. The geographical segments are the basis on which the Group reports its segment information to management. Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors.

#### Commercial Reserves

Proved and probable oil and gas reserves are estimated quantities of commercially producible hydrocarbons which the existing geological, geophysical and engineering data show to be recoverable in future years from known reservoirs. The proved and probable reserves conform to the definition approved by the Petroleum Resources Management System.

#### Oil and Gas Development and Producing Assets

The Group applies the successful efforts method of accounting for oil and gas assets, having regard to the requirements of IFRS 6 "Exploration for and Evaluation of Mineral Resources".

All licence acquisition, exploration and evaluation costs are initially capitalised as intangible assets in cost centres by field or by exploration area, as appropriate, pending determination of commerciality of the relevant property. Directly attributable administration costs are capitalised insofar as they relate to specific exploration activities, as are finance costs to the extent they are directly attributable to financing development projects. Pre-licence costs and general exploration costs not specific to any particular licence or prospect are expensed as incurred.

If prospects are deemed to be impaired ('unsuccessful') on completion of the evaluation, the associated costs are charged to the Income Statement. If the field is determined to be commercially viable, the attributable costs are transferred to development/producing assets within property, plant and equipment in single field cost centres.

Subsequent expenditure is capitalised only where it either enhances the economic benefits of the development/producing asset or replaces part of the existing development/producing asset.

Net proceeds from any disposal of an exploration asset are initially credited against the previously capitalised costs. Any surplus proceeds are credited to the Income Statement. Net proceeds from any disposal of development/producing assets are credited against the previously capitalised cost. Gains and losses on disposals of development/producing assets are determined by comparing proceeds from sale with the appropriate portion of the net capitalised costs of the asset and are recognised in the Income Statement for the year.

#### Depreciation, Depletion and Amortisation

All expenditure carried within each field is amortised from the commencement of commercial production on a unit of production basis, which is the ratio of gas production in the period to the estimated quantities of commercial reserves at the end of the period plus the production in the period, generally on a field by field basis. In certain circumstances, fields within a single development area may be combined for depletion purposes. Costs used in the unit of production calculation comprise the net book value of capitalised costs plus the estimated future field development costs necessary to bring the reserves into production.

#### Impairment

At each balance sheet date, the Group reviews the carrying amount of development and producing assets to determine whether there is any indication that those assets have suffered an impairment loss. This includes exploration and appraisal costs capitalised which are assessed for impairment in accordance with IFRS 6. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

For development/producing assets, the recoverable amount is the greater of fair value less costs to dispose and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an expected weighted average cost of capital. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

## 2. Accounting Policies continued

Should an impairment loss subsequently reverse, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

### Decommissioning Provision

Where a material liability for the removal of existing production facilities and site restoration at the end of the productive life of a field exists, a provision for decommissioning is recognised. The amount recognised is the present value of estimated future expenditure determined in accordance with local conditions and requirements. The cost of the relevant property, plant and equipment is increased with an amount equivalent to the provision and depreciated on a unit of production basis. Changes in estimates are recognised prospectively, with corresponding adjustments to the provision and the associated fixed asset. The unwinding of the discount on the decommissioning provision is included within finance costs.

### Property, Plant and Equipment other than Oil and Gas Assets

Property, plant and equipment other than oil and gas assets are stated at cost less accumulated depreciation and any provision for impairment. Depreciation is charged so as to write off the cost of assets on a straight-line basis over their useful lives as follows:

|                             | Useful lives in years |
|-----------------------------|-----------------------|
| Buildings and constructions | 10 to 20 years        |
| Machinery and equipment     | 2 to 5 years          |
| Vehicles                    | 5 years               |
| Office and other equipment  | 4 to 12 years         |

Inventory purchased with the intention to be used in future capital investment projects is recognised as development and production assets within the property, plant and equipment.

### Inventories

Inventories typically consist of materials, spare parts and hydrocarbons, and are stated at the lower cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

### Revenue Recognition

Revenue from sale of goods represents amounts invoiced in respect of sales of gas, condensate and LPG exclusive of indirect taxes and excise duties and is recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped. To the extent that revenue arises from test production during an evaluation programme, an amount is charged from intangible exploration assets to cost of sales so as to reflect a zero net margin.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

### Foreign Currencies

The Group's consolidated financial statements and those of the Company are presented in US Dollars. The functional currency of the subsidiaries which operate in Ukraine is Ukrainian Hryvnia. The remaining entities have US Dollars as their functional currency.

## NOTES

forming part of the financial statements continued

### 2. Accounting Policies continued

The functional currency of individual companies is determined by the primary economic environment in which the entity operates, normally the one in which it primarily generates and expends cash. In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency ("foreign currencies") are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. 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. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items which are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses arising on retranslation are included in net profit or loss for the period, except for exchange differences arising on balances which are considered long term investments where the changes in fair value are recognised directly in equity.

On consolidation, the assets and liabilities of the Group's subsidiaries which do not use US Dollars as their functional currency are translated into US Dollars as follows:

- (a) assets and liabilities for each Balance Sheet presented are translated at the closing rate at the date of that Balance Sheet;
- (b) income and expenses for each Income Statement are translated at average monthly 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
- (c) all resulting exchange differences are recognised in Other Comprehensive Income.

The principal rates of exchange used for translating foreign currency balances at 31 December 2014 were \$1:UAH15.8 (2013: \$1:UAH8.3), \$1:£0.6 (2013: \$1:£0.6), \$1:€0.8 (2013: \$1:€0.6).

#### Pensions

The Group contributes to a local government pension scheme within Ukraine and defined benefit plans. The Group has no further payment obligations towards the local government pension scheme once the contributions have been paid.

Defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The Group companies participate in a mandatory State defined retirement benefit plan, which provides for early pension benefits for employees working in certain workplaces with hazardous and unhealthy working conditions. The Group also provides lump sum benefits upon retirement subject to certain conditions. The early pension benefit (in the form of a monthly annuity) is payable by employers only until the employee has reached the statutory retirement age (62 – for males, 60 – for females). The pension scheme is based on a benefit formula which depends on each individual member's average salary, his/her total length of past service and total length of past service at specific types of workplaces ("list II" category). The employer is responsible for 100% for "list II" categories of early pensioners. The amount of attributed pension payments depends on the employees' respective lengths of service at the Group in specific types of positions/workplaces during the last 12.5/10 years – for males and females respectively.

The liability recognised in the Balance Sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. Since Ukraine has no deep market in such bonds, the market rates on government bonds are used.

## 2. Accounting Policies continued

The current service cost of the defined benefit plan, recognised in the Income Statement in employee benefit expense, except where included in the cost of an asset, reflects the increase in the defined benefit obligation resulting from employee service in the current year, benefit changes curtailments and settlements. Past-service costs are recognised immediately in income.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is included in employee benefit expense in the Income Statement.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

### Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable/receivable under operating leases are charged/credited to the Income Statement on a straight-line basis over the term of the relevant lease. Benefits received or given as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

### Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax, including UK corporation and overseas tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates which are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Income Statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Other taxes which include recoverable value added tax, sales tax and custom duties represent the amounts receivable or payable to local tax authorities in the countries where the Group operates.

### Financial Instruments

Financial assets and financial liabilities are recognised on the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument.

The Group classifies its financial assets as loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The Group does not currently utilise derivative financial instruments.

## NOTES

forming part of the financial statements continued

### 2. Accounting Policies continued

#### Trade Receivables

Trade receivables are amounts due from customers for goods sold in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

For the financial assets carried at amortised cost the evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the consolidated Income Statement.

#### Investments

Investments in subsidiaries are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

#### Trade Payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

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

#### Borrowings and Loan Notes

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the Income Statement over the period of the borrowings using the effective interest method. Direct transaction costs are accounted for on an amortised cost basis in profit and loss using the effective interest method and are added/deducted to/from the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

#### Equity Instruments

Ordinary shares are classified as equity. Equity instruments issued by the Company and the Group are recorded at the proceeds received, net of direct issue costs. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

## 2. Accounting Policies continued

### Finance Costs and Debt

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Finance costs of debt are allocated to periods over the term of the related debt at the effective interest rate on the carrying amount. Directly attributable transaction costs are deducted from the debt proceeds on initial recognition of the liability and are amortised and charged to the Income Statement as finance costs over the term of the debt.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

### Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and deposits held at call with banks and other short-term highly liquid investments which are readily convertible to a known amount of cash with no significant loss of interest.

## 3. Critical Accounting Estimates and Assumptions

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 which have a risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

### (a) Recoverability of Development and Production Assets in Ukraine

According to the Group's accounting policies, costs capitalised as assets are assessed for impairment at each balance sheet date. In assessing whether an impairment loss has occurred, the carrying value of the asset is compared to its recoverable amount, which IAS 36 Impairment of Assets defines as the higher of fair value less costs of disposal and value in use. Management does not believe it possible to measure fair value reliably, due to both the absence of an active market in which to sell the asset and the current political and economic climate in Ukraine. Therefore, as in previous years, management has used value in use, using a discounted cash flow model to measure its recoverable amount. The cash flows in the model are projected in real terms, i.e. they do not take into account the impact on cash flows of the estimated inflation during the period of projection. The discount rate is adjusted accordingly and represents a real terms discount rate.

The valuation method used for determination of recoverable value in use is based on unobservable market data, which is within Level 3 of the fair value hierarchy.

The estimate of value in use requires judgment in the following areas:

- (i) *Sales price* – As outlined in the Finance Review and Operational Environment, Principal Risks and Uncertainties sections of the Strategic Report, the Ukraine gas price was significantly lower during the first quarter of 2014 but increased substantially in subsequent quarters. Nevertheless, there continues to be a level of uncertainty in forecasting the Ukraine gas price due to the current political and economic climate in Ukraine. The estimate used in the calculation is based on International Monetary Fund ("IMF") imported gas price forecasts for Ukraine.
- (ii) *Reserves* – Management's estimate of reserves is based on a third party reserves report which relies on a combination of technical and operational data and independent reservoir interpretations.
- (iii) *Production levels* – Management's estimate of production levels is derived from the field development plan, which in turn is related to the estimate of recoverable reserves.
- (iv) *Capital expenditures* – Management's estimate of capital expenditures is based on the assessments of internal technical experts and market data about prices for projected types and volumes of expenditures. The prices are obtained from tender offers as well as different public sources. The part of capital expenditures which is pegged to the US Dollar is recalculated using the expected USD/UAH exchange rates based on the forecasts of independent external financial institutions. A capital expenditure allowance of \$500,000 per year is assumed for maintenance of development and production assets.

## NOTES

forming part of the financial statements continued

### 3. Critical Accounting Estimates and Assumptions continued

- (v) *Discount rate* – Management applies an expected weighted average cost of capital as a discount rate, which reflects both the time value of money and its assessment of the risk associated with development and producing oil and gas assets in Ukraine. Due to the recent events in Ukraine, there is an increased level of risk associated with operating in Ukraine, and consequently a higher discount rate has been applied. For 2015 and 2016 the discount rate applied was 21% and 16% respectively. From 2017 to 2024 the discount rate gradually decreases from 14% (2017) to 12% (2024 onwards) based on the projected correlation of the country risk premium for investment in Ukraine and the Ukrainian country default swap curve. The discount rates represent a real weighted average cost of capital, i.e. they do not take into account the impact of the estimated inflation during the period of projection.
- (vi) *Life of field* – Management's estimate of recoverable amount is based on recovering reserves beyond the validity of its current production licences. Management believes that the current licences, which are due to expire in July 2024 will be extended under applicable legislation in Ukraine until the end of the economic life of the field, which is assessed to be June 2036. No application for such an extension has been made at the date of this report, however management considers the assumption to be reasonable based on its intention to seek such an extension in due course and that the Group is legally entitled to request an extension.

The impairment assessment carried out at 31 December 2014 has not resulted in an impairment loss.

Further details of this assessment, including the sensitivity to the above assumptions, are set out in Note 14.

#### (b) Decommissioning

The Group has decommissioning obligations in respect of its Ukrainian asset. The full extent to which the provision is required depends on the legal requirements at the time of decommissioning, the costs and timing of any decommissioning works and the discount rate applied to such costs.

Starting from 2013 a detailed assessment of gross decommissioning cost was undertaken on a well-by-well basis using local data on day rates and equipment costs. The discount rate applied on the decommissioning cost provision at 31 December 2014 was 14.20% (31 December 2013: 7.88% as restated, see Note 4). The discount rate is calculated based on the yield to maturity of Ukrainian Government bonds denominated in the currency in which the liability is expected to be settled and with the settlement date that approximates the timing of settlement of decommissioning obligations.

The change in estimate during 2014 reflects a combination of a revision in the estimated costs (reduction of \$120,601) and the discount rate applied (increase of \$324,125).

The decommissioning costs are estimated to be incurred by June 2036, which is the end of the economic life of the field. As outlined in (a)(vi) above, management believes that the current licences, which are due to expire in July 2024, will be extended until June 2036.

#### (c) Depreciation of Development and Production Assets

Development and production assets held in property, plant and equipment are depreciated on a unit of production basis at a rate calculated by reference to proven and probable reserves and incorporating the estimated future cost of developing and extracting those reserves. Future development costs are estimated using assumptions about the number of wells required to produce those reserves, the cost of the wells, future production facilities and operating costs, together with assumptions on oil and gas realisations, and are revised annually. The reserves estimates used are determined using estimates of gas in place, recovery factors, future hydrocarbon prices and also take into consideration the Group's latest development plan for the associated development and production asset. Additionally, as outlined in (a)(vi) above, the latest development plan and therefore the inputs used to determine the depreciation charge, assume that the current licences which are due to expire in July 2024, can be extended until June 2036.

### 3. Critical Accounting Estimates and Assumptions continued

#### (d) Timing of recovery of purchase tax receivable

The Group has significant receivables from the State Budget of Ukraine relating to reimbursement of purchase tax arising on purchases of goods and services from external service and product providers. The Group recognises recoverable purchase tax only to the extent that it is probable that the purchase tax payable arising on the sales of gas, condensate and LPG production will be sufficient to offset the purchase tax due from the State within a reasonable period. Estimating the recoverability, net present value and classification (current asset versus non-current asset) of purchase tax receivable requires management to make an estimate of the timing of future revenues in order to calculate the amount and timing of the purchase tax payable available for offset. See Note 17 for further details.

#### (e) Recoverability of materials inventory

The majority of the Group's materials inventory balance comprises items to be used in the Ukraine drilling programme. Where there is uncertainty whether the materials will be realised through the drilling programme, or through sale, the materials are recorded at selling price, less any associated costs. Where materials inventory is intended for sale, management uses current market rates to estimate the recoverable amount through sale.

A full review of the Group's materials inventory was undertaken at 31 December 2013 following the revision to the field development plan, which reduced the number and phasing of new wells in the fields from 27 to 10. The reduced drilling activity has meant that the Group has a reduced short-term requirement for drilling materials. The reduction in future utilisation of this inventory, coupled with unsuccessful attempts during the year to sell unwanted items, has led to the write down of the materials inventory balance at 31 December 2013, as outlined in Note 16.

Further review of the Group's materials inventory was undertaken at 31 December 2014 and has not led to a write down of the materials inventory at the balance sheet date.

#### (f) Recognition of deferred tax asset

The recognition of deferred tax assets is based upon whether it is more likely than not that sufficient and suitable taxable profits will be available in the future against which the reversal of temporary differences can be deducted. This requires judgment for forecasting future profits.

Further details of the deferred tax assets recognised can be found in Note 21.

#### (g) Functional currency

An entity's functional currency is the currency of the primary economic environment in which the entity operates. If a foreign entity conducts significant amounts of business in more than one underlying currency, management's judgment will be required to determine the functional currency in which financial results are measured with the greatest degree of relevance and reliability.

### 4. Correction of prior period errors and changes in accounting policies and classification

During the preparation of the consolidated financial statements for the year ended 31 December 2014, the Group became aware of matters related to the preparation of the consolidated financial statements for the years ended 31 December 2013 and 31 December 2012 that require restatement.

The errors, changes in accounting policies and changes in classification were corrected and treated in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors" by restating comparative amounts. The effect and nature of these restatements are detailed below.

#### (a) Change in the estimates used for calculation of decommissioning provision

In the 2013 consolidated financial statements, the Group incorrectly used a US Dollar denominated discount rate for calculation of the decommissioning provision as at 31 December 2013. Had the Ukrainian Hryvnia denominated discount rate been used, the liability would have reduced by \$821,000 (discount rate of 7.88% vs 4.57%).

Correction of the error resulted in a decrease in the decommissioning provision and a corresponding decrease in property, plant and equipment as at 31 December 2013 of \$821,000.

## NOTES

forming part of the financial statements continued

### **4. Correction of prior period errors and changes in accounting policies and classification** continued **(b) Deferred tax asset and functional currency for tax basis**

With effect from 1 January 2013, the functional currency of two of the Group's subsidiaries was changed from US Dollars to Ukrainian Hryvnia. The change was triggered by the increasing influence of the Ukrainian Hryvnia on the subsidiaries' operations, compared to previous years. However, management did not change the functional currency in the tax accounting with US Dollars remaining the currency used for the deferred income tax calculation in 2013.

Correction of the error resulted in a decrease in the deferred tax asset of \$1,259,000 in the consolidated Balance Sheet and a corresponding increase in the income tax charge of \$865,000 in the consolidated Income Statement and an increase in the foreign exchange reserve of \$394,000 in the consolidated Statement of Comprehensive Income as at 31 December 2013.

### **(c) Reclassification of materials inventory related to development and producing assets to property, plant and equipment**

In 2014, the Group corrected an error leading to a change in its accounting policy in respect of the initial recognition of inventory purchased with the intention to be used in future capital investment projects. The change of the accounting policy was applied retrospectively resulting in a decrease of the long-term inventory and a corresponding increase in property, plant and equipment of \$1,115,000 as at 31 December 2013 and \$2,390,000 as at 31 December 2012.

### **(d) Reclassifications of the consolidated Cash Flow Statement as a result of discussions with the Financial Reporting Council's Conduct Committee in respect of its review of the 2012 Annual Report and Accounts**

#### **(i) Reclassification of purchase tax paid relating to purchase of property, plant and equipment**

In 2014, the Group changed its accounting policy and reclassified purchase tax paid relating to the purchase of property, plant and equipment as cash flows from operating activities for the year ended 31 December 2014. The comparative figures for the year ended 31 December 2013 have been restated to reflect the reclassification of the purchase tax paid. The reclassification resulted in a decrease in the net cash used in investing activities, and a corresponding decrease in the net cash from operating activities of \$4,765,000 for the year ended 31 December 2013.

#### **(ii) Reclassification of the proceeds from sale of materials inventory and purchase of materials inventory relating to development and producing assets**

A change in the Group's accounting policy in respect of materials inventory relating to development and producing assets resulted in the reclassification of cash flows related to the sale and purchase of materials inventory in the consolidated Cash Flow Statement for the year ended 31 December 2013. The reclassification resulted a decrease in the Purchase of materials inventory relating to development and producing assets and an increase in the Purchase of property, plant and equipment of \$5,701,000, as well as a decrease in the Proceeds from sale of materials inventory and an increase in the Proceeds from sale of property, plant and equipment of \$706,000.

### **(e) Reclassification of the consolidated Cash Flow Statement as a result of a change in accounting policy**

The Group reclassified equipment rental income from investing activities to operating activities for the year ended 31 December 2013 to reflect current year changes in accounting policy. The reclassification in a decrease in the net cash used in investing activities, and a corresponding increase in the net cash from operating activities of \$209,000 for the year ended 31 December 2013.

**4. Correction of prior period errors and changes in accounting policies and classification** continued

The effect of the restatements on the consolidated Balance Sheet is presented below:

|                                      |         | 31 December<br>2013<br>as reported<br>\$000 | Adjustment<br>\$000 | 31 December<br>2013<br>as restated<br>\$000 | 31 December<br>2012<br>as reported<br>\$000 | Adjustment<br>\$000 | 31 December<br>2012<br>as restated<br>\$000 |
|--------------------------------------|---------|---------------------------------------------|---------------------|---------------------------------------------|---------------------------------------------|---------------------|---------------------------------------------|
|                                      | Comment |                                             |                     |                                             |                                             |                     |                                             |
| <b>Non-current assets</b>            |         |                                             |                     |                                             |                                             |                     |                                             |
| Property, plant and equipment        | (a),(c) | 73,405                                      | 294                 | <b>73,699</b>                               | 233,508                                     | 2,390               | <b>235,898</b>                              |
| Inventories                          | (c)     | 1,115                                       | (1,115)             | —                                           | 2,390                                       | (2,390)             | —                                           |
| Deferred tax                         | (b)     | 36,353                                      | (1,259)             | <b>35,094</b>                               | 3,169                                       | —                   | <b>3,169</b>                                |
| <b>Total non-current assets</b>      |         | 116,970                                     | (2,080)             | <b>114,890</b>                              | 246,146                                     | —                   | <b>246,146</b>                              |
| <b>Total assets</b>                  |         | 155,479                                     | (2,080)             | <b>153,399</b>                              | 299,754                                     | —                   | <b>299,754</b>                              |
| <b>Non-current liabilities</b>       |         |                                             |                     |                                             |                                             |                     |                                             |
| Provision for decommissioning        | (a)     | (1,631)                                     | 821                 | <b>(810)</b>                                | (6,776)                                     | —                   | <b>(6,776)</b>                              |
| <b>Total non-current liabilities</b> |         | (1,631)                                     | 821                 | <b>(810)</b>                                | (10,831)                                    | —                   | <b>(10,831)</b>                             |
| <b>Total liabilities</b>             |         | (5,115)                                     | 821                 | <b>(4,294)</b>                              | (14,636)                                    | —                   | <b>(14,636)</b>                             |
| <b>Net assets</b>                    |         | 150,364                                     | (1,259)             | <b>149,105</b>                              | 285,118                                     | —                   | <b>285,118</b>                              |
| <b>Equity</b>                        |         |                                             |                     |                                             |                                             |                     |                                             |
| Foreign exchange reserve             | (b)     | (6,172)                                     | (394)               | <b>(6,566)</b>                              | 1,419                                       | —                   | <b>1,419</b>                                |
| Accumulated losses                   | (b)     | (430,942)                                   | (865)               | <b>(431,807)</b>                            | (303,779)                                   | —                   | <b>(303,779)</b>                            |
| <b>Total equity</b>                  |         | 150,364                                     | (1,259)             | <b>149,105</b>                              | 285,118                                     | —                   | <b>285,118</b>                              |

The effect of the restatements on the consolidated Income Statement and consolidated Statement of Comprehensive Income is presented below:

|                                                   |         | 2013<br>as reported<br>\$000 | Adjustment<br>\$000 | 2013<br>as restated<br>\$000 |
|---------------------------------------------------|---------|------------------------------|---------------------|------------------------------|
|                                                   | Comment |                              |                     |                              |
| Income tax (charge)/credit                        | (b)     | 35,757                       | (865)               | <b>34,892</b>                |
| <b>Loss for the year</b>                          |         | <b>(127,163)</b>             | <b>(865)</b>        | <b>(128,028)</b>             |
| Equity – foreign currency translation             | (b)     | (7,591)                      | (394)               | <b>(7,985)</b>               |
| <b>Total comprehensive expense for the period</b> |         | <b>(134,754)</b>             | <b>(1,259)</b>      | <b>(136,013)</b>             |

The effect of the restatements on loss per share is presented below:

|                                        | Note | As reported | As restated    |
|----------------------------------------|------|-------------|----------------|
| <b>Loss per ordinary share (cents)</b> |      |             |                |
| Basic and diluted                      | 13   | (39.7)c     | <b>(39.9)c</b> |

## NOTES

forming part of the financial statements continued

### 4. Correction of prior period errors and changes in accounting policies and classification continued

The effect of the restatements on the consolidated Cash Flow Statements is presented below:

|                                                                              | Comment  | 2013<br>as reported<br>\$000 | Adjustment<br>\$000 | 2013<br>as restated<br>\$000 |
|------------------------------------------------------------------------------|----------|------------------------------|---------------------|------------------------------|
| <b>Operating activities</b>                                                  |          |                              |                     |                              |
| Cash from operations                                                         | (d) (i)  | 26,490                       | (4,556)             | <b>21,934</b>                |
| Taxation paid                                                                |          | (1,921)                      | —                   | <b>(1,921)</b>               |
| Interest received                                                            |          | 861                          | —                   | <b>861</b>                   |
| <b>Net cash from operating activities</b>                                    |          | <b>25,430</b>                | <b>(4,556)</b>      | <b>20,874</b>                |
| <b>Investing activities</b>                                                  |          |                              |                     |                              |
| Purchase of property, plant and equipment                                    | (d) (ii) | (18,999)                     | (5,701)             | <b>(24,700)</b>              |
| Increase in related purchase tax receivable                                  | (d) (i)  | (4,765)                      | 4,765               | —                            |
| Purchase of intangible assets                                                |          | (103)                        | —                   | <b>(103)</b>                 |
| Purchase of materials inventory relating to development and producing assets | (d) (ii) | (5,701)                      | 5,701               | —                            |
| Proceeds from sale of materials inventory                                    | (d) (ii) | 706                          | (706)               | —                            |
| Equipment rental income                                                      |          | 209                          | (209)               | —                            |
| Proceeds from sale of property, plant and equipment                          | (d) (ii) | 185                          | 706                 | <b>891</b>                   |
| <b>Net cash used in investing activity</b>                                   |          | <b>(28,468)</b>              | <b>4,556</b>        | <b>(23,912)</b>              |
| <b>Net decrease in cash and cash equivalents</b>                             |          | <b>(3,038)</b>               | <b>—</b>            | <b>(3,038)</b>               |
| <b>Cash and cash equivalents at the beginning of the year</b>                |          | <b>28,453</b>                | <b>—</b>            | <b>28,453</b>                |
| Effect of foreign exchange rate changes                                      |          | (331)                        | —                   | <b>(331)</b>                 |
| <b>Cash and cash equivalents at the end of the year</b>                      |          | <b>25,084</b>                | <b>—</b>            | <b>25,084</b>                |

## 5. Segmental Information

In line with the Group's internal reporting framework and management structure, the key strategic and operating decisions are made by the Board of Directors, who review internal monthly management reports, budget and forecast information as part of this process. Accordingly, the Board of Directors is deemed to be the Chief Operating Decision Maker within the Group.

The Group's only class of business activity is oil and gas exploration, development and production. The Group's operations are located in Ukraine, with its head office in the United Kingdom. These geographical regions are the basis on which the Group reports its segment information. The segment results as presented represent operating profit/(loss) before depreciation, amortisation and impairment loss.

|                                      | Ukraine<br>2014<br>\$000 | United<br>Kingdom<br>2014<br>\$000 | Total<br>2014<br>\$000 |
|--------------------------------------|--------------------------|------------------------------------|------------------------|
| <b>Turnover</b>                      |                          |                                    |                        |
| Gas sales                            | 20,201                   | —                                  | 20,201                 |
| Condensate sales                     | 11,171                   | —                                  | 11,171                 |
| Liquefied Petroleum Gas sales        | 3,200                    | —                                  | 3,200                  |
| Total sales                          | 34,572                   | —                                  | 34,572                 |
| <b>Segment result</b>                | 18,282                   | (3,078)                            | 15,204                 |
| <b>Depreciation and amortisation</b> | —                        | —                                  | (8,852)                |
| <b>Operating profit</b>              |                          |                                    | 6,352                  |
| <b>Segment assets</b>                | 72,680                   | 22,033                             | 94,713                 |
| <b>Capital additions*</b>            | 4,320                    | 5                                  | 4,325                  |

There are no inter-segment sales within the Group and all products are sold in the geographical region in which they are produced. Gas sales to the Group's largest customer in 2014 amounted to \$18,094,000 (2013: \$25,980,000).

|                                      | *Restated<br>Ukraine<br>2013<br>\$000 | United<br>Kingdom<br>2013<br>\$000 | Total<br>2013<br>\$000 |
|--------------------------------------|---------------------------------------|------------------------------------|------------------------|
| <b>Turnover</b>                      |                                       |                                    |                        |
| Gas sales                            | 28,034                                | —                                  | 28,034                 |
| Condensate sales                     | 8,664                                 | —                                  | 8,664                  |
| Liquefied Petroleum Gas sales        | 39                                    | —                                  | 39                     |
| Total sales                          | 36,737                                | —                                  | 36,737                 |
| <b>Segment result</b>                | 14,559                                | (1,232)                            | 13,327                 |
| <b>Depreciation and amortisation</b> |                                       |                                    | (17,545)               |
| <b>Impairment loss</b>               |                                       |                                    | (159,199)              |
| <b>Operating loss</b>                |                                       |                                    | (163,417)              |
| <b>Segment assets</b>                | 127,783                               | 25,616                             | 153,399                |
| <b>Capital additions†</b>            | 24,000                                | 4                                  | 24,004                 |

\* As restated. See Note 4.

† Comprises additions to property, plant and equipment (Note 14).

## NOTES

forming part of the financial statements continued

### 6. Cost of Sales

|                                                               | 2014<br>\$000 | 2013<br>\$000 |
|---------------------------------------------------------------|---------------|---------------|
| Depreciation of development and producing asset (Note 14)     | 8,727         | 17,312        |
| Production taxes                                              | 8,602         | 7,167         |
| Staff costs (Note 9)                                          | 1,938         | 2,369         |
| Cost of inventories recognised as an expense                  | 810           | 908           |
| Write downs of inventories recognised as an expense (Note 16) | —             | 3,045         |
| Workover costs                                                | 879           | 1,827         |
| Geological services                                           | 531           | 578           |
| Other expenses                                                | 1,220         | 458           |
|                                                               | <b>22,707</b> | <b>33,664</b> |

### 7. Administrative Expenses

|                                        | 2014<br>\$000 | 2013<br>\$000 |
|----------------------------------------|---------------|---------------|
| Staff costs (Note 9)                   | 3,531         | 4,247         |
| Rent expenses                          | 480           | 553           |
| Auditors' remuneration                 | 349           | 401           |
| Consultancy fees                       | 315           | 737           |
| Depreciation of other assets (Note 14) | 104           | 214           |
| Amortisation of intangible assets      | 21            | 19            |
| Other expenses                         | 713           | 1,120         |
|                                        | <b>5,513</b>  | <b>7,291</b>  |

|                                                   | 2014<br>\$000 | 2013<br>\$000 |
|---------------------------------------------------|---------------|---------------|
| Audit of the Company and subsidiaries             | 216           | 181           |
| Audit related assurance services – interim review | 62            | 56            |
| <b>Total assurance services</b>                   | <b>278</b>    | <b>237</b>    |
| Tax compliance services                           | 54            | 28            |
| Tax advisory services                             | —             | 54            |
| Corporate finance services                        | 17            | 82            |
| <b>Total non-audit services</b>                   | <b>71</b>     | <b>164</b>    |
| <b>Total audit and other services</b>             | <b>349</b>    | <b>401</b>    |

Total remuneration of the Group auditors, PricewaterhouseCoopers LLP, and other member firms of PricewaterhouseCoopers in 2014 amounted to \$254,000, including \$229,000 payable for the audit and related assurance services and \$25,000 payable for tax compliance services. Total remuneration to Deloitte LLP and other member firms of Deloitte Touche Tohmatsu Limited in 2014 amounted to \$95,000, including \$49,000 payable for the audit and related assurance services for the year 2013 and \$46,000 payable for non-audit services. In 2013 all amounts shown as auditors' remuneration were payable to Deloitte LLP and other member firms of Deloitte Touche Tohmatsu Limited.

## 8. Remuneration of Directors

|                       | 2014<br>\$000 | 2013<br>\$000 |
|-----------------------|---------------|---------------|
| Directors' emoluments | 793           | 906           |

The emoluments of the individual Directors were as follows:

|                  | Total<br>emoluments<br>2014<br>\$000 | Total<br>emoluments<br>2013<br>\$000 |
|------------------|--------------------------------------|--------------------------------------|
| Keith Henry      | 412                                  | 391                                  |
| Alexey Timofeyev | 74                                   | 235                                  |
| Adrian Coates    | 74                                   | 70                                   |
| Alastair Graham  | 74                                   | 70                                   |
| Alexey Pertin    | 74                                   | 70                                   |
| Sergei Glazunov  | 85                                   | 70                                   |
|                  | 793                                  | 906                                  |

The emoluments include base salary and fees. According to the register of Directors' interests, no rights to subscribe for shares in or debentures of the Group companies were granted to any of the Directors or their immediate families during the financial year, and there were no outstanding options to Directors.

## 9. Staff Numbers and Costs

The average monthly number of employees on a full time equivalent basis during the year (including Executive Directors) was as follows:

| Group                  | Number of employees<br>2014 | 2013 |
|------------------------|-----------------------------|------|
| Management/operational | 103                         | 102  |
| Administrative support | 54                          | 53   |
|                        | 157                         | 155  |

The aggregate staff costs of these employees were as follows:

|                       | 2014<br>\$000 | 2013<br>\$000 |
|-----------------------|---------------|---------------|
| Wages and salaries    | 4,381         | 5,416         |
| Pension costs         | 991           | 1,009         |
| Social security costs | 97            | 191           |
|                       | 5,469         | 6,616         |

## 10. Finance Costs

|                                                              | 2014<br>\$000 | 2013<br>\$000 |
|--------------------------------------------------------------|---------------|---------------|
| Unwinding of discount on decommissioning provision (Note 20) | 46            | 520           |
| Other finance costs                                          | 2             | 113           |
|                                                              | 48            | 633           |

## NOTES

forming part of the financial statements continued

### 11. Taxation

#### (a) Analysis of expense/(income) in period:

|                               | 2014<br>\$000 | *Restated<br>2013<br>\$000 |
|-------------------------------|---------------|----------------------------|
| <i>Current tax</i>            |               |                            |
| Overseas – current year       | 1,232         | 1,358                      |
| Overseas – prior year         | (253)         | 124                        |
| <i>Deferred tax</i> (Note 21) |               |                            |
| UK – current year             | 1,354         | (36,100)                   |
| UK – prior year               | —             | (274)                      |
|                               | <b>2,333</b>  | <b>(34,892)</b>            |

The effect of the restatements described in Note 4 is presented below:

|                               | As reported<br>2013<br>\$000 | Restatement<br>\$000 | As restated<br>2013<br>\$000 |
|-------------------------------|------------------------------|----------------------|------------------------------|
| <i>Current tax</i>            |                              |                      |                              |
| Overseas – current year       | 1,358                        | —                    | 1,358                        |
| Overseas – prior year         | 124                          | —                    | 124                          |
| <i>Deferred tax</i> (Note 21) |                              |                      |                              |
| UK – current year             | (36,965)                     | 865                  | (36,100)                     |
| UK – prior year               | (274)                        | —                    | (274)                        |
|                               | (35,757)                     | 865                  | (34,892)                     |

#### (b) Factors affecting tax charge for the year:

The tax assessed for the year is different than the blended rate of corporation tax in the UK of 21.5%. The expense/(income) for the year can be reconciled to the profit/(loss) as per the Income Statement as follows:

|                                                                     | 2014<br>\$000 | *Restated<br>2013<br>\$000 |
|---------------------------------------------------------------------|---------------|----------------------------|
| Profit/(loss) before tax from continuing operations                 | 8,088         | (162,920)                  |
| Tax charge/(credit) at UK tax rate of 21.50% (2013: 23.25%)         | 1,739         | (37,879)                   |
| <b>Tax effects of:</b>                                              |               |                            |
| Lower foreign corporate tax rates in Ukraine (2014: 18%, 2013: 19%) | 4             | (689)                      |
| Disallowed expenses and non-taxable income                          | (14,957)      | 4,334                      |
| Recognition of deferred tax assets on historical losses             | —             | (4,638)                    |
| Recognition of deferred tax on decommissioning                      | —             | (332)                      |
| Losses not recognised as deferred tax assets                        | 15,800        | —                          |
| Adjustment for reduction in UK corporate tax rate                   | —             | 4,462                      |
| Prior year adjustments                                              | (253)         | (150)                      |
| Tax expense/(income) for the year                                   | <b>2,333</b>  | <b>(34,892)</b>            |

**11. Taxation** continued

|                                                         | As reported<br>2013<br>\$000 | Restatement<br>\$000 | As restated<br>2013<br>\$000 |
|---------------------------------------------------------|------------------------------|----------------------|------------------------------|
| Loss before tax from continuing operations              | (162,920)                    | —                    | <b>(162,920)</b>             |
| Tax credit at UK tax rate of 21.50% (2013: 23.25%)      | (37,879)                     | —                    | <b>(37,879)</b>              |
| <b>Tax effects of:</b>                                  |                              |                      |                              |
| Lower foreign corporate tax rates in Ukraine (18%)      | (689)                        | —                    | <b>(689)</b>                 |
| Disallowed expenses and non-taxable income              | 3,249                        | 1,085                | <b>4,334</b>                 |
| Recognition of deferred tax assets on historical losses | (4,638)                      | —                    | <b>(4,638)</b>               |
| Recognition of deferred tax on decommissioning          | (332)                        | —                    | <b>(332)</b>                 |
| Adjustment for reduction in UK corporate tax rate       | 4,682                        | (220)                | <b>4,462</b>                 |
| Prior year adjustments                                  | (150)                        | —                    | <b>(150)</b>                 |
| Tax credit for the year                                 | (35,757)                     | 865                  | <b>(34,892)</b>              |

**12. Loss for the Financial Year**

The Company has taken advantage of the exemption allowed under section 408 of the Companies Act 2006 and has not presented its own Income Statement in these financial statements. The Group profit for the year includes a Parent Company loss after tax of \$5,766,000 for the year ended 31 December 2014. For the year ended 31 December 2013, the Group loss included a Parent Company loss after tax of \$174,948,000.

**13. Earnings/(Loss) per Share**

The calculation of basic profit or loss per ordinary share has been based on the profit or loss for the year and 320,637,836 (2013: 320,637,836) ordinary shares, being the weighted average number of shares in issue for the year. There are no dilutive instruments.

**14. Property, Plant and Equipment**

|                                                                            | 2014                                                           |                                |                | 2013 ("Restated")                                              |                                |                |
|----------------------------------------------------------------------------|----------------------------------------------------------------|--------------------------------|----------------|----------------------------------------------------------------|--------------------------------|----------------|
|                                                                            | Development<br>and<br>Production<br>assets<br>Ukraine<br>\$000 | Other fixed<br>assets<br>\$000 | Total<br>\$000 | Development<br>and<br>Production<br>assets<br>Ukraine<br>\$000 | Other fixed<br>assets<br>\$000 | Total<br>\$000 |
| <b>Group</b>                                                               |                                                                |                                |                |                                                                |                                |                |
| <b>Cost</b>                                                                |                                                                |                                |                |                                                                |                                |                |
| At beginning of year                                                       | 277,014                                                        | 1,272                          | 278,286        | 263,563                                                        | 1,133                          | 264,696        |
| Additions                                                                  | 3,995                                                          | 330                            | 4,325          | 23,451                                                         | 452                            | 23,903         |
| Change in decommissioning provision                                        | (204)                                                          | —                              | (204)          | (6,274)                                                        | —                              | (6,274)        |
| Disposals                                                                  | (924)                                                          | (330)                          | (1,254)        | (1,241)                                                        | (285)                          | (1,526)        |
| Exchange differences                                                       | (131,627)                                                      | (288)                          | (131,915)      | (2,485)                                                        | (28)                           | (2,513)        |
| At end of year                                                             | 148,254                                                        | 984                            | 149,238        | 277,014                                                        | 1,272                          | 278,286        |
| <b>Accumulated depreciation and impairment</b>                             |                                                                |                                |                |                                                                |                                |                |
| At beginning of year                                                       | 203,784                                                        | 803                            | 204,587        | 27,949                                                         | 849                            | 28,798         |
| Charge for year                                                            | 8,727                                                          | 104                            | 8,831          | 17,312                                                         | 214                            | 17,526         |
| Impairment loss                                                            | —                                                              | —                              | —              | 159,199                                                        | —                              | 159,199        |
| Impairment materials inventory related to development and producing assets | —                                                              | —                              | —              | 539                                                            | —                              | 539            |
| Disposals                                                                  | (37)                                                           | (193)                          | (230)          | (126)                                                          | (242)                          | (368)          |
| Exchange differences                                                       | (98,960)                                                       | (257)                          | (99,217)       | (1,089)                                                        | (18)                           | (1,107)        |
| At end of year                                                             | 113,514                                                        | 457                            | 113,971        | 203,784                                                        | 803                            | 204,587        |
| <b>Net book value at beginning of year</b>                                 | <b>73,230</b>                                                  | <b>469</b>                     | <b>73,699</b>  | <b>235,614</b>                                                 | <b>284</b>                     | <b>235,898</b> |
| <b>Net book value at end of year</b>                                       | <b>34,740</b>                                                  | <b>527</b>                     | <b>35,267</b>  | <b>73,230</b>                                                  | <b>469</b>                     | <b>73,699</b>  |

## NOTES

forming part of the financial statements continued

### 14. Property, Plant and Equipment *continued*

In accordance with the Group's accounting policies, oil and gas development and producing assets are tested for impairment at each balance sheet date. In assessing whether an impairment loss has occurred, the carrying amount of the asset is compared to the value in use. The Group estimates value in use of its development and producing assets using a discounted cash flow model.

As there was no drilling in 2014, the reserves report prepared by ERC Equipoise Limited in London as of 31 December 2013 is still effective and was not updated as of 31 December 2014.

The impairment assessment carried out at 31 December 2014 has not resulted in an impairment loss.

The calculation of value in use is most sensitive to the following assumptions, the bases of which are set out in Note 3(a):

- (i) *Commodity prices* – the model assumes gas prices of \$300/Mm<sup>3</sup> (UAH6,600/Mm<sup>3</sup>) in 2015 increasing to \$340/Mm<sup>3</sup> (UAH8,000/Mm<sup>3</sup>) during 2016–2019 and onwards. The prices were estimated on the basis of International Monetary Fund imported gas price forecasts for Ukraine.
- (ii) *Discount rate* – reflects the current market assessment of the time value of money and risks specific to the Group. The discount rate has been determined as the weighted average cost of capital based on observable inputs and inputs from third party financial analysts. For 2015 and 2016 the discount rate applied was 21% and 16% respectively. From 2017 to 2024 the discount rate gradually decreases from 14% (2017) to 12% (2024 onwards) based on the projected correlation of the country risk premium for investment in Ukraine and the Ukrainian country default swap curve. The discount rates represent a real weighted average cost of capital, i.e. they do not take into account the impact of the estimated inflation during the period of projection.
- (iii) *Production levels and Reserves* – production levels are based on the data included in the third party reserves report. This report includes estimated production volumes, including from new wells, over the remaining useful life of the MEX-GOL and SV gas and condensate fields in Ukraine. The estimated production is based on the Group's current development programme, which includes the drilling of six new wells (2013: ten new wells), and the workover of existing currently non-producing wells, which will recover the same reserves with lower capital expenditure.
- (iv) *Production taxes* – management assumed production tax rates of 55% for gas and 45% for condensate extracted from deposits up to depths of 5,000 metres and 28% for gas and 21% for condensate extracted from deposits deeper than 5,000 metres. These rates were introduced by the Government as an emergency measure in 2014 and have been extended through to 31 December 2015. From 1 January 2016, the Group has assumed that these rates will reduce to normalised levels of 28% for gas extracted from deposits up to depths of 5,000 metres and 15% for gas extracted from deposits deeper than 5,000 metres. For condensate, the rates assumed remain the same for 2015 and thereafter.
- (v) *Capital expenditures* – management assumed that most capital expenditures are to be incurred during 2016–2021. A capital expenditure allowance of \$500,000 per year is assumed for maintenance of the development and producing assets. The proportion of capital expenditures which is pegged to the US Dollar is recalculated using the forecast \$/UAH exchange rates based on the long-term projections of the International Monetary Fund.
- (vi) *Life of field* – the current licences, which are due to expire in July 2024, can be extended under applicable legislation in Ukraine until the end of the economic life of the field, which is assessed to be June 2036 on the basis of the reserves report. No application for such an extension has been made at the date of this report, but management consider the assumption to be reasonable based on their intention to seek such an extension in due course and that the Group is legally entitled to request an extension. However, if the extension were not granted, it would result in a further reduction of \$18,400,000 in the carrying value.

**14. Property, Plant and Equipment** continued

The Group's discounted cash flow model in Ukrainian Hryvnia, flexed for sensitivities, produced the following results:

|                                                                   | Recoverable<br>amount<br>\$000 | Net book<br>value<br>\$000 | Headroom/<br>(Shortfall)<br>\$000 |
|-------------------------------------------------------------------|--------------------------------|----------------------------|-----------------------------------|
| 31 December 2014                                                  | 80,223                         | 34,740                     | 45,483                            |
| Sensitivities:                                                    |                                |                            |                                   |
| 1. \$25/Mm <sup>3</sup> reduction in gas price                    | 69,233                         | 34,740                     | 34,493                            |
| 2. \$25/Mm <sup>3</sup> increase in gas price                     | 91,239                         | 34,740                     | 56,499                            |
| 3. Breakeven gas price \$230/Mm <sup>3</sup>                      | 34,436                         | 34,740                     | (304)                             |
| 4. Breakeven flow rates 29 Mm <sup>3</sup> /day for all new wells | 35,133                         | 34,740                     | 393                               |
| 5. Assuming no reduction in production tax rates from 2016        | 50,734                         | 34,740                     | 15,994                            |
| 6. Breakeven discount rate 24%                                    | 35,006                         | 34,740                     | 266                               |

According to the results of the impairment test performed, there is no impairment of development and production assets at 31 December 2014.

The effect of the restatements described in Note 4 is presented below:

| Group                                                                      | Development<br>and<br>Production<br>assets<br>2013<br>Ukraine<br>As reported<br>\$000 | Restatement<br>\$000 | Development<br>and<br>Production<br>assets<br>2013<br>Ukraine<br>As restated<br>\$000 |
|----------------------------------------------------------------------------|---------------------------------------------------------------------------------------|----------------------|---------------------------------------------------------------------------------------|
| <b>Cost</b>                                                                |                                                                                       |                      |                                                                                       |
| At beginning of year                                                       | 261,173                                                                               | 2,390                | 263,563                                                                               |
| Additions                                                                  | 23,451                                                                                | —                    | 23,451                                                                                |
| Disposals                                                                  | (505)                                                                                 | (736)                | (1,241)                                                                               |
| Change in decommissioning provision                                        | —                                                                                     | (6,274)              | (6,274)                                                                               |
| Exchange differences                                                       | (7,938)                                                                               | 5,453                | (2,485)                                                                               |
| At end of year                                                             | 276,181                                                                               | 833                  | 277,014                                                                               |
| <b>Accumulated depreciation and impairment</b>                             |                                                                                       |                      |                                                                                       |
| At beginning of year                                                       | 27,949                                                                                | —                    | 27,949                                                                                |
| Charge for year                                                            | 17,312                                                                                | —                    | 17,312                                                                                |
| Impairment loss                                                            | 159,199                                                                               | —                    | 159,199                                                                               |
| Impairment materials inventory related to development and producing assets | —                                                                                     | 539                  | 539                                                                                   |
| Disposals                                                                  | (126)                                                                                 | —                    | (126)                                                                                 |
| Exchange differences                                                       | (1,089)                                                                               | —                    | (1,089)                                                                               |
| At end of year                                                             | 203,245                                                                               | 539                  | 203,784                                                                               |
| <b>Net book value at end of year</b>                                       | <b>72,936</b>                                                                         | <b>294</b>           | <b>73,230</b>                                                                         |

## NOTES

forming part of the financial statements continued

### 15. Investments

| <b>Company</b>                       | <b>Shares in subsidiary undertakings<br/>\$000</b> | <b>Loans to subsidiary undertakings<br/>\$000</b> | <b>Total<br/>\$000</b> |
|--------------------------------------|----------------------------------------------------|---------------------------------------------------|------------------------|
| <b>Cost</b>                          |                                                    |                                                   |                        |
| At 1 January 2013                    | 17,279                                             | 244,756                                           | 262,035                |
| Additions including accrued interest | —                                                  | 18,015                                            | 18,015                 |
| Impairment of loans to subsidiary    | —                                                  | (192,064)                                         | (192,064)              |
| At 31 December 2013                  | 17,279                                             | 70,707                                            | 87,986                 |
| <b>Cost</b>                          |                                                    |                                                   |                        |
| At 1 January 2014                    | <b>17,279</b>                                      | <b>70,707</b>                                     | <b>87,986</b>          |
| Additions including accrued interest | —                                                  | <b>6,376</b>                                      | <b>6,376</b>           |
| Disposals                            | —                                                  | <b>(1,871)</b>                                    | <b>(1,871)</b>         |
| Exchange differences                 | —                                                  | <b>(7,614)</b>                                    | <b>(7,614)</b>         |
| <b>At 31 December 2014</b>           | <b>17,279</b>                                      | <b>67,598</b>                                     | <b>84,877</b>          |

In accordance with the Company's accounting policies, loans to subsidiaries have been reviewed to assess recoverability. At 31 December 2013 as a result of the impairment recognised in the carrying value of the Group's assets in Ukraine (Note 14), an impairment of \$192,064,000 was recorded against the carrying value of loans between the Company and its subsidiaries. No further impairment was recognised against the carrying value of loans at 31 December 2014.

#### Subsidiary undertakings

At 31 December 2014, the Company's subsidiary undertakings, all of which are included in the consolidated financial statements, were:

|                                               | <b>Country of incorporation</b> | <b>Country of operation</b> | <b>Principal activity</b>    | <b>% of shares held</b> |
|-----------------------------------------------|---------------------------------|-----------------------------|------------------------------|-------------------------|
| Regal Petroleum Corporation Limited           | Jersey                          | Ukraine                     | Oil & Natural Gas Extraction | 100%                    |
| Regal Petroleum Corporation (Ukraine) Limited | Ukraine                         | Ukraine                     | Service Company              | 100%                    |
| Refin Limited                                 | Ukraine                         | Ukraine                     | Service Company              | 100%                    |
| Regal Petroleum (Jersey) Limited              | Jersey                          | United Kingdom              | Holding company              | 100%                    |
| Regal Group Services Limited                  | United Kingdom                  | United Kingdom              | Service Company              | 100%                    |

The Parent Company, Regal Petroleum plc, holds direct interests in 100% of the share capital of Regal Petroleum (Jersey) Limited and Regal Group Services Limited, with all other companies owned indirectly by the Parent Company. Regal Petroleum Corporation Limited is controlled through its 100% ownership by Regal Petroleum (Jersey) Limited. Regal Petroleum Corporation (Ukraine) Limited is controlled through its 100% ownership by Regal Petroleum (Jersey) Limited and Regal Group Services Limited, and Refin Limited is controlled through its 100% ownership by Regal Petroleum (Jersey) Limited and Regal Petroleum Corporation (Ukraine) Limited.

Regal Group Services Limited, company number 5252958, has adopted the subsidiary audit exemption allowed under section 479A of the Companies Act 2006, for the year ended 31 December 2014.

### 16. Inventories

|                  | <b>Group</b>          |                       |
|------------------|-----------------------|-----------------------|
| <b>Current</b>   | <b>2014<br/>\$000</b> | <b>2013<br/>\$000</b> |
| Materials        | <b>1,951</b>          | 3,729                 |
| Condensate stock | <b>148</b>            | 143                   |
|                  | <b>2,099</b>          | 3,872                 |

**16. Inventories** continued

Non-current inventory presented by inventory purchased with the intention to be used in future capital investment projects was restated at 31 December 2013 and 31 December 2012 due to an error leading to a change of accounting policy as described in Note 4. The change of accounting policy was applied retrospectively resulting in a decrease in the long-term inventory and a corresponding increase in property, plant and equipment of \$1,115,000 as at 31 December 2013 and \$2,390,000 as at 31 December 2012.

A full review of the Group's materials inventory balance was undertaken at 31 December 2013 following the revision to the field development plan, which reduced the number and phasing of new wells in the field. The reduction in future utilisation of this inventory, coupled with unsuccessful attempts during the year to sell unwanted items, has led to the write down of the materials inventory balance.

The majority of the Group's materials inventory is held at written down value, due to historic impairment charges, and the write down following the review of the materials inventory referred to above. The cumulative total write down as at 31 December 2014 on the balance above was \$4,809,000 (2013: \$4,809,000).

**17. Trade and Other Receivables**

|                                | <b>Group</b> |              | <b>Company</b> |              |
|--------------------------------|--------------|--------------|----------------|--------------|
|                                | <b>2014</b>  | <b>2013</b>  | <b>2014</b>    | <b>2013</b>  |
| <b>Non-current</b>             | <b>\$000</b> | <b>\$000</b> | <b>\$000</b>   | <b>\$000</b> |
| VAT receivable                 | 1,309        | 5,953        | —              | —            |
|                                | <b>1,309</b> | <b>5,953</b> | <b>—</b>       | <b>—</b>     |
|                                |              |              |                |              |
|                                | <b>Group</b> |              | <b>Company</b> |              |
|                                | <b>2014</b>  | <b>2013</b>  | <b>2014</b>    | <b>2013</b>  |
| <b>Current</b>                 | <b>\$000</b> | <b>\$000</b> | <b>\$000</b>   | <b>\$000</b> |
| VAT receivable                 | 2,236        | 8,090        | 57             | 83           |
| Trade receivables              | 740          | 1            | —              | —            |
| Prepayments and accrued income | 241          | 610          | 30             | 118          |
| Other receivables              | 219          | 84           | 327            | 56           |
|                                | <b>3,436</b> | <b>8,785</b> | <b>414</b>     | <b>257</b>   |

None of the Group's trade receivables are past due or impaired. All trade receivables are considered to be of high credit quality.

No impairment provision was charged against trade and other receivables during 2014 (2013: \$nil).

At 31 December 2014, the Group's total financial receivables amounted to \$740,000 and 100% were denominated in Ukrainian Hryvnia (31 December 2013: \$84,000 and 99% were denominated in US Dollars). Further description of financial receivables is disclosed in Note 26.

Current VAT receivable in respect of the Group includes \$2,236,000 (2013: \$7,308,000) relating to capital expenditure in Ukraine which is expected to be recovered via an offset against VAT payable on future sales in that country. There is an additional \$1,309,000 (2013: \$5,953,000) of VAT receivable which is included within non-current trade and other receivables as, based on the Group's future sales projections which are derived from the assumptions in the value in use model outlined in the notes, it is not expected to be recoverable within one year. The Directors are satisfied that all such amounts are fully recoverable.

At 31 December 2014, the Group was in dispute with the Ukrainian tax authorities in respect of VAT receivable on imported leased equipment, with a possible liability of up to \$532,000 inclusive of penalties and other associated costs. There is a level of ambiguity in the interpretation of the relevant tax legislation, and the position adopted by the Group has been challenged by the Ukrainian tax authorities, which has led to legal proceedings to resolve the issue. Management believes that adequate defences exist to the claim and do not expect the challenge by the Ukrainian tax authorities to be successful. Accordingly, no liability has been recognised in these consolidated financial statements for the year ended 31 December 2014.

## NOTES

forming part of the financial statements continued

### 18. Cash and Cash Equivalents

|                          | <b>Group</b>  |        | <b>Company</b> |        |
|--------------------------|---------------|--------|----------------|--------|
|                          | <b>2014</b>   | 2013   | <b>2014</b>    | 2013   |
|                          | <b>\$000</b>  | \$000  | <b>\$000</b>   | \$000  |
| Cash at bank and on hand | <b>23,403</b> | 9,939  | <b>14,061</b>  | 7,820  |
| Short-term deposits      | <b>8,433</b>  | 15,145 | —              | 9,072  |
|                          | <b>31,836</b> | 25,084 | <b>14,061</b>  | 16,892 |

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods depending on the immediate cash requirements of the Group and earn interest at the respective short-term deposit rates. The terms and conditions upon which the Group's short-term deposits are made allow immediate access to all cash deposits, with no significant loss of interest.

However, the significant pressures on the Ukrainian banking system, with high risks in the capital strength, liquidity and creditworthiness of a number of Ukrainian banks, may affect the terms and conditions upon which the Group's short-term deposits are made. More details of such risks are set out in Notes 26 and 28.

### 19. Trade and Other Payables

|                              | <b>Group</b> |       | <b>Company</b> |       |
|------------------------------|--------------|-------|----------------|-------|
|                              | <b>2014</b>  | 2013  | <b>2014</b>    | 2013  |
|                              | <b>\$000</b> | \$000 | <b>\$000</b>   | \$000 |
| Taxation and social security | <b>990</b>   | 133   | —              | —     |
| Accruals and deferred income | <b>677</b>   | 1,084 | <b>260</b>     | 168   |
| Advances received            | <b>255</b>   | 1,722 | —              | —     |
| Trade payables               | <b>7</b>     | 545   | —              | 70    |
|                              | <b>1,929</b> | 3,484 | <b>260</b>     | 238   |

Management consider that the carrying amount of trade payables approximates to their fair value. At 31 December 2014, the Group's total financial payables amounted to \$201,000 and 96% were denominated in US Dollars (31 December 2013: \$839,000 and 66% were denominated in Ukrainian Hryvnia). Further description of financial payables is disclosed in Note 26.

### 20. Provision for Decommissioning

|                                 | <b>2014</b>  | Restated<br>2013 |
|---------------------------------|--------------|------------------|
| <b>Group</b>                    | <b>\$000</b> | \$000            |
| At beginning of year            | <b>810</b>   | 6,776            |
| Amounts provided                | —            | 90               |
| Unwinding of discount (Note 10) | <b>46</b>    | 520              |
| Change in estimate              | <b>(204)</b> | (6,364)          |
| Exchange differences            | <b>(397)</b> | (212)            |
| <b>At end of year</b>           | <b>255</b>   | 810              |

The Company did not have provisions balances at 31 December 2014 and 31 December 2013.

The provision for decommissioning is based on the net present value of the Group's estimated liability for the removal of the Ukraine production facilities and well site restoration at the end of production life. In 2013, detailed assessment of the gross decommissioning cost was undertaken on a well-by-well basis using local data on day rates and equipment costs, as compared to previous years, where the same cost was assumed for each well. The change in estimate during 2013 reflects a combination of this revision in the estimated costs and the discount rate applied. These costs are expected to be incurred by 2036 (2013: by 2036), although if the costs were to be incurred at the current expiry of the production licences in 2024, the provision for decommissioning at 31 December 2014 would be \$1,257,000 (31 December 2013: \$2,012,000).

**20. Provision for Decommissioning** continued

The provision for decommissioning was restated at 31 December 2013 due to the change of discount rate as described in Note 4. The effect of the restatements is presented below:

| Group                           | Provision for<br>decommissioning<br>2013 as reported<br>\$000 | Restatement<br>\$000 | Provision for<br>decommissioning<br>2013 as restated<br>\$000 |
|---------------------------------|---------------------------------------------------------------|----------------------|---------------------------------------------------------------|
| At beginning of year            | 6,776                                                         | —                    | 6,776                                                         |
| Amounts provided/(utilised)     | 180                                                           | (90)                 | 90                                                            |
| Unwinding of discount (Note 10) | 520                                                           | —                    | 520                                                           |
| Change in estimate              | (5,633)                                                       | (731)                | (6,364)                                                       |
| Exchange differences            | (212)                                                         | —                    | (212)                                                         |
| <b>At end of year</b>           | <b>1,631</b>                                                  | <b>(821)</b>         | <b>810</b>                                                    |

**21. Deferred Tax**

| Company                                      | 2014<br>\$000 | *Restated<br>2013<br>\$000 |
|----------------------------------------------|---------------|----------------------------|
| <b>Deferred tax recognised on tax losses</b> |               |                            |
| At beginning of year                         | 7,807         | 3,169                      |
| Credited to Income Statement – current year  | 54            | 4,638                      |
| <b>At end of year</b>                        | <b>7,861</b>  | <b>7,807</b>               |

| Group                                                                       | 2014<br>\$000 | 2013<br>\$000 |
|-----------------------------------------------------------------------------|---------------|---------------|
| <b>Deferred tax recognised relating to development and production asset</b> |               |               |
| At beginning of year                                                        | 27,287        | (4,055)       |
| (Charged)/credited to Income Statement – current year                       | (1,408)       | 31,462        |
| Credited to Income Statement – prior year                                   | —             | 274           |
| Effect of exchange difference                                               | (13,327)      | (394)         |
| <b>At end of year</b>                                                       | <b>12,552</b> | <b>27,287</b> |

At 31 December 2014 the Group recognised a deferred tax asset of \$7,861,000 in relation to UK tax losses carried forward (31 December 2013: \$7,807,000). There was a further \$66 million (31 December 2013: \$57 million) of unrecognised UK tax losses carried forward for which no deferred tax asset has been recognised. These losses can be carried forward indefinitely, subject to certain rules regarding capital transactions and changes in the trade of the Company. The Directors consider it appropriate to recognise deferred tax assets resulting from accumulated tax losses at 31 December 2014 to the extent that it is probable that there will be sufficient future taxable profits.

The deferred tax asset relating to the Group's development and producing asset at 31 December 2014 was recognised on the tax effect of the temporary differences between the carrying value of the Group's development and producing asset in Ukraine, and its tax base. This is deemed recoverable on the projected future profits generated by the Group's operations in Ukraine. The forecast profits are based on the current field development plan, and are determined using data from the same cash flow model which was used for impairment review of the Group's development and production asset in Ukraine, as outlined in Note 14. Based on these projections, the deferred tax asset recognised will be recovered by 2020. However, should future field development not result in additional production, only \$3 million of the \$12 million deferred tax recognised would be recoverable based on forecast profits available from the Group's existing wells.

## NOTES

forming part of the financial statements continued

### 21. Deferred Tax continued

Losses accumulated in a Ukrainian subsidiary service company of UAH952,365,000 (\$60,391,000) at 31 December 2014 and UAH41,364,000 (\$5,175,000) at 31 December 2013 mainly originated as foreign exchange differences on inter-company loans and for which no deferred tax asset was recognised as this subsidiary is not expected to have taxable profits to utilise these losses in the future.

#### Factors affecting future tax charge

On 1 January 2014, the main rate of corporation tax in Ukraine was reduced from 19% to 18%. The UK corporation tax rate has reduced from 23% to 21% from 1 April 2014, giving a blended average rate for the year of 21.5%, and further reduced from 21% to 20% effective from 1 April 2015. These rate changes were substantively enacted on 2 July 2013. The deferred tax assets at 31 December 2013 have been updated to reflect the reduction in the tax rates. These rate changes are not expected to have a further material effect on the Group's tax balances.

### 22. Called Up Share Capital

|                                           | 2014        |        | 2013        |        |
|-------------------------------------------|-------------|--------|-------------|--------|
|                                           | Number      | \$000  | Number      | \$000  |
| <b>Allotted, called up and fully paid</b> |             |        |             |        |
| Opening balance at 1 January              | 320,637,836 | 28,115 | 320,637,836 | 28,115 |
| Issued during the year                    | —           | —      | —           | —      |
| Closing balance at 31 December            | 320,637,836 | 28,115 | 320,637,836 | 28,115 |

There are no restrictions over ordinary shares issued.

### 23. Other Reserves

Other reserves, the movements in which are shown in the statements of changes in equity, comprise the following:

#### Capital contributions reserve

The capital contributions reserve is non-distributable and represents the value of equity invested in subsidiary entities prior to the Company listing.

#### Merger reserve

The merger reserve represents the difference between the nominal value of shares acquired by the Company and those issued to acquire subsidiary undertakings. This balance relates wholly to the acquisition of Regal Petroleum (Jersey) Limited and that company's acquisition of Regal Petroleum Corporation Limited during 2002.

#### Foreign exchange reserve

Exchange reserve movement for the year attributable to currency fluctuations.

## 24. Operating Lease Arrangements

### The Group as Lessee

|                                                                                     | <b>Group</b> |              | <b>Company</b> |              |
|-------------------------------------------------------------------------------------|--------------|--------------|----------------|--------------|
|                                                                                     | <b>2014</b>  | <b>2013</b>  | <b>2014</b>    | <b>2013</b>  |
|                                                                                     | <b>\$000</b> | <b>\$000</b> | <b>\$000</b>   | <b>\$000</b> |
| Minimum lease payments under operating leases recognised as an expense for the year | <b>480</b>   | 427          | <b>297</b>     | 301          |

At the balance sheet date the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

|                          | <b>Land and buildings</b> |              |
|--------------------------|---------------------------|--------------|
|                          | <b>2014</b>               | <b>2013</b>  |
|                          | <b>\$000</b>              | <b>\$000</b> |
| <b>Group and Company</b> |                           |              |
| Amounts payable due:     |                           |              |
| – Within one year        | <b>218</b>                | 350          |
|                          | <b>218</b>                | 350          |

Operating lease payments represent rentals payable by the Group for office properties, which were negotiated and fixed for an average of one year.

## 25. Reconciliation of Operating Profit/(Loss) to Operating Cash Flow

|                                                             | <b>2014</b>    | <b>*Restated<br/>2013</b> |
|-------------------------------------------------------------|----------------|---------------------------|
|                                                             | <b>\$000</b>   | <b>\$000</b>              |
| <b>Group</b>                                                |                |                           |
| Operating profit/(loss) from continuing operations          | <b>6,352</b>   | (163,417)                 |
| Depreciation, amortisation and impairment charges           | <b>8,852</b>   | 176,744                   |
| Write down of inventory (Note 16)                           | –              | 3,045                     |
| Reversal of write down of inventory                         | –              | (313)                     |
| Movement in provisions                                      | <b>79</b>      | (499)                     |
| (Increase)/decrease in operating stock                      | <b>(99)</b>    | 164                       |
| Decrease in debtors                                         | <b>4,812</b>   | 5,905                     |
| (Decrease)/increase in creditors                            | <b>(434)</b>   | 305                       |
| <b>Cash from operations</b>                                 | <b>19,562</b>  | 21,934                    |
| <b>Company</b>                                              |                |                           |
| Operating loss                                              | <b>(2,981)</b> | (195,032)                 |
| Depreciation and amortisation                               | <b>9</b>       | 39                        |
| Movement in provisions (including against subsidiary loans) | –              | 191,542                   |
| (Increase)/decrease in debtors                              | <b>(157)</b>   | 2,326                     |
| (Decrease)/increase in creditors                            | <b>22</b>      | (409)                     |
| <b>Cash used in operations</b>                              | <b>(3,107)</b> | (1,534)                   |

## NOTES

forming part of the financial statements continued

### 26. Financial Instruments

#### Capital Risk Management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Group defines its capital as equity. The primary source of the Group's liquidity has been cash generated from operations.

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.

The capital structure of the Group consists of equity attributable to the equity holders of the parent, comprising issued share capital, share premium, reserves and retained deficit.

There are no capital requirements imposed on the Group.

The Group's financial instruments comprise cash and cash equivalents and various items such as debtors and creditors that arise directly from its operations. The Group has bank accounts denominated in British Pounds, US Dollars, Euros, Canadian Dollars and Ukrainian Hryvnia. The Group does not have any borrowings. The main future risks arising from the Group's financial instruments are currently currency risk, interest rate risk, liquidity risk and credit risk.

The Group's financial assets and financial liabilities, measured at amortised cost, which approximates their fair value comprise the following:

#### Financial Assets

|                             | 2014<br>\$000 | 2013<br>\$000 |
|-----------------------------|---------------|---------------|
| <b>Group</b>                |               |               |
| Cash and cash equivalents   | 31,836        | 25,084        |
| Trade and other receivables | 740           | 85            |
|                             | <b>32,576</b> | <b>25,169</b> |

At 31 December 2014, \$17,456,000 of Group cash and cash equivalents were held with a related party bank, Unex Bank, see Note 28 for details (31 December 2013: \$7,915,000).

|                             | 2014<br>\$000 | 2013<br>\$000 |
|-----------------------------|---------------|---------------|
| <b>Company</b>              |               |               |
| Cash and cash equivalents   | 14,061        | 16,892        |
| Trade and other receivables | 327           | 56            |
|                             | <b>14,388</b> | <b>16,948</b> |

#### Financial Liabilities

|                          | 2014<br>\$000 | 2013<br>\$000 |
|--------------------------|---------------|---------------|
| <b>Group</b>             |               |               |
| Trade and other payables | 7             | 545           |
| Accruals                 | 204           | 720           |
|                          | <b>211</b>    | <b>1,265</b>  |

|                          | 2014<br>\$000 | 2013<br>\$000 |
|--------------------------|---------------|---------------|
| <b>Company</b>           |               |               |
| Trade and other payables | —             | 70            |
| Accruals                 | 260           | 168           |
|                          | <b>260</b>    | <b>238</b>    |

All assets and liabilities of the Group where fair value is disclosed are level 2 in the fair value hierarchy and valued using the current cost accounting technique.

**26. Financial Instruments** continued**Currency Risk**

The functional currencies of the Group's entities are US Dollars and Ukrainian Hryvnia. The following analysis of net monetary assets and liabilities shows the Group's currency exposures. Exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the relevant entity.

| <b>Currency</b>                      | <b>2014<br/>\$000</b> | <b>2013<br/>\$000</b> |
|--------------------------------------|-----------------------|-----------------------|
| Canadian Dollars                     | 2                     | 3                     |
| British Pounds                       | 2,441                 | 295                   |
| Euros                                | 166                   | 1,783                 |
| United States Dollars                | —                     | 43                    |
| Ukrainian Hryvnia                    | —                     | —                     |
| Net monetary assets less liabilities | 2,609                 | 2,124                 |

**Foreign Currency Sensitivity Analysis**

The following table presents sensitivities of profit and loss to reasonably possible changes in exchange rates applied at the end of the reporting period, with all other variables held constant:

|                                      | <b>At<br/>31 December<br/>2014<br/>After tax impact on<br/>profit or loss<br/>\$000</b> | <b>At<br/>31 December<br/>2013<br/>After tax impact on<br/>profit or loss<br/>\$000</b> |
|--------------------------------------|-----------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| EUR strengthening by 30% (2013: 20%) | 50                                                                                      | 356                                                                                     |
| GBP strengthening by 30% (2013: 20%) | 732                                                                                     | 594                                                                                     |

A positive number above indicates a decrease in loss/increase in profit where the indicated currency strengthens against the functional currency. For a weakening of the indicated currency against the functional currency, there would be an equal and opposite impact on the loss/profit, and the balances above are shown negative. The Group holds currencies to match the currencies of future capital and operational expenditure.

**Interest Rate Risk Management**

The Group is not exposed to interest rate risk on financial liabilities as none of the entities in the Group have any external borrowings. The Group does not use interest rate forward contracts and interest rate swap contracts as part of its strategy.

The Group is exposed to interest rate risk on financial assets as entities in the Group hold money market deposits at floating interest rates. The risk is managed by fixing interest rates for a period of time when indications exist that interest rates may move adversely.

The Group's exposure to interest rates on financial assets and financial liabilities are detailed in the liquidity risk section below.

**Interest Rate Sensitivity Analysis**

The sensitivity analysis below has been determined based on exposure to interest rates for non-derivative instruments at the balance sheet date. A 0.5% increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of a reasonably possible change in interest rates.

## NOTES

forming part of the financial statements

### 26. Financial Instruments continued

If interest rates earned on money market deposits had been 0.5% higher/lower and all other variables were held constant, the Group's:

- profit for the year ended 31 December 2014 would increase by \$105,000 in the event of 0.5% higher interest rates and decrease by \$105,000 in the event of 0.5% lower interest rates (2013: decrease of loss for the year ended 31 December 2013 by \$40,000 in the event of 0.5% higher interest rates and increase by \$40,000 in the event of 0.5% lower interest rates). This is mainly attributable to the Group's exposure to interest rates on its money market deposits; and
- other equity reserves would not be affected (2013: not affected).

Interest payable on the Group's liabilities would have an immaterial effect on the profit or loss for the year.

#### Liquidity Risk

The Group's objective throughout the year has been to ensure continuity of funding. Operations have primarily been financed through revenue from Ukrainian operations.

Details of the Group's cash management policy are explained in Note 18.

Liquidity risk for the Group is further detailed under the "Going concern risks" section of the Strategic Report.

#### Credit Risk

Credit risk principally arises in respect of the Group's cash balance. In the UK, where \$14.2 million of the overall cash is held (31 December 2013: \$16.9 million), the Group only deposits cash surpluses with major banks of high quality credit standing. The remaining balance of \$17.6 million was held in Ukraine (31 December 2013: \$8.2 million). The political and economic turmoil in Ukraine, as outlined in the Strategic Report, caused Standard & Poor's to downgrade Ukraine's sovereign credit rating in December 2014 to "CCC- with a negative outlook". There is no international credit rating information available for the specific banks in Ukraine where the Group currently holds its cash and cash equivalents.

The significant devaluation of the Ukrainian Hryvnia, has resulted in the National Bank of Ukraine, among other measures, imposing comprehensive restrictions on the processing of client payments by banks, on the purchase of foreign currency on the inter-bank market and on the remittance of funds outside Ukraine. These restrictions, and the many other economic issues in Ukraine, have put great strain on the Ukrainian banking system, with increasing risks in the capital strength, liquidity and creditworthiness of a large number of Ukrainian banks, and very high rates in the wholesale and overnight markets. In addition, there have been significant deposit outflows from the banking system and widespread restructuring of bank clients' maturing liabilities. Furthermore, as a result of recommendations from the International Monetary Fund, significant reforms to the Ukrainian banking sector are being implemented, which are intended to strengthen the capitalisation of the Ukrainian banks.

In light of the deterioration in the banking sector in Ukraine, the Group has started to diversify its banking arrangements between a number of banks in Ukraine. These steps are designed to spread the risks associated with each bank's creditworthiness, but the Ukrainian banking sector remains weakly capitalised and so the risks associated with the banks in Ukraine remain significant, including in relation to the banks with which the Group operates bank accounts. Further details are set out in the Strategic Report and in Note 28 in relation to the Group's cash deposits with Unex Bank.

None of the Group's trade receivables are past due or impaired. All trade receivables are considered to be of high credit quality.

**26. Financial Instruments** continued**Interest Rate Risk Profile of Financial Assets**

The Group had the following cash and cash equivalent balances which are included in financial assets as at 31 December 2014 with an exposure to interest rate risk:

| Currency          | Total         | Floating rate<br>financial<br>assets | Fixed rate<br>financial<br>assets | Total         | Floating rate<br>financial<br>assets | Fixed rate<br>financial<br>assets |
|-------------------|---------------|--------------------------------------|-----------------------------------|---------------|--------------------------------------|-----------------------------------|
|                   | 2014<br>\$000 | 2014<br>\$000                        | 2014<br>\$000                     | 2013<br>\$000 | 2013<br>\$000                        | 2013<br>\$000                     |
| Canadian Dollars  | 2             | 2                                    | —                                 | 3             | 3                                    | —                                 |
| Euros             | 166           | 166                                  | —                                 | 1,783         | 1,783                                | —                                 |
| British Pounds    | 2,441         | 2,441                                | —                                 | 477           | 477                                  | —                                 |
| Ukrainian Hryvnia | 17,496        | 17,496                               | —                                 | 7,888         | 7,888                                | —                                 |
| US Dollars        | 11,731        | 11,731                               | —                                 | 14,933        | 14,933                               | —                                 |
|                   | <b>31,836</b> | <b>31,836</b>                        | <b>—</b>                          | <b>25,084</b> | <b>25,084</b>                        | <b>—</b>                          |

Cash deposits included in the above balances comprise short term deposits.

**Interest Rate Risk Profile of Financial Liabilities**

The Group had no interest bearing financial liabilities at the year end (2013: \$nil).

**Maturity of Financial Liabilities**

The maturity profile of financial liabilities, on an undiscounted basis, is as follows:

| Group               | 2014<br>\$000 | 2013<br>\$000 |
|---------------------|---------------|---------------|
|                     |               |               |
| In one year or less | 211           | 1,265         |
|                     | <b>211</b>    | <b>1,265</b>  |
|                     |               |               |
| Company             | 2014<br>\$000 | 2013<br>\$000 |
|                     |               |               |
| In one year or less | 260           | 238           |
|                     | <b>260</b>    | <b>238</b>    |

**Borrowing Facilities**

The Group did not have any borrowing facilities available to it at the year end (2013: \$nil).

**Fair Value of Financial Assets and Liabilities**

The fair value of all financial instruments is not materially different from the book value.

**27. Capital Commitments**

Amounts contracted in relation to the Group's 2015 investment programme in the MEX-GOL and SV gas and condensate fields in Ukraine, but not provided for in the financial statements at 31 December 2014, were \$171,000 (2013: \$2,153,000).

## NOTES

forming part of the financial statements

### 28. Related Party Disclosures

Key management personnel of the Group are considered to comprise only the Directors. Details of Directors' remuneration are disclosed in Note 8.

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

|                                 | 2014<br>\$000 | 2013<br>\$000 |
|---------------------------------|---------------|---------------|
| Sale of goods/services          | 86            | 1,976         |
| Purchase of goods/services      | 172           | 885           |
| Amounts owed by related parties | 44            | 19            |
| Amounts owed to related parties | 12            | 4             |

All related party transactions were with subsidiaries of the ultimate Parent Company. The amounts outstanding were unsecured and will be settled in cash.

As of 31 December 2014, the Company's immediate parent company was Energiees Management Limited, which is 100% owned by Pelidona Services Limited, which is 100% owned by Lovitia Investments Ltd, which is 100% owned by Mr V Novinskiy. Accordingly, the Company was ultimately controlled by Mr V Novinskiy.

The Group operates bank accounts in Ukraine with a related party bank, Unex Bank, which is ultimately controlled by Mr V Novinskiy. There were the following transactions and balances with Unex Bank during the year:

|                          | 2014<br>\$000 | 2013<br>\$000 |
|--------------------------|---------------|---------------|
| Interest income          | 1,987         | 812           |
| Bank charges             | 14            | 17            |
| Cash held at end of year | 17,456        | 7,915         |

Cash held with Unex Bank in Ukraine is held on similar terms to the remainder of the Group's cash balances in Ukraine (see Note 18). The political and economic turmoil in Ukraine, as outlined in the Strategic Report, caused Standard & Poor's to downgrade Ukraine's sovereign credit rating in December 2014 to "CCC- with a negative outlook".

The significant strains affecting the Ukrainian banking system, which are detailed in the Strategic Report and in Note 26, have caused the Group to start to diversify its banking arrangements between a number of banks in Ukraine. These steps are designed to spread the risks associated with each bank's creditworthiness.

The Group holds a significant proportion of its Ukrainian Hryvnia cash deposits in Unex Bank, but is taking steps to rebalance its cash holdings between other banks in Ukraine.

In the meantime, the Group has obtained additional assurances regarding the security of its cash deposits in Unex Bank, including a representation letter from Unex Bank advising that it continues to fulfil all regulatory requirements of the National Bank of Ukraine, as well as a guarantee and security over another asset from companies within the Smart Holding Group in support of the Group's cash deposits in Unex Bank.

At the date of this report, none of the Company's controlling parties prepares consolidated financial statements available for public use.

## 29. Post Balance Sheet Events

**Revision to Tax Code.** In late December 2014, the Ukrainian Government enacted a law which significantly revised the tax code effective from 1 January 2015. The most significant changes are:

- Revised corporate tax computation rules, whereby the basis for calculating corporation tax is now adjusted accounting profit, rather than a separate calculation of taxable income and deductible expenses;
- Revisions to the rules governing the payment of VAT, which require output VAT to be paid to the tax authorities based on the supply of the good or service, net of input VAT if this VAT is determined to have been paid to the tax authorities by the Group's suppliers;
- A new real estate (property) tax to be levied based on the floor area of the Group's buildings (subject to certain reliefs).

Management expects that the VAT revision and new property tax will increase its tax payments in 2015 but cannot yet determine by how much. Management does not believe the new corporate tax rules will significantly change its corporate profit taxes.

**Transfer pricing.** On 25 December 2014, the Ukrainian Government passed the first reading on changes to transfer pricing ("TP") regulations. The main changes, which are likely to apply from 2015, are:

- Introduction of the arm's length principle replacing market price. If the price or profitability for the controlled transactions does not fall within the arm's length range, TP adjustments will be made to a median level (not the lower/upper limit of the range as is currently allowed);
- The definitions of related parties and controlled transactions are expanded;
- The criteria for recognition of controlled transactions have been separated for corporate profit tax and VAT purposes.
- Reduction of the threshold for controlled transactions to UAH1 million or 3% of the taxpayer's revenue with one counterparty;
- The priority of "official sources" of information will no longer apply;
- Increased penalties for non-reporting of controlled transactions and for not providing TP documentation;
- Penalties for non-provision of TP documentation changed to 3% of the amount of the controlled transaction.

Management is currently evaluating the impact of the changes to the TP legislation on the Group's activities.

**Currency restriction.** On 4 March 2015, the National Bank of Ukraine strengthened currency control restrictions and introduced the following additional restrictions:

- The threshold for service payments to non-residents, which require price expertise of the Foreign Markets Monitoring Centre, was decreased from €50,000 to €25,000 per year with one counterparty;
- In order to purchase or transfer foreign currency abroad under import transactions, clients are obliged to provide to the servicing bank a Certificate from the State Fiscal Service of Ukraine on the absence of tax debt;
- Companies cannot purchase foreign currency if they have more than \$10,000 on their current and deposit accounts in all banks;
- A ban on remitting funds to foreign investors through payment of dividends on securities traded on the stock exchange and a decrease in the charter capital or the exit of foreign investors from legal entities.

The currency restrictions have significantly affected the Group's ability to purchase foreign currency and to remit funds outside Ukraine, which has affected the Group's treasury and currency management.

Since the beginning of 2015, the Parliament and the Cabinet of Ministers of Ukraine have passed for approval a number of changes to various legislative acts in respect of the Ukrainian gas market and procedure of obtaining licences for gas extraction. Management is currently assessing the possible impact of these changes on the Group.

## NOTES

forming part of the financial statements

### 29. Post Balance Sheet Events *continued*

As a result of the continuing geopolitical and economic upheaval in Ukraine, there has been a significant devaluation of the Ukrainian Hryvnia against the US Dollar which is likely to affect the carrying value of the Group's assets in the future. Since 1 January 2015, the Ukrainian Hryvnia has devalued against the US Dollar from UAH15.8/\$1.00 to UAH20.7/\$1.00 on 22 May 2015.

The significant strains affecting the Ukrainian banking system, which are detailed in the Strategic Report and in Note 26, have caused the Group to start to diversify its banking arrangements between a number of banks in Ukraine. The Group currently holds a significant proportion of its Ukrainian Hryvnia cash deposits in a related party bank, Unex Bank, but is currently taking steps to rebalance its cash holdings between other banks in Ukraine. In the meantime, the Group has obtained additional assurances regarding the security of its cash deposits in Unex Bank, including a representation letter from Unex Bank advising that it continues to fulfil all regulatory requirements of the National Bank of Ukraine, as well as a guarantee and security over another asset from companies within the Smart Holding Group in support of the Group's cash deposits in Unex Bank.

In April 2015, it was announced that the imported gas price calculated under the longstanding gas supply agreement between Russia and Ukraine was to be \$248/Mm<sup>3</sup> for the second quarter of 2015, reflecting the recent decrease in global oil commodity prices.

The maximum industrial gas price set by the National Commission for State Energy and Public Utilities Regulation with effect from 1 May 2015 is \$324/Mm<sup>3</sup> (UAH 6,810/Mm<sup>3</sup> using the exchange rate at 30 April 2015 of UAH21.0/\$1.00).

## ADVISORS

### Company Secretary and Registered Office

**Chris Phillips**  
16 Old Queen Street  
London SW1H 9HP  
United Kingdom

### Auditors

**PricewaterhouseCoopers LLP**  
1 Embankment Place  
London WC2N 6RH  
United Kingdom

### Bankers

**Lloyds Bank Corporate**  
London Chief Office  
155 Bishopsgate  
London EC2M 3YB  
United Kingdom

### Solicitors

**Pinsent Masons LLP**  
30 Crown Place  
London EC2A 4ES  
United Kingdom

### Nominated Advisor

**Strand Hanson Limited**  
26 Mount Row  
London W1K 3SQ  
United Kingdom

### Joint Broker

**Merrill Lynch International**  
Merrill Lynch Financial Centre  
2 King Edward Street  
London EC1A 1HQ  
United Kingdom

### Joint Broker

**Jefferies Hoare Govett**  
Vintners Place  
68 Upper Thames Street  
London EC4V 3BJ  
United Kingdom

### Share Registry

**Computershare Investor Services PLC**  
The Pavilions  
Bridgwater Road  
Bristol BS99 6ZY  
United Kingdom

### PR Advisors

**Citigate Dewe Rogerson**  
3 London Wall Buildings  
London EC2M 5SY  
United Kingdom

## GLOSSARY

|                        |                                              |              |                                                                                       |
|------------------------|----------------------------------------------|--------------|---------------------------------------------------------------------------------------|
| <b>bbl</b>             | barrel                                       | <b>MMboe</b> | million barrels of oil equivalent                                                     |
| <b>boe</b>             | barrels of oil equivalent                    | <b>%</b>     | per cent                                                                              |
| <b>Bscf</b>            | thousands of millions of standard cubic feet | <b>scf</b>   | standard cubic feet measured at 14.7 pounds per square inch and 60 degrees Fahrenheit |
| <b>boepd</b>           | barrels of oil equivalent per day            | <b>\$</b>    | United States Dollar                                                                  |
| <b>HSES</b>            | health, safety, environment and security     | <b>UAH</b>   | Ukrainian Hryvnia                                                                     |
| <b>km</b>              | kilometres                                   |              |                                                                                       |
| <b>km<sup>2</sup></b>  | square kilometres                            |              |                                                                                       |
| <b>LPG</b>             | liquefied petroleum gas                      |              |                                                                                       |
| <b>m<sup>3</sup></b>   | cubic metre                                  |              |                                                                                       |
| <b>m<sup>3</sup>/d</b> | cubic metres per day                         |              |                                                                                       |
| <b>Mm<sup>3</sup></b>  | thousand cubic metres                        |              |                                                                                       |
| <b>Mtonnes</b>         | thousand tonnes                              |              |                                                                                       |
| <b>MMbbl</b>           | million barrels                              |              |                                                                                       |

**Regal Petroleum plc**  
16 Old Queen Street  
London  
SW1H 9HP  
+44 (0)20 3427 3550  
[www.regalpetroleum.com](http://www.regalpetroleum.com)  
[info@regalpetroleum.com](mailto:info@regalpetroleum.com)  
Stock code: RPT