Alliance Oil Company Ltd

International Accounting Standard No. 34

Condensed Consolidated Interim
Financial Statements
and Review Report

30 June 2018

CONTENT

ALLIANCE OIL COMPANY LTD

Statement of management's responsibilities for the preparation and approval of the condensed consolidated interim financial statements for the quarter and six months ended 30 June 2018

Management is responsible for the preparation of the condensed consolidated interim financial statements that present fairly the financial position of Alliance Oil Company Ltd and its subsidiaries (the «Group») as at 30 June 2018, and the results of its operations, cash flows and changes in shareholders' equity for the six months then ended, in compliance with IAS 34, «Interim financial reporting».

In preparing the condensed consolidated interim financial statements, management is responsible for:

- properly selecting and applying accounting policies and significant estimates;
- presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- providing additional disclosures when compliance with the specific requirements in International Financial Reporting Standards («IFRS») are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance; and
- making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- preventing and detecting fraud and other irregularities.

On behalf of management:

Andreas Andreou
Director

V.V. Bondarenko
Chief Financial Officer

10 September 2018

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REPORT ON REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

To the Shareholder and Management of Alliance Oil Company Ltd.

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of Alliance Oil Company Ltd. and its subsidiaries (the "Group") as of 30 June 2018 and the related condensed consolidated interim statements of profit or loss and comprehensive income for the three months and six months then ended, and changes in equity and cash flows for the six months then ended, and selected explanatory notes. Management is responsible for the preparation and presentation of these condensed consolidated interim financial statements in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on these condensed consolidated interim financial statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Material Uncertainty Related to Going Concern

The accompanying condensed consolidated interim financial statements have been prepared assuming that the Group will continue as a going concern. As discussed in Notes 2 and 17 to the condensed consolidated interim financial statements, the Group has incurred loss for the period, ended 30 June 2018, of USD 203.7 million and its current liabilities exceeded its current assets by USD 655.3 million. These events or conditions, along with other matters as set forth in Notes 2 and 17, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as going concern. Management's plans concerning these matters are also discussed in Notes 2 and 17 to the condensed consolidated interim financial statements.
The condensed consolidated interim financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements are not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Andrei Shvetsov
Engagement partner

Deloitte & Touche

АКЦИОНЕРНОЕ ОБЩЕСТВО «ДЕЛОЙТ И ТУШ СНГ»
для аудиторских заключений и отчетов
Россия, г. Москва, ул. Лесная, д. 5

10 September 2018

The Entity: Alliance Oil Company Limited

Registration number: 25413

Address: Clarendon House, 2 Church Street, Hamilton, HM 11, Bermuda

Audit Firm: AO "Deloitte & Touche CIS"

Certificate of state registration № 018.482, issued by the Moscow Registration Chamber on 30.10.1992.

Primary State Registration Number: 1027700425444

Certificate of registration in the Unified State Register № 77 004840299 of 13.11.2002, issued by Moscow Interdistrict Inspectorate of the Russian Ministry of Taxation № 39.

Member of Self-regulated organization of auditors "Russian Union of auditors" (Association), ORNZ 11603080484.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS (UNAUDITED)

(Expressed in USD thousands)		Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Revenue					
Revenue from sales of crude oil and gas		265,121	170,884	489,137	336,808
Revenue from sales of oil products		624,761	475,491	1,252,030	998,665
Revenue from other sales		14,840	8,550	30,036	16,010
		904,722	**654,925**	**1,771,203**	**1,351,483**
Cost of sales					
Production costs of crude oil and gas	5	(162,433)	(96,685)	(301,846)	(188,460)
Production costs of oil products	6	(529,390)	(390,558)	(1,085,970)	(823,530)
Cost of other sales		(7,035)	(4,743)	(13,400)	(9,621)
Depletion and depreciation of oil and gas production and refining assets		(43,820)	(48,999)	(89,242)	(93,238)
Gross profit		**162,044**	**113,940**	**280,745**	**236,634**
Selling expenses		(62,833)	(58,378)	(132,333)	(120,234)
Administrative expenses		(20,777)	(28,146)	(41,347)	(51,898)
Depreciation and amortisation of marketing and other assets		(3,621)	(4,090)	(7,502)	(7,983)
Other operating (expenses)/income, net		(3,481)	6,816	(5,868)	7,038
Foreign currency exchange loss from non-financing activities, net		(41,534)	(8,961)	(43,134)	(3,803)
Operating income		**29,798**	**21,181**	**50,561**	**59,754**
Interest income		14,762	9,728	29,917	18,955
Finance costs	7	(69,890)	(50,257)	(121,912)	(100,227)
Share of profits of associates and joint ventures		-	943	-	1,867
Foreign currency exchange (loss)/gain from financing activities, net		(52,583)	(39,441)	(50,551)	22,653
(Loss)/Profit before tax		**(77,913)**	**(57,846)**	**(91,985)**	**3,002**
Income tax expense	8	(107,335)	(3,119)	(111,724)	(17,194)
Loss for the period		**(185,248)**	**(60,965)**	**(203,709)**	**(14,192)**
Attributable to:					
Owner of the Company		(206,193)	(79,172)	(237,946)	(36,099)
Non-controlling interests		20,945	18,207	34,237	21,907
		(185,248)	**(60,965)**	**(203,709)**	**(14,192)**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

(Expressed in USD thousands)	Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Loss for the period	(185,248)	(60,965)	(203,709)	(14,192)
Other comprehensive income				
Items that may be reclassified subsequently to profit or loss:				
Effect of translation of foreign operations	(92,962)	(56,215)	(79,559)	36,877
Currency exchange differences on intercompany loans forming net investment in foreign operations, net of income tax	-	(4,438)	-	2,374
Other comprehensive (loss)/income for the period, net of income tax	**(92,962)**	**(60,653)**	**(79,559)**	**39,251**
Total comprehensive (loss)/income for the period	**(278,210)**	**(121,618)**	**(283,268)**	**25,059**
Attributable to:				
Owner of the Company	(284,033)	(127,193)	(304,602)	(2,878)
Non-controlling interests	5,823	5,575	21,334	27,937
	(278,210)	**(121,618)**	**(283,268)**	**25,059**

ALLIANCE OIL COMPANY LTD

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

(Expressed in USD thousands)	Note	30 June 2018	31 December 2017
ASSETS			
Non-current assets			
Property, plant and equipment	9	2,213,435	2,400,156
Goodwill		39,470	43,003
Deferred tax assets	8	46,596	60,942
Other financial assets	10	621,460	639,986
Other non-current assets		2,752	1,425
		2,923,713	**3,145,512**
Current assets			
Inventories		228,825	198,518
Trade and other accounts receivable		78,542	64,387
Value added tax recoverable and other taxes receivable		104,693	83,401
Income tax receivable		13,428	11,496
Advances paid and prepaid expenses		91,345	90,553
Cash and cash equivalents		138,836	183,111
		655,669	**631,466**
TOTAL ASSETS		**3,579,382**	**3,776,978**
EQUITY AND LIABILITIES			
Capital and reserves			
Share capital		2	2
Additional paid-in capital		1,353,807	1,353,807
Translation reserve on intercompany loans		(512,551)	(512,551)
Foreign currency translation reserve		(1,472,006)	(1,405,350)
Retained earnings		937,433	1,210,153
Equity attributable to owner of the Company		**306,685**	**646,061**
Non-controlling interests		158,678	166,235
TOTAL EQUITY		**465,363**	**812,296**
Non-current liabilities			
Loans and borrowings	11	1,212,345	1,213,897
Advances received	12	341,549	286,004
Financing component of long-term advances received	12	59,435	40,110
Deferred tax liabilities	8	149,522	96,723
Provision for decommissioning and site restoration costs		33,807	34,290
Post-employment benefit obligations		6,417	6,580
		1,803,075	**1,677,604**
Current liabilities			
Loans and borrowings	11	756,421	828,340
Trade and other accounts payable	13	136,234	63,808
Advances received and accrued expenses		319,984	283,611
Income tax payable		4,400	10,341
Other taxes payable		93,905	100,978
		1,310,944	**1,287,078**
TOTAL LIABILITIES		**3,114,019**	**2,964,682**
TOTAL EQUITY AND LIABILITIES		**3,579,382**	**3,776,978**

The accompanying notes on pages 6-15 are an integral part of these interim condensed consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

	Attributable to owner of the Company							
(Expressed in USD thousands)	Share capital	Additional paid-in capital	Translation reserve on inter-company loans	Foreign currency translation reserve	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 2017	**2**	**1,353,798**	**(516,117)**	**(1,477,508)**	**1,290,952**	**651,127**	**249,836**	**900,963**
(Loss)/Profit for the period	-	-	-	-	(36,099)	**(36,099)**	21,907	**(14,192)**
Other comprehensive income, net of income tax	-	-	2,374	30,847	-	**33,221**	6,030	**39,251**
Total comprehensive income/(loss) for the period	**-**	**-**	**2,374**	**30,847**	**(36,099)**	**(2,878)**	**27,937**	**25,059**
Changes in ownership of subsidiaries	-	11	-	-	-	**11**	(85)	**(74)**
Balance at 30 June 2017	**2**	**1,353,809**	**(513,743)**	**(1,446,661)**	**1,254,853**	**648,260**	**277,688**	**925,948**
Balance at 31 December 2017	**2**	**1,353,807**	**(512,551)**	**(1,405,350)**	**1,210,153**	**646,061**	**166,235**	**812,296**
Adjustment on initial application of IFRS 9 (Note 10, 11)	-	-	-	-	(34,774)	**(34,774)**	-	**(34,774)**
Balance at 1 January 2018 (adjusted for the effect of IFRS 9)	**2**	**1,353,807**	**(512,551)**	**(1,405,350)**	**1,175,379**	**611,287**	**166,235**	**777,522**
(Loss)/Profit for the period	-	-	-	-	(237,946)	**(237,946)**	34,237	**(203,709)**
Other comprehensive loss, net of income tax	-	-	-	(66,656)	-	**(66,656)**	(12,903)	**(79,559)**
Total comprehensive (loss)/income for the period	**-**	**-**	**-**	**(66,656)**	**(237,946)**	**(304,602)**	**21,334**	**(283,268)**
Changes in ownership of subsidiaries	-	-	-	-	-	**-**	(15)	**(15)**
Dividends	-	-	-	-	-	**-**	(28,876)	**(28,876)**
Balance at 30 June 2018	**2**	**1,353,807**	**(512,551)**	**(1,472,006)**	**937,433**	**306,685**	**158,678**	**465,363**

CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

(Expressed in USD thousands)	**Six months ended 30 June 2018**	**Six months ended 30 June 2017**
Operating activities		
(Loss)/Profit before tax	(91,985)	3,002
Adjustments for:		
Depreciation, depletion and amortisation	96,744	101,221
Interest income	(29,917)	(18,955)
Finance costs	121,912	100,227
Foreign currency exchange loss/(gain) from financing activities, net	50,551	(22,653)
Foreign currency exchange loss from non-financing activities, net	43,134	3,803
Share of profits of associates and joint venture	-	(1,867)
Other non-cash items	5,502	1,841
Operating cash flows before changes in working capital	**195,941**	**166,619**
Movements in working capital and other liabilities		
(Increase)/Decrease in inventories	(47,892)	13,002
(Increase)/Decrease in accounts receivable, advances paid and prepaid expenses	(57,599)	11,409
Increase in accounts payable, advances received and accrued expenses	175,344	76,951
Cash generated from operations	**265,794**	**267,981**
Interest paid	(101,115)	(95,965)
Income tax paid	(42,227)	(28,009)
Total cash generated from operating activities	**122,452**	**144,007**
Investing activities		
Investments in oil and gas production assets	(63,018)	(36,743)
Investments in refining assets	(5,802)	(10,318)
Investments in marketing and other assets	(6,612)	(3,877)
Interest capitalised and paid	(1,247)	(1,687)
Proceeds from disposal of assets	281	199
Interest received	3,858	2,805
Loans provided	(23,819)	(29,704)
Total cash used in investing activities	**(96,359)**	**(79,325)**
Financing activities		
Proceeds from loans and borrowings	325,191	246,445
Repayment of loans and borrowings	(277,361)	(298,456)
Partial bonds repayment	(87,418)	-
Bank loans issue costs	(1,176)	-
Bond restructuring costs	(405)	-
Dividends distributed	(23,437)	-
Other financial activities	(21)	(74)
Total cash used in financing activities	**(64,627)**	**(52,085)**
Effect of foreign currencies exchange rate changes	(5,741)	2,371
Change in cash and cash equivalents	**(44,275)**	**14,968**
Cash and cash equivalents at beginning of the period	183,111	138,113
Cash and cash equivalents at end of the period	**138,836**	**153,081**

Note 1 Organisation

Alliance Oil Company Limited (the «Company») and its subsidiaries (together the «Group») is an independent vertically integrated oil and gas holding with upstream operations in the Russian Federation and Kazakhstan and downstream operations in the Russian Federation. The Group's upstream operations include crude oil and gas exploration, extraction and production in the Timano-Pechora, Volga-Urals and Tomsk regions of the Russian Federation and the Atyrau region of Kazakhstan. The downstream operations include oil refining, transportation, marketing and sales of oil products in the Russian Far East and Eastern Siberia.

Alliance Oil Company Limited was incorporated in Bermuda on 1 September 1998 as a tax exempted limited liability private company. The Company's registered office is located at: Clarendon House, 2 Church Street, Hamilton HM11, Bermuda.

Note 2 Basis of preparation and significant accounting policies

These condensed consolidated interim financial statements for the six months ended 30 June 2018 have been prepared in accordance with IAS 34, «Interim financial reporting». These consolidated condensed interim financial statements supplement the annual consolidated financial statements prepared in accordance with International Financial Reporting Standards.

The principal accounting policies and significant judgments and estimates applied therein are consistent with those of the consolidated financial statements for the year ended 31 December 2017, except for the policies which were changed to comply with the new or amended standards and interpretations that are in force for the year beginning on 1 January 2018 (Note 3) and estimates regarding recoverability of deferred tax assets.

<u>Income taxes</u>

Taxes on income in the interim periods are accrued using the tax rate that would be applicable to expected total annual profit or loss.

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant judgment on the part of management is required to determine total deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies. Future taxable profits and total tax benefits that are probable in the future are based on a midterm business plan prepared by management and the extrapolated results thereafter. This business plan is based on management's expectations that are believed to be reasonable under the relevant circumstances.

The recognised deferred tax asset represents income taxes recoverable through future deductions from income tax expense and is recorded in the consolidated statement of financial position. Deferred income tax assets are recognised to the extent that utilisation of the related tax benefit is probable. Taking into account recent legal and market developments management recognised allowance for deferred tax assets for unused tax losses in the amount of USD 88.1 million (Note 8).

<u>Seasonality of operations</u>

The Group's operations are not seasonal. Income and expenses are earned and incurred evenly during the financial year.

<u>Going concern</u>

In assessing its going concern status, management has taken account of the Group's financial position, expected future trading performance, its borrowings and available credit facilities, anticipated additional borrowing facilities under negotiation and its capital expenditures commitments and plans, together with other risks facing the Group. The Group has incurred loss for the six months ended 30 June 2018 of USD 203.7 million (the six months ended 30 June 2017: 14.2 million), the Group's current liabilities at

Note 2 Basis of preparation and significant accounting policies (continued)

30 June 2018 exceeded its current assets by USD 655.3 million (31 December 2017: by USD 655.6 million). After reviewing the Group's forecasts and projections (Note 17), management concluded that the Group has adequate resources to continue in operational existence for at least the next 12 months from the date of authorisation of these condensed consolidated financial statements. Thus, it is appropriate to adopt the going concern basis in preparing these condensed consolidated financial statements.

Note 3 Adoption of new and revised standards and interpretations

The following amendments to standards were applied for the first time in 2018:

- IFRS 9 «Financial instruments»

  The final version of IFRS 9 issued in 2014 replaces IAS 39 «Financial Instruments: Recognition and Measurement», as well as all previous versions of IFRS 9. IFRS 9 brings together the requirements for the classification and measurement, impairment and hedge accounting of financial instruments.

  In respect of impairment of financial assets (loans provided), IFRS 9 replaces the «incurred loss» model used in IAS 39 with a new «expected credit loss» model that will require a more timely recognition of expected credit losses. According to the new standard, expected credit losses for financial assets were estimated based on the credit risk of the debtors. The effect of initial application (additional reserves) in the total amount of USD 27.6 million, net of income tax, was recognised directly in equity with no effect on profit or loss in 2017 and 2018.

  Also the Group applied new requirements in respect for recognition of the result of non-substantial modifications of loan agreements. The cumulative effect was recognised directly in equity in the total amount of USD 7.2 million, net of income tax.

- IFRS 15 «Revenue from contracts with customers»

  IFRS 15 establishes a single framework for revenue recognition and contains requirements for related disclosures. The new standard replaces IAS 18 «Revenue», IAS 11 «Construction Contracts», and the related interpretations on Revenue recognition. As a result of the analysis performed by the Group, the conclusion was made that the standard has no significant impact on the condensed consolidated interim financial statements.

Note 4 Segment information

The Group identifies segments in accordance with the criteria set forth in IFRS 8 «Operating segments», as well as based on how its operations are regularly reviewed by the chief operating decision-maker in order to analyse performance and allocate resources.

The Group has identified the following business segments:

- Upstream segment, which includes crude oil and gas exploration, extraction and production;
- Downstream segment, which includes oil refining, transportation and sale of oil products;
- Management and other companies segment, which include management function, parent company and subsidiaries involved in non-core activities.

Management reviews and evaluates the performance of these segments on a regular basis.

Management assesses the performance of the operating segments based on segment-adjusted EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation). The segment financial information provided to management is prepared using the management accounts and includes segment-adjusted EBITDA as a measure of profitability in order to allocate finance and make operational decisions. Segment-adjusted EBITDA is prepared on a basis that does not directly align with IFRS. The explanations for the differences as to IFRS are included below, as a reconciliation of segment-adjusted EBITDA to profit before tax.

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 4 Segment information (continued)

Business segment assets and liabilities are not reviewed by management and, thus, are not disclosed in these condensed consolidated interim financial statements.

Financial information by reportable segments is presented below:

Quarter ended 30 June 2018

	Upstream	Down-stream	Management and other companies	Total reportable segments	Inter-segment eliminations	Reconci-ling items	Total
Total segment revenue	200,345	702,102	140	902,587	(467)	2,602	904,722
Less inter-segment revenue	-	(459)	(8)	(467)	467	-	-
Revenue from external customers	200,345	701,643	132	902,120	-	2,602	904,722
Segment-adjusted EBITDA	**97,093**	**38,825**	**(19,486)**	**116,431**	**-**	**9,550**	**125,981**
Foreign currency exchange gain/(loss) from financing activities, net	14,900	(60,035)	(3,840)	(48,975)	-	(3,608)	(52,583)
Profit/(Loss) for the period	**48,676**	**(46,365)**	**(61,002)**	**(58,691)**	**-**	**(126,557)**	**(185,248)**

Quarter ended 30 June 2017

	Upstream	Down-stream	Management and other companies	Total reportable segments	Inter-segment eliminations	Reconci-ling items	Total
Total segment revenue	153,647	503,803	417	657,867	(4,180)	1,238	654,925
Less inter-segment revenue	-	(3,941)	(239)	(4,180)	4,180	-	-
Revenue from external customers	153,647	499,862	178	653,687	-	1,238	654,925
Segment-adjusted EBITDA	**51,089**	**40,423**	**(26,382)**	**65,130**	**-**	**9,701**	**74,831**
Foreign currency exchange (loss)/gain from financing activity, net	(5,491)	(41,076)	3,402	(43,165)	-	3,724	(39,441)
Loss for the period	**(5,753)**	**(35,586)**	**(33,958)**	**(75,297)**	**-**	**14,332**	**(60,965)**

Six months ended 30 June 2018

	Upstream	Down-stream	Management and other companies	Total reportable segments	Inter-segment eliminations	Reconci-ling items	Total
Total segment revenue	378,381	1,389,054	239	1,767,674	(563)	4,092	1,771,203
Less inter-segment revenue	-	(547)	(16)	(563)	563	-	-
Revenue from external customers	378,381	1,388,507	223	1,767,111	-	4,092	1,771,203
Segment-adjusted EBITDA	**163,661**	**65,313**	**(38,366)**	**190,608**	**-**	**5,285**	**195,893**
Foreign currency exchange gain/(loss) from financing activity, net	12,938	(58,134)	(1,989)	(47,185)	-	(3,366)	(50,551)
Profit/(Loss) for the period	**52,335**	**(52,483)**	**(90,227)**	**(90,375)**	**-**	**(113,334)**	**(203,709)**

Six months ended 30 June 2017

	Upstream	Down-stream	Management and other companies	Total reportable segments	Inter-segment eliminations	Reconci-ling items	Total
Total segment revenue	324,019	1,043,336	774	1,368,129	(17,859)	1,213	1,351,483
Less inter-segment revenue	(10,206)	(7,187)	(466)	(17,859)	17,859	-	-
Revenue from external customers	313,813	1,036,149	308	1,350,270	-	1,213	1,351,483
Segment-adjusted EBITDA	**116,267**	**79,003**	**(47,576)**	**147,694**	**-**	**14,385**	**162,079**
Foreign currency exchange gain from financing activity, net	2,439	18,013	4,645	25,097	-	(2,444)	22,653
Profit/(Loss) for the period	**8,168**	**10,975**	**(62,802)**	**(43,659)**	**-**	**29,467**	**(14,192)**

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 4 Segment information (continued)

Revenue of the Upstream and Downstream segments includes revenue from sales of crude oil and gas, and oil products, respectively, as well as revenue from other sales.

The reconciliation of segment-adjusted EBITDA to the Group level adjusted EBITDA includes the following reconciling items:

- elimination of unrealised gains/losses on intra-segment operations;
- foreign currency exchange gains/losses from non-financing activities;
- share of profits of associate and joint venture.

The prices used in transactions between reportable segments are determined at an arm's length basis in a manner equal to transactions with third parties, with the exception of received and provided loans.

Reconciliation of the segment-adjusted EBITDA to profit before tax is presented below:

	Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Adjusted EBITDA of reportable segments	116,431	65,130	190,608	147,694
Effect of reconciling items	9,550	9,701	5,285	14,385
Adjusted EBITDA	**125,981**	**74,831**	**195,893**	**162,079**
Depreciation, depletion and amortisation	(47,441)	(53,089)	(96,744)	(101,221)
Interest income	14,762	9,728	29,917	18,955
Finance costs	(69,890)	(50,257)	(121,912)	(100,227)
Foreign currency exchange (loss)/gain from financing activities, net	(52,583)	(39,441)	(50,551)	22,653
Foreign currency exchange loss from non-financing activities, net	(45,098)	-	(45,098)	-
Expected credit losses	(3,770)	-	(3,770)	-
Other	126	382	280	763
(Loss)/Profit before tax	**(77,913)**	**(57,846)**	**(91,985)**	**3,002**

Note 5 Production costs of crude oil and gas

	Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Mineral extraction tax	70,915	49,169	135,356	103,366
Crude oil purchased for re-sale	64,743	17,456	110,899	26,005
Employee benefits	7,107	7,909	15,575	16,017
Repairs and maintenance	6,077	7,206	12,134	13,309
Taxes other than income tax and mineral extraction tax	3,972	4,631	7,789	9,280
Materials and fuel	2,469	2,951	5,550	6,386
Other	7,150	7,363	14,543	14,097
	162,433	**96,685**	**301,846**	**188,460**

Note 6 Production costs of oil products

	Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Crude oil purchased for refining	370,650	253,929	772,948	564,677
Taxes other than income tax	70,821	51,313	141,052	98,819
Transportation	32,292	30,010	70,463	67,749
Oil products purchased for re-sale	28,672	26,041	45,820	36,731
Materials	8,948	9,998	20,113	22,102
Employee benefits	6,466	6,203	12,653	11,750
Other	11,541	13,064	22,921	21,702
	529,390	**390,558**	**1,085,970**	**823,530**

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 7 Finance costs

	Quarter ended 30 June 2018	Quarter ended 30 June 2017	Six months ended 30 June 2018	Six months ended 30 June 2017
Interest expense on loans and borrowings	23,590	24,694	47,172	49,340
Interest expense on bonds	18,637	21,679	38,633	42,953
Amortisation of debt issue costs and bank commissions	(512)	1,719	1,548	3,880
Unwinding of discount on provision for decommissioning and site restoration costs	775	616	1,622	1,193
Loans and borrowings modification losses, net (Note 11)	19,797	-	19,797	-
Other	8,055	2,481	14,009	4,644
Less: amounts included in the cost of qualifying assets	(452)	(932)	(869)	(1,783)
	69,890	**50,257**	**121,912**	**100,227**

Note 8 Income tax

The recognised deferred tax asset represents income taxes recoverable through future deductions from income tax expense and is recorded in the consolidated statement of financial position. Deferred income tax assets are recognised to the extent that utilisation of the related tax benefit is probable. Taking into account recent legal and market developments management recognised allowance for deferred tax assets for unused tax losses in the amount of USD 88.1 million.

Russian tax legislation imposes 15% withholding tax on the amount of interest paid by russian companies to foreign entities at the moment of money transfer. Provision for withholding tax in the amount of USD 24.7 million was recognised in profit or loss.

	Six months ended 30 June 2018
Balance at 31 December 2017:	
Deferred tax asset	60,942
Deferred tax liability	(96,723)
Net deferred tax liability at 31 December 2017	**(35,781)**
Adjustment on initial application of IFRS 9	8,389
Net deferred tax liability at 1 January 2018 adjusted for the effect of IFRS 9	**(27,392)**
Deferred income tax charged for the reporting period	34,899
Allowance for deferred tax assets	(88,143)
Withholding tax	(24,665)
Effect of translation to presentation currency	2,375
Balance at 30 June 2018:	
Deferred tax asset	46,596
Deferred tax liability	(149,522)
Net deferred tax liability at 30 June 2018	**(102,926)**

Note 9 Property, plant and equipment

During the six months ended 30 June 2018, additions to the construction and acquisition of production and other assets amounted to USD 109.0 million (six months ended 30 June 2017: USD 55.5 million), including USD 95.8 million related to oil and gas fields (six months ended 30 June 2017: USD 37.2 million) and USD 7.5 million related to AO NNK-Khabarovsk Oil Refinery (six months ended 30 June 2017: USD 14.4 million).

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 9 Property, plant and equipment (continued)

Useful economic lives of oil and gas production assets

The Group's oil and gas production assets are depleted over the respective life of the oil and gas fields using the unit-of-production method based on 2P oil and gas reserves and incorporating the anticipated future capital cost for the development of those reserves. Depletion rates for the six months ended 30 June 2018 were based on an independent reserve engineer report as at 31 December 2017 (six months ended 30 June 2017: based on the report as at 31 December 2016).

Note 10 Other financial assets

	30 June 2018	31 December 2017
Loans provided to an entity under common control, including interest accrued	634,378	617,254
Loan provided to a third party, including interest accrued	22,242	22,242
Less: expected credit losses	(35,387)	-
Other	227	490
	621,460	**639,986**

As a result of initial application of IFRS 9 in 2018, the Group recognised directly in equity expected credit losses in respect of loans provided in the total amount of USD 27.6 million, net of income tax, as at 1 January 2018.

During the six months ended 30 June 2018, new tranches of the RUB-denominated loan were provided to an entity under common control in the amount of RUB 1,399.3 million (USD 23.8 million) bearing interest of 8.21% per annum and maturing in March 2019.

Note 11 Loans and borrowings

					30 June 2018
	Currency	Interest rate	Principal	Interest	Total
Non-convertible interest-bearing Eurobonds	USD	7.0%-11.5%	721,921	13,326	735,247
Bank loans denominated in USD	USD	6.53%	600,492	3,202	603,694
Bank loans denominated in RUB	RUB	9.25%-15.5%	524,895	2,627	527,522
Non-convertible interest-bearing bonds	RUB	9.5%	101,682	621	102,303
Total loans and borrowings			**1,948,990**	**19,776**	**1,968,766**
Short-term and current portion of long-term loans and borrowings					756,421
Long-term loans and borrowings					**1,212,345**

					31 December 2017
	Currency	Interest rate	Principal	Interest	Total
Non-convertible interest-bearing Eurobonds	USD	7.0%-11.0%	765,493	14,491	779,984
Bank loans denominated in USD	USD	5.3%	608,204	2,500	610,704
Bank loans denominated in RUB	RUB	10.75%-15.5%	490,109	3,184	493,293
Non-convertible interest-bearing bonds	RUB	10.25%	157,165	1,091	158,256
Total loans and borrowings			**2,020,971**	**21,266**	**2,042,237**
Short-term and current portion of long-term loans and borrowings					828,340
Long-term loans and borrowings					**1,213,897**

As a result of initial application of IFRS 9 in 2018, the Group recognised directly in equity effect of non-substantial modifications of loan agreements in the total amount of USD 7.2 million, net of income tax. Amendments to loan agreements signed in 2018 resulted in modification losses in the amount of USD 19.8 million recognised in profit or loss (Note 7).

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 11 Loans and borrowings (continued)

In June 2018, non-convertible interest-bearing RUB-denominated bonds, issued by AO Neftegazkholding, a subsidiary of the Group, were partially repaid in the amount of RUB 2,632 million (USD 42.6 million). Remaining RUB-denominated bonds in the amount of RUB 6,495 million (USD 103.5 million) will be redeemed in accordance with the approved redemtion schedules up to June 2021. The coupon rate is equal to the Central Bank of Russia key rate increased by 2.25 percentage points, but not less than 8.5% per annum. As at 30 June 2018, the coupon rate was 9.5% per annum (31 December 2017: 10.25%).

The Group refinanced non-convertible interest-bearing RUB-denominated bonds by obtaining a long-term prepayment for crude oil delivery in the total amount of USD 580 million, containing a financial liability component (balance as at 30 June 2018 of USD 59.4 million).

In February 2018, AO Neftegazkholding obtained a new revolving credit line in the amount of RUB 1,000 million (USD 17.5 million as of the transaction date) for Eurobonds refinancing. The credit line has an interest rate of the Central Bank of Russia key rate increased by 3 percentage points. As at 30 June 2018, the interest rate amounted to 10.25% per annum. The credit line is available till February 2020.

In February 2018, AO Neftegazkholding obtained a new revolving credit line in the total amount of RUB 4,000 million (USD 67.4 million as of the transaction dates). The credit line has an interest rate of the Central Bank of Russia key rate increased by 2 percentage points. As at 30 June 2018, the interest rates were in the range of 9,25% - 9.75% per annum. The credit line is available till February 2020. The credit line was obtained for Eurobonds and bank loans refinancing.

In February 2018, AO NNK-Khabarovsk Oil Refinery, a subsidiary of the Group, partially repaid a USD-denominated bank loan in the amount of USD 21.9 million. In May 2018, the bank revised the loan repayment schedule and increased the interest rate from 5.3% to 6.53% per annum. According to the new payment schedule, the loan facility was partially repaid in the amount of USD 5.5 million.

In March 2018, the Group partially repaid five-year USD-denominated Eurobonds, prolonged by Alliance Oil Company Ltd in March 2015, in the amount of USD 44.9 million.

Total borrowings include collateralised liabilities of USD 49.0 million (31 December 2017: USD 58.3 million).

As at 30 June 2018, loans and borrowings were collateralised by:

- 100% of the Group's holding in OOO SN-Gazdobycha (31 December 2017: 100%);
- proceeds from sale of gas in the amount of USD 6.9 million;
- property, plant and equipment with a carrying value of USD 71.7 million (31 December 2017: USD 80.4 million).

The maturity profile of the Group's loans and borrowings based on contractual undiscounted payments, including accrued interest, was as follows:

			30 June 2018
	Principal	**Interest**	**Total**
Within one year	733,969	157,481	891,450
Within second year	587,023	105,030	692,053
Within years three and four	243,591	88,247	331,838
Five years and more	368,909	29,082	397,991
	1,933,492	**379,840**	**2,313,332**

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 11 Loans and borrowings (continued)

	31 December 2017		
	Principal	**Interest**	**Total**
Within one year	808,613	154,629	963,242
Within second year	290,292	92,623	382,915
Within years three and four	724,224	70,421	794,645
Five years and more	207,747	14,151	221,898
	2,030,876	**331,824**	**2,362,700**

The interest payments were based on the interest rate effective at 30 June 2018 and 31 December 2017, respectively. The principal and interest payments denominated in RUB were converted into USD using the exchange rate at 30 June 2018 and 31 December 2017, respectively.

The Group is subject to external requirements imposed on Eurobonds and loans provided by certain banks on the basis of net debt to adjusted EBITDA ratio. As at 30 June 2018 and 31 December 2017, the Group was restricted from incurring additional loans and borrowings except for refinancing of existing borrowings owing to the increase in the net debt to adjusted EBITDA ratio. This restriction does not create breach or event of default for the Eurobonds and other loans.

Note 12 Advances received

As at 30 June 2018, long-term advances received in the amount of USD 341.5 million (31 December 2017: USD 286 million) represented a long-term prepayment for crude oil delivery, containing a financial liability component of USD 59.4 million (31 December 2017: USD 40.1 million).

Note 13 Trade and other accounts payable

	30 June 2018	**31 December 2017**
Trade accounts payable, excluding Accounts payable for crude oil purchaised for refining	33,837	25,525
Accounts payable for crude oil purchaised for refining	44,039	3,923
Accounts payable for acquisition of property, plant and equipment	51,451	29,427
Dividends payable	3,282	-
Other payables	3,625	4,933
	136,234	**63,808**

Note 14 Financial instruments fair value

The different levels in fair value have been defined as follows:

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

The estimated fair values of loans and borrowings bearing fixed interest rate (Level 3 in the fair value measurement hierarchy) with stated maturities were estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risks and remaining maturities. The discount rates used ranged from 5.66% p.a. to 11.13% p.a. (31 December 2017: 3.65% p.a. to 10.7% p.a.) depending on the length and currency of the liability. The fair values of loans and borrowings bearing a fixed interest rate as at 30 June 2018 exceeded their carrying values by USD 23.2 million (31 December 2017: USD 74.6 million).

in thousands of US Dollars (TUSD) unless indicated otherwise

Note 14 Financial instruments fair value (continued)

Management believes that the fair values of the following financial assets and liabilities approximate their carrying amount (Level 3 in the fair value measurement hierarchy):

- trade and other accounts receivable;
- other financial assets;
- cash, cash equivalents and restricted cash;
- trade and other accounts payable;
- financing component of long-term advances received.

Note 15 Related party transactions

Related parties include shareholders, associate, joint venture and other related parties representing entities under common ownership and control with the Group, as well as members of key management personnel.

Significant balances with related parties:

	30 June 2018	31 December 2017
Entities under common control		
Long-term loans provided including interest accrued	634,378	617,254
Less: expected credit losses	(35,380)	-
Trade and other accounts receivable	1,710	1,817
Other related parties		
Trade and other accounts receivable	8,552	7,768

All related party balances are unsecured and will be settled in cash under normal commercial credit terms. No guarantees have been given or received in relation to any related party balance.

Significant transactions with related parties:

	Six months ended 30 June 2018	Six months ended 30 June 2017
Entities under common control		
Interest income	25,859	15,383
Loans provided	23,819	6,601
Other related parties		
Revenue	36,520	27,733

Transactions with shareholders with significant influence, associate, entities under common control and other related parties relate to transactions in the ordinary course of business with terms and conditions, which management believes to be similar to transactions with third parties.

Revenue from sales to related parties mainly includes sales of oil products in the domestic market.

As at 30 June 2018 and 31 December 2017, 100% of the Company's shares were pledged under the loan provided to the parent company.

At 30 June 2018 and 31 December 2017, the principal beneficial shareholder and the ultimate controlling party of the Group was Mr. Eduard Y. Khudaynatov.

Note 16 Commitments and contingencies

The Group’s contractual capital commitments, including value added tax, at 30 June 2018 and 31 December 2017 amounted to USD 226.2 million and USD 127.4 million, respectively.

Note 17 Financial risk management

At 30 June 2018, the Group's current liabilities exceeded its current assets by USD 655.3 million (31 December 2017: USD 655.6 million).

The Group's net cash flow position is monitored on a daily basis by its central treasury function with weekly cash movements and cash balances being reported to management. A significant portion of crude oil and oil products sales contracts is executed on an advanced basis. The Group also employs a strict policy for collecting doubtful debts and monitoring trade debtors. Furthermore, the Group prepares detailed budgets and forecasts and reviews the global and domestic oil price environment on a monthly basis in order to optimise crude oil sales, supply routes, oil product mix and refinery volumes. Management is now focused on matching the maturity profiles of financial assets and liabilities, as well as reducing short-term debt through repayment of existing short-term loans.

Management plans among other options to obtain further long-term prepayments for the future crude oil sales in order to refinance its short-term loans and borrowings. Management also considers other financial instruments for that purpose. The Group has successfully re-negotiated non-convertible interest-bearing RUB-denominated bonds and bank loans, extending its matutity and securing a more comfortable payment schedule. However, the Group's ability to refinance its short-term loans and borrowings depends on a number of factors both within and outside of management's control. Management recognises that the uncertainty regarding successful refinancing of the Group's short-term loans and borrowings represent a material uncertainty which may cast significant doubt upon the Group's ability to continue as a going concern and therefore the Group may be unable to continue to realise assets and discharge liabilities in the normal course of business.

Note 18 Operating environment of the Group

The Group's business operations are primarily located in the Russian Federation and are thus exposed to risks and uncertainties of the economic environments and financial markets of the Russian Federation.

The Russian Federation continues to display some characteristics of an emerging market. The Russian economy is particularly sensitive to world oil and gas prices, therefore, significant prolonged declines in world oil prices have a negative impact on the Russian economy. The tax, currency and customs legislation is subject to varying interpretations, frequent changes and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation.

This operating environment has a significant impact on the Group's operations and financial position. Management is taking necessary measures to ensure sustainability of the Group's operations. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

On 1 June 2017 the Office of Foreign Assets Control of U.S. Department of the Treasury («OFAC») included AO Nezavisimaya Neftegazovaya Kompaniya and AO NNK-Primornefteproduct, subsidiaries of the Group, to the Specially Designated Nationals and Blocked Persons list. Sanctions were imposed pursuant to the US President Executive Order No. 13722 of 15 March 2016, concerning blocking the property of the Government of North Korea and the Workers' party of Korea, and prohibiting certain transactions with North Korea.

The Group cooperates with OFAC on all arising matters. The Group has received a confirmation from The Bank of New York Mellon of the current absence of obstacles for the provision of services and payments settlement under the Group's existing Eurobonds.

Note 19 Significant events after the end of the period

In July 2018, the Group refinanced a long-term RUB-denominated bank loan by a new long-term credit line in the amount of RUB 5,000 million (USD 79.5 million as of the transaction date), maturing in December 2020. The credit line has an interest rate in the range of the Central Bank of Russia key rate increased by 4 percentage point.